Deloitte.

International Tax

World Tax Advisor

27 May 2011

In this issue:

Indian tribunal clarifies "beneficial ownership" for loss set-offs following group restructuring 1
Australia: Budget 2011-12 implications for foreign investors....... 3
China: Update on supervision of private equity 5
Peru: New rules allowing election of financial and tax year approved....... 8
South Africa: SARS rules registration of external company will not automatically create PE 9
In brief 10
Tax treaty round up....... 11
Are You Getting Your Global Tax Alerts? 12

Indian tribunal clarifies "beneficial ownership" for loss set-offs following group restructuring

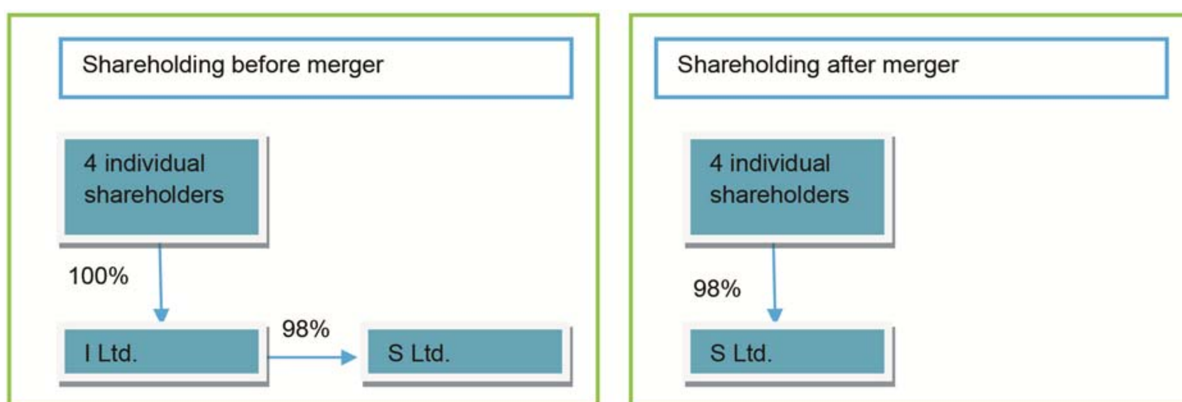
A key factor in evaluating group restructuring in India is the ability to set off tax losses within the group. While India allows the carryforward of losses provided certain criteria are met, section 79 of the Income-tax Act, 1961 (ITA) prohibits the carryforward and setoff of a prior year's business losses (but not its unabsorbed depreciation) if there is a change in more than 51% of the "beneficial shareholding" in a closely held company during the year. The only exception provided in the statute is if the change in shareholding results from the death of a shareholder or the transfer of shares by way of a gift to a relative of a shareholder.

Relying on section 79 and a paucity of clarifying judicial precedent, India's tax authorities previously have denied the setoff of losses following a greater than 51% change in shareholding within a group of companies. However, separate decisions of the Delhi and Bangalore benches of the Income Tax Appellate Tribunal (ITAT) provide some clarity and potential for relief for companies and their shareholders.

Delhi ITAT *Select Holiday Resorts Private Limited*

Under the facts presented in *Select Holiday Resorts Private Limited*, 98% of the shares of S Ltd. (the loss company) were held by I Ltd. (which made a profit). I Ltd. was, in turn, held by a group of four individual shareholders. A reverse merger was undertaken, whereby I Ltd. was merged into S Ltd. As a result of the merger, I Ltd. ceased to exist and the shares of S Ltd. were transferred to the four individual shareholders of I Ltd.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.



Because there was a *prima facie* change in the shareholding beyond 51%, the tax authorities denied the merged entity the setoff of carried forward tax losses. The taxpayer successfully appealed the denial to the Commissioner of Income-tax (Appeals), who found that, because there was no change in the control and management of S Ltd. pursuant to the merger, the restriction in section 79 did not apply and S Ltd. could set off the losses.

In affirming the Appeals Commissioner's decision, the ITAT observed that I Ltd. held 98% of the shares of S Ltd. before the merger and that 100% of the shares of I Ltd. were held by four (related) individuals who managed and controlled I Ltd. and S Ltd. As a result of the merger, these individuals held 98% of the shares of the amalgamated company (i.e. S Ltd.) post-merger. According to the ITAT, this made it clear that there was no change in the management of S Ltd., which remained with the same set of persons previously exercising control. The ITAT also drew support for its conclusion from the list the taxpayers submitted of the board of directors of the two companies before the merger and the list of directors of the merged company, which demonstrated that the management of S Ltd. remained in the same hands.

The ITAT also approved the Appeals Commissioner's rationale for treating the merger as akin to the death of a shareholder. The ITAT observed that, similar to the death of a living person followed by the transfer of the decedent's shares to his/her legal heirs, the legal termination of a company is followed by the transfer of the benefits of the company's assets (including shares in another company) to its shareholders.

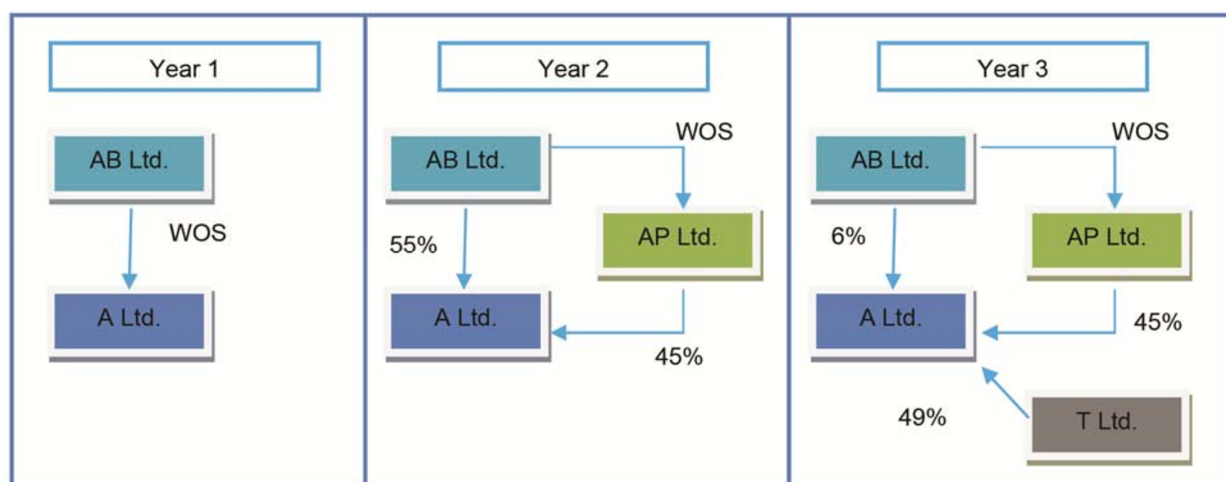
Accordingly, the Tribunal held that, although the change in the shareholding of S Ltd. was greater than 51%, the change was merely due to the merger of the two companies and there was no change in the control and management of S Ltd. Consequently, S Ltd. could set off prior year tax losses.

Bangalore ITAT *Amco Power Systems Limited*

In *Amco Power Systems Limited*, AB Ltd. wholly owned A Ltd. in Year 1. In Year 2, AB's wholly owned subsidiary AP Ltd. held 45% of A's shares, with the remaining 55% still held by AB. In Year 3, AB continued to directly hold 6% of A's shares and another 45% indirectly (through AP), while an unrelated party (T Ltd.) obtained a 49% shareholding in A.

A Ltd. claimed a setoff in Year 3 of prior year losses, which was denied by the tax authorities on the grounds that there was a change in the shareholding beyond the permitted 51%.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.



On appeal to the ITAT, A argued that there was no change in the "voting power" of the "beneficial owners" exceeding the 51% restriction under section 79. That is, A remained at least 51% controlled by the same group because AP Ltd. is a 100% subsidiary of AB Ltd. and, consequently, the shares and voting power of A are beneficially held by AB Ltd. It is not necessary, the taxpayer argued, that at least 51% of the registered shareholders remain the same. The tax authorities countered that a subsidiary is an independent company and that the shares it holds cannot be said to be beneficially held by the subsidiary's parent company.

In deciding in favor of the taxpayer, the ITAT made several observations. First, AB controls the board of directors of its subsidiary, AP. Further, in contrast to other tax provisions under which, e.g. dividends earned by a subsidiary are not considered earned by the subsidiary's parent company, the requirement of section 79 references "voting power." Thus, the ITAT found that, for losses to be set off, section 79 requires that 51% of the "voting power" be "beneficially held" during the relevant income year by the same persons who held the voting right during the loss year. Because the AP board of directors is controlled by AB Ltd., a holding company, AB controlled AP's voting power and, thus, beneficially held such voting power. Accordingly, A is entitled to the setoff of the carryforward business losses.

Conclusion

These two decisions of the ITAT are certain to provide some guidance to taxpayers and the tax authorities alike as to how to approach the prescribed 51% holding requirement when examining loss setoffs in the context of a group restructuring.

— Percy Chhapgar (Mumbai)
Partner
Deloitte India
pchhapgar@deloitte.com

Ketan Ved (Mumbai)
Senior Manager
Deloitte India
kved@deloitte.com

Kaynaz Dadinath (Mumbai)
Deputy Manager
Deloitte India
kdadinath@deloitte.com

Australia:
Budget 2011-12 implications for foreign investors

The Australian 2011-12 Federal Budget, delivered on 10 May 2011, contains some announcements that affect non-Australian investors.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

Amendments to debt-to-equity integrity rules

The government has indicated that it will amend the debt-to-equity rules to restrict the application of an integrity provision (section 974-80 of the Income Tax Assessment Act 1997) that may deem certain debt interests to be equity interests. Broadly, the effect of this recharacterization will result in a denial of any interest deductions and will treat the returns as dividends.

The proposed amendments will ensure that the integrity provision will only apply to arrangements where both the purpose and effect is that the ultimate investor has, in substance, an equity interest in the issuer company. The integrity provision will not apply where the Commissioner of Taxation considers that it would be unreasonable for the provision to apply.

The Australian Taxation Office (ATO) has for many years taken the position that this integrity provision could have broad operation and application to stapled securities and an array of financing arrangements. Although the budget announcement may be viewed as an opportunity to provide clarity and certainty for taxpayers, the concern is that any amendments that support the ATO's position may have adverse ramifications for taxpayers. These concerns are further exacerbated by the fact that the measure will apply retroactively as from 1 July 2001. Taxpayers will need to monitor the development of the legislation that will give effect to this announcement.

Functional currency

The ability to use a foreign currency to determine Australian taxable income will be expanded to trusts and partnerships that keep their accounts solely or predominantly in a foreign currency. This measure should address a long-standing anomaly in the operation of the functional currency rules and should reduce compliance costs associated with holding offshore assets in trust and partnership structures. This measure would take effect from the date of Royal Assent of the amending legislation.

Investment manager regime (IMR)

The government will introduce amendments to the income tax law to prevent the ATO from raising assessments for certain investment income of foreign-managed funds for the 2010-11 income year where the fund has never filed an Australian tax return. This measure extends the arrangements announced on 17 December 2010, which applied to the 2009-10 and prior income years. The government indicated that these interim arrangements are intended to provide certainty regarding the tax arrangements for certain portfolio investment income of foreign-managed funds and will enable them to comply with U.S. reporting requirements.

The government noted that the Board of Taxation is examining the design of an IMR as part of its review of the tax treatment of collective investment vehicles (CIV) and indicated that the government has asked the Board to report on an investment manager regime as it relates to foreign managed funds by the end of the third quarter of 2011. Extending the previously announced measure is intended to allow the government time to consider the Board's report prior to making a final decision on the tax treatment of these investments. The Board will continue to progress other aspects of an IMR as part of its CIV review, with a view to reporting to the government by 31 December 2011.

Unfortunately, the measure provides no certainty for investors realizing profits after 30 June 2011 or for prospective investors. Until this issue is resolved, a barrier to direct investment in the Australian stock market by foreign managed funds will remain.

The government also has reconfirmed its intention to amend the tax law, with effect from the 2010-11 income year, to exempt relevant investment income of a foreign-managed fund that is deemed to have a permanent establishment in Australia as a result of investing through an Australian intermediary (e.g. manager/broker). This measure is designed to remove an impediment to foreign funds engaging Australian investment advisers to manage primarily offshore assets.

Managed Investment Trusts (MITs)

The government would update the list of countries reported in the income tax regulations whose residents are eligible to access a reduced withholding tax rate on certain distributions from Australian MITs. The reduced rate of withholding is restricted to residents of countries with which Australia has effective exchange of information (EOI) arrangements and

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

which are listed in the regulations. The measure would update the list to include Singapore, Belize, the Cayman Islands, the Bahamas, Monaco, San Marino, St. Christopher and Nevis and St. Vincent and the Grenadines.

Tax agreements with Mauritius and Montserrat

As previously announced, the government has signed a tax information exchange agreement (TIEA) and an additional benefits agreement (ABA) with Mauritius. The TIEA provides for the exchange of information between Australia and Mauritius upon request in relation to criminal and civil tax matters. The ABA will establish an administrative mechanism to resolve transfer pricing disputes between taxpayers and the tax authorities of Australia and Mauritius and will eliminate the double taxation of certain income derived by retirees, government employees and students.

The government has reconfirmed that Australia and Montserrat have signed a TIEA. The TIEA provides for the exchange of information between Australia and Montserrat upon request in relation to civil and criminal tax matters.

Infrastructure

The real value of tax deductions from infrastructure projects erodes over the length of the project due to long lead times between incurring deductible expenditure in the early stages of the project and earning income. Under current arrangements, investors face a risk that a change in ownership of an infrastructure project and change in business operation means future owners will not be able to access previous years' losses. Consequently, the government would improve certainty for investors by uplifting project losses associated with designated infrastructure projects at the government bond rate and exempting those losses from the restrictions on the carryforward of tax losses (i.e. the continuity-of-ownership test and the same business test). This measure improves certainty for investors by ensuring that the value of losses will be maintained through time and making it more likely that projects will be able to utilize prior year tax losses. It also should improve efficiency by allowing the transfer of such projects to investors with the ability to maximize returns.

A decision-maker would be empowered to confer designated infrastructure project status on privately financed public infrastructure of national significance based on a range of criteria, including a global capital expenditure cap of AUD 25 billion over the period from Royal Assent of the enabling legislation to 30 June 2017.

— Peter Madden (Sydney)
Partner
Deloitte Australia
pmadden@deloitte.com.au

Vik Khanna (Melbourne)
Partner
Deloitte Australia
vkhanna@deloitte.com.au

Alyson Rodi (Sydney)
Partner
Deloitte Australia
arodi@deloitte.com.au

Claudio Cimetta (Melbourne)
Partner
Deloitte Australia
ccimetta@deloitte.com.au

David Watkins (New York)
Client Services Executive
Deloitte Tax LLP
davwatkins@deloitte.com

China: Update on supervision of private equity

The Chinese government has stepped up agency efforts to enhance the development and supervision of private equity (PE) in the country. This article highlights the supervision of private equity in China, with a focus on recent developments relating to equity investment enterprises (EIEs).

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

Structures and supervising agencies

Privately offered funds – The term "private equity" in the context of U.S. and European investors is a form of alternative investment in unlisted equity and includes, in a broader sense, venture capital, growth funds and buy-outs. The Chinese translation of the term (*Simujijin*), however, has dual meanings: it can either mean the typical U.S./European form of PE or the types of funds that are privately offered but invest in publicly listed companies. Unlike private investment in public equity (PIPE) deals in western markets in which the fund subscribes to a listed company through private placement, a *Simujijin* fund manager in China earns trading profits in the open market. The closest comparison of *Simujijin* in western markets would be an equity-focused hedge fund.

There is currently no formal supervisory body for this type of *Simujijin*. The media has reported that an exposure draft on a revision of China's Securities Investment Fund Law has been circulating among industry practitioners, according to which the *Simujijin* may fall under the supervision of the China Securities Regulatory Commission. The focus of the supervision would be on how the fund is raised to qualified investors, the scope of fund operations, asset protection and the prevention of insider trading and stock price manipulation.

Yangguang (Sunshine) Simujijin – Some *Simujijin* have been offered as trust products and marketed to retail investors through banks and other financial institutions. These hybrid (privately and publicly offered) funds are called *Sunshine Simujijin* and are regulated by the China Banking Regulatory Commission. Supervision focuses on how the fund is raised to retail investors, qualification of investment advisors and reporting and disclosure requirements.

Equity investment enterprises (*Guquan Touzi Qiye*) – "Equity investment enterprise" is the official Chinese translation of the western concept of PE. EIEs focus on investment in unlisted equity and are regulated by the National Development and Reform Commission (NDRC). These EIEs, together with venture capital enterprises (governed by the Provisional Measures for the Management of Venture Capital Enterprises, as issued by 10 administrative authorities led by the NDRC in 2005), form the broader western concept of PE in China.

Supervision of EIEs in pilot locations

Since June 2008, the NDRC has introduced an administrative registration requirement for EIEs on a trial basis in the following pilot locations:

- Tianjin;
- Beijing;
- Yangtze River Delta (Shanghai, Jiangsu Province and Zhejiang Province); and
- Wuhan.

Notably, the pilot locations do not include important regional centers, such as Chongqing and Guangdong.

On 31 January 2011, the NDRC issued guidance (Notice 253) to the provincial governments in the pilot locations. As detailed below, Notice 253 sets out general principles governing registration, fund-raising activities and various operational aspects of EIEs, and applies to both domestic and foreign-invested EIEs.

Form of EIEs and management companies – An EIE may be established in the form of a company or partnership and should comply with the PRC Company Law or Partnership Enterprise Law, respectively.

An EIE established in the form of a company may have its own internal management team or may outsource its management to other EIEs or management companies. Notice 253 does not specify whether the management team of a partnership EIE must be the general partner (GP). Under the PRC Partnership Enterprise Law, limited partners (LPs) could lose limited liability protection if they participate in management, which may explain why the management team of a partnership EIE is generally the GP.

Fund raising – Notice 253 provides that the capital of an EIE can only be raised privately from investors with the capability of risk identification and risk management. There should be no advertisements, public events or public displays of fund product materials in the fund-raising process. In addition, the fund sponsor should fully disclose the risk factors of the investment. There should be no guarantee on fixed returns.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

Illegal fund raising is one of the main problem areas of the industry. The focus of the NDRC's supervision is to develop a mature pool of investors/LPs.

Scope of investment – An EIE can invest only in the equity interest of unlisted companies. Any unused funds may be deposited in a bank or used to purchase fixed-income investment products, such as government bonds. In addition, the investment should comply with national industrial policies, investment policies and macro-economic policies. Furthermore, foreign-invested EIEs should follow the approval procedure for investment projects in accordance with the relevant regulations before making any investments.

By restricting investment to unlisted equity interest, strictly speaking, common private equity deals, such as pre-IPO investments or buy-outs, are not allowed or the fund will be forced to sell after the IPO. This seemingly is not the intention of Notice 253, and further clarification is likely once implementation rules are released.

Registration – Notice 253 requires EIEs in the pilot locations, including EIEs that invest in other EIEs (a fund of funds), to register with the NDRC. Registration is not required, however, for the following:

- Venture capital investment enterprises that already have registered in accordance with the 2005 Provisional Measures for the Management of Venture Capital Enterprises;
- EIEs with committed capital of less than RMB 500 million or the foreign currency equivalent; and
- EIEs set up by a single organization or individual or within the same group (defined as 100% identical ownership by the same ultimate organization).

In addition, if an EIE outsources its management functions, the management company also will be subject to the registration requirements.

An EIE must submit the application for registration to the local (provincial or municipal) coordinating authority in which it is located for preliminary review. This authority can be the local DRC or the local Financial Service Office or its equivalent, as deemed appropriate by the provincial government.

Upon receiving the application package, the local authority will submit the preliminary review opinion to the NDRC within 20 working days, which will decide whether to accept the registration within another 20 working days. If accepted, the name and basic information of the EIE will be published on the list of registered EIEs on the NDRC's official website.

There is no due date for the registration, but if the local authority discovers noncompliance with the registration requirement, it will require the EIE and management company to complete the registration within 20 working days.

Disclosure – In addition to the disclosure requirement on investors as governed by the relevant articles of association or partnership agreement, an EIE must submit its annual business reports and audited financial statements to the NDRC and the local coordinating authority within four months after the end of the accounting year. Equity management companies and the custodians also should submit reports on assets under management and assets under custody to the NDRC and the local coordinating authority within four months after the accounting year ends.

An EIE must notify the NDRC and the local coordinating authority within 10 working days when any of the following major events occur:

- Amendment of the documents of an EIE or its management company, such as the articles of association, partnership agreement or outsource management agreement;
- Increase or reduction in the capital or debt financing of an EIE or its management company;
- Merger or split of an EIE or its management company;
- Change to the management company or custodian, including a change in the senior management personnel and other significant changes; or
- Dissolution or liquidation of an EIE.

Noncompliance – Notice 253 aims to implement a moderate level of regulation of EIEs by a registration information management system and improvement of the information disclosure. If an EIE or its management company fails to comply with the registration requirement, they will be asked to complete the registration. An EIE or management company that

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

fails to register after so requested will be treated as a "noncompliant EIE and management company" and be named-and-shamed on the relevant list on the NDRC's official website. In addition, a registered EIE will be subject to an annual audit within five months from the end of its accounting year.

Comments

Future national EIE rule – Notice 253 will have a significant impact on the development of the private equity industry. Although not in the form of national law, regulations or even administrative measures but rather issued as a relatively low level internal communication between the NDRC and the provincial governments, the notice is the first set of rules regulating the PE/EIE sector. The pilot nature of Notice 253, however, likely will create challenges and issues. The solutions to these, combined with the feedback from all stakeholders, will form the basis of future national rules for PEs/EIEs.

Supervision philosophy – In the NDRC's explanatory note to Notice 253, the officials explain that the philosophy of the regulation is based on a combination of industry self-discipline and "moderate" government supervision. For example, from a procedural perspective, a post-set-up registration and disclosure of information process is used rather than pre-approval. The aim is to develop the necessary skill set by investors that can self-manage risks without endorsement by the government authority.

The "moderate" supervision has not been further defined. Given the pilot nature of Notice 253, it will be necessary to wait and see how and under what circumstances the government intervenes in the industry to better understand the government's supervision philosophy.

Following the 2008 financial crisis, governments in other jurisdictions, such as the U.S. and Europe, also enhanced efforts to regulate the PE industry. The focus of these initiatives included preventing systematic financial risk, limiting the application of leverage and debt push down in deals and avoiding conflicts of interest between funds, the management of target companies and investment banks involved in the deals. While the focus of supervision is different in China, with the development of the industry, these issues may become important aspects of the regulatory regime in the future.

Development of LPs – Since the 2008 pilot measures, a major motive for EIEs to register with the NDRC is to obtain funding from the National Social Security Fund. With the development of the national 12th five-year plan, and key developments in financial sectors and installment of a social security system, there will be an abundant supply of domestic LPs, both in quantum and diversity. The development of the risk management skill and fund assessment and selection skills of the LPs will be vital to the development of the industry as a whole.

Notice 253 was issued to provincial governments, so it is now up to those governments to issue detailed implementation rules.

— Gary Wai Kuen Chan (Shanghai)
Partner
Deloitte China
garychan@deloitte.com.cn

Julie Zhi-yue Zhang (Shanghai)
Senior Manager
Deloitte China
julzhang@deloitte.com.cn

Angela Ming Zhi Pan (Shanghai)
Manager
Deloitte China
apan@deloitte.com.cn

Peru:
New rules allowing election of financial and tax year approved

Peru's Parliament approved new rules on 12 May 2011 that would allow resident taxpayers to elect to use either a calendar year or a different one-year period for financial and tax purposes. Currently, resident taxpayers must keep their accounting records and calculate taxable income on a calendar year basis, with no exceptions (the financial year and the tax year being the same). If approved by the Executive, the amended rules will apply as from 1 January 2012.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

The proposed rules still would require the tax year to coincide with the financial year, which is a 12-month period. However, even though in principle the financial year would still begin on 1 January and end on 31 December, the new provisions provide companies with an option to elect for different starting and ending dates for their financial (and therefore tax) years from among alternatives set forth by the Peruvian tax authorities, for either of the following reasons:

- Because there are special conditions affecting the industry or economic sector of the company concerned; or
- Due to other circumstances identified by the tax authorities.

A request to change to a financial and tax year differing from the calendar year would have to be approved by the ultimate decision-making body of the company and the Peruvian tax authorities, and then included in the company's bylaws. Once made, an election would not be able to be modified for the subsequent two years.

The new financial and tax year would commence on the first calendar day of any quarter of the year.

For the interim period between the old and the new financial and tax years, a taxpayer would need to file an income tax return and pay any tax due. For these purposes, the tax year would comprise the period between 1 January and the day before the new financial and tax year commenced (which would not be able to exceed one year). The proposed rules state that the tax authorities will issue guidance on the requirements and deadlines relating to these compliance obligations within one year after the provisions are enacted.

Comments

Under existing rules, Peruvian resident taxpayers must keep their accounting records, close their financial statements, prepare annual tax returns and pay tax due on a calendar year basis. The proposed rules attempt to ease the administrative, accounting and tax compliance burdens on certain companies resulting from special conditions that affect a particular industry, relationships with nonresident entities, foreign rules applicable to economic groups, etc., by allowing companies to choose a financial and tax year that is more in line with the natural cycle of their business. The proposed rules also recognize that business has become increasingly globalized and Peru needs to keep pace with developments worldwide and prevent distortions in the preparation of financial statements and business forecasts.

The executive has until 8 June 2011 to suggest amendments to the proposed provisions or to approve the enactment of the law.

— Gustavo Lopez-Ameri (Lima)
Partner
Deloitte Peru
glopezameri@deloitte.com

Ana Luz Bandini (New York)
Senior Manager
Deloitte Tax LLP
anbandini@deloitte.com

South Africa:
SARS rules registration of external company will not automatically create PE

In a recent binding private ruling, the South African Revenue Service (SARS) examined the issue of whether registration as an "external company" by a nonresident company that did not have its effective management in South Africa would constitute a permanent establishment (PE) in South Africa, concluding that a PE would not arise.

Applicable law

According to section 322 of the Companies Act, a foreign company that establishes a place of business in South Africa must register as an "external company" with the appropriate authorities. The registration obliges the company to comply with the provisions of the Companies Act, as well as submit statutory returns and file financial statements.

A registered external company will be considered a resident for exchange control purposes in South Africa, but will not automatically become a tax resident in South Africa. Only a company that is incorporated, established or formed in South Africa or that has its place of effective management in South Africa is a tax resident under domestic tax legislation.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

Proposed transaction

The ruling involved a nonresident company ("taxpayer") whose business activities are to provide subordinated interest-bearing loans to companies incorporated in South Africa and subscribe for preference shares in these companies. Thus, the taxpayer's balance sheet would reflect the loans and owned shares as assets. The taxpayer's income would consist of interest from the loans, dividends from the subsidiaries and any capital gains derived from the sale of shares. The investors taking part in the funding would all be foreign.

The taxpayer's affairs would be managed by its board of directors situated in the country in which the taxpayer is incorporated (not South Africa). Board meetings also would be held in that country. As for investment advice and recommendations on which South African companies to invest in, the taxpayer would appoint another foreign company ("Investment Advisor") to conduct the necessary research and obtain information on potential targets in Africa. The Investment Advisor would contract with a South African company via an "investment advisory arrangement" to carry out the actual research. However, the Investment Advisor would make the evaluations and further recommendations regarding the investment opportunities. The actual decision on whether or not to invest in a specific company would be made by the taxpayer's board of directors.

Binding private ruling

SARS concluded in the ruling that registration of the taxpayer as an external company would not create a PE in South Africa. The ruling, however, is subject to the conditions and assumptions that the taxpayer will not have any employees or conduct any business activities in South Africa other than to maintain its status as an external company for exchange control purposes. The ruling also assumes that the external company will not have a dependent agent operating on its behalf in South Africa.

Comments

The definition of a PE in section 1 of the Income Tax Act refers to the definition in the OECD model treaty, the general definition of which is "a fixed place of business through which the business of an enterprise is wholly or partly carried on." The facts in the proposed transaction are such that it is clear that the taxpayer will not have any connection to South Africa other than investing in South African companies. The taxpayer will be a shareholder and provide interest-bearing loans to the companies in question. SARS' position appears to be that these activities should not constitute a PE from an OECD model treaty perspective. According to SARS, the mere fact that a nonresident company is registered as an external company for exchange control purposes will not change this conclusion.

— Louise Vosloo (Johannesburg)
Director
Deloitte South Africa
lvosloo@deloitte.co.za

Helena Areschoug (Johannesburg)
Consultant
Deloitte South Africa
heareschoug@deloitte.co.za

In brief

Indonesia – Taxpayers should expect a more aggressive audit approach by the Indonesian tax authorities in 2011. Earlier this year, the government announced its intention to increase the budget revenue from tax collection made through tax audits by 13% from the 2010 budget. The Directorate General of Taxation recently issued a circular setting out the 2011 tax audit plans and strategy to tax offices throughout the country. According to the circular, the authorities will focus on certain high net wealth individual taxpayers and specific industries for corporate taxpayers. Industries that will be subject to audit include mining, textiles, automotive, construction and telecommunications.

Jersey – The GST rate increases to 5% on 1 June 2011.

Thailand – The cabinet has approved tax measures relating to investment under Islamic law. The measures include an exemption from income tax, VAT, specific business tax and stamp duty for the investor and trustee with respect to income and the transfer of assets between each other, as well as an exemption or reduction of the transfer fee on the transfer of immovable property between the two parties. An investor in *Sukuk* (i.e. securities in the form of securitization) is exempt

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

from income tax on benefits received from the investment provided the payment is subject to a 15% withholding tax and is not included in the investor's year-end tax computation.

United States – For individuals or entities with a reporting obligation, the Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1) must be received by the Treasury Department on or before 30 June 2011 for calendar year 2010 and for those with signature or other authority who deferred filings for prior years. Reporting is required by any U.S. citizen or resident; or any entity created, organized or formed under the laws of the U.S., any U.S. state, the District of Columbia, the U.S. territories and insular possessions or the Indian tribes, provided the individual or entity has a financial interest in, or signature or other authority over, any foreign financial account and the aggregate value of all such 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.

Canada-Turkey – The 2009 treaty entered into force on 4 May 2011 and will apply as from 1 January 2012. When in effect, the treaty provides for a 15% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 10% of the voting power of the payer company; otherwise, the rate will be 20%. The rate on interest will be 15% and that on royalties, 10%.

China-Czech Republic – The 2009 treaty entered into force on 4 May 2011 and will generally apply as from 1 January 2012. When in effect, the treaty provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 25% of the payer company's capital; otherwise, the rate will be 10%. The rate on interest will be 7.5% and that on royalties, 10%.

China-Syria – When in effect, the treaty signed on 31 October 2010 provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 25% of the payer company's capital; otherwise, the rate will be 10%.The rate on interest and royalties will be 10%.

China-Zambia – When in effect, the treaty signed on 26 July 2010 provides for a 5% withholding tax on dividends and royalties. The rate on interest will be 10%.

Czech Republic-Bahrain – When in effect, the treaty signed on 24 May 2011 provides for a 5% withholding tax on dividends. Interest and royalties will only be subject to taxation in the country of residence of the recipient.

EU-Korea Free Trade Agreement – After months of negotiations, the EU-Korea Free Trade Agreement (FTA) has been ratified by the European Commission and the South Korean authorities. The FTA, which will provisionally come into force on 1 July 2011, allows for cost savings, through reduced duty rates, to be claimed on goods moving between the two regions provided they meet stringent requirements.

Finland-Aruba/Netherlands Antilles – 2009 economic agreements between Finland and Aruba and the Netherlands Antilles enter into force 1 June 2011 and will apply as from 1 January 2012. Limited in nature, the agreements provide that Finland will exempt from tax dividends paid from Aruba or the Netherlands Antilles to Finland by a wholly owned subsidiary of a Finnish company if the profits of the subsidiary are derived from certain activities (to include manufacturing, tourism, construction, agriculture and oil and gas activities and energy production). The Netherlands Antilles as a jurisdiction within the Kingdom of the Netherlands, however, was dissolved as from 10 October 2010, with two new jurisdictions, Curaçao

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

and Sint Maarten, coming into existence as separate constituent countries with a status comparable to that of Aruba. Three other islands (Bonaire, Sint Eustatius and Saba) became overseas special municipalities of the Netherlands.

Italy-Panama – When in effect, the treaty signed on 31 December 2010 provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 25% of the payer company's capital; otherwise, the rate will be 10%. The rate on interest will be 5% if paid to a bank; otherwise, the rate will be 10%. The rate on royalties will be 10%.

Korea-Panama – When in effect, the treaty signed on 20 October 2010 provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 25% of the payer company' capital; otherwise, the rate will be 15%. The general rate on interest will be 5% and that on royalties, 10%.

Luxembourg-Panama – When in effect, the treaty signed on 7 October 2010 provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 10% of the payer company' capital; otherwise the rate will be 15%. The rate on interest and royalties will be 5%.

Norway-Macedonia – When in effect, the treaty signed on 19 April 2011 provides for a 10% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 25% of the payer company's capital; otherwise, the rate will be 15%. The rate on interest and royalties will be 5%.

OECD – The Committee on Fiscal Affairs has released a discussion draft and opened consultation on proposed changes to the commentary to articles 10, 11, and 12 of the model tax convention regarding the meaning of the term "beneficial owner". Comments are due by 15 July 2010.

Are You Getting Your Global Tax Alerts?

Throughout the week, Deloitte provides commentary and analysis on developments affecting cross-border transactions on a free subscription basis delivered straight to your email. Read the recent alerts below or visit the archive.
Subscribe: http://www.deloitte.com/view/en_GX/global/insights/browse-by-content-type/email-alerts/index.htm?id=us_email_Tax_WTA
Archives: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/article/c18d173f622d2210VgnVCM100000ba42f00aRCRD.htm?id=us_email_Tax_WTA

Australia
Reportable tax positions schedule being developed
The Australian Taxation Office (ATO) recently announced that it is developing a schedule requiring certain taxpayers to disclose Reportable Tax Positions (RTPs). The new RTP schedule is viewed by the ATO as part of its approach to move away from reactive compliance activities towards a role that is "proactive and advisory" and follows the recent introduction of similar disclosure requirements in the U.S. [Issued: 25 May 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/dd025da6b0920310VgnVCM1000001a56f00aRCRD.htm?id=us_email_Tax_WTA_052711
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_australia_250511.pdf?id=us_email_Tax_WTA_052711

Brazil
Thin cap rules clarified
Clarifications to the thin capitalization rules provide guidance on the scope and computation of deductible interest expense based on the debt-to-equity ratios in the law enacted in 2010. [Issued: 19 May 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/25123f5a63900310VgnVCM1000001a56f00aRCRD.htm?id=us_email_Tax_WTA_052711
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_brazil_190511.pdf?id=us_email_Tax_WTA_052711

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.

United States

Potential U.S.-Poland treaty missing from Senate treaty hearing agenda

The Senate Committee on Foreign Relations has announced a hearing on the pending agreements with Hungary, Luxembourg and Switzerland. Notably missing are the pending treaty with Chile and the still-under-negotiation treaty with Poland (which currently does not have a modern limitation on benefits article). [Issued: 19 May 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/345c9bb001700310VgnVCM1000001a56f00aRCRD.htm?id=us_email_Tax_WTA_052711
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_unitedstates_051911.pdf?id=us_email_Tax_WTA_052711

Talk to Us

If you have questions or comments about the content of *Global InSight*, or would like to contact a member of the IAS Newsletter Editorial Board, contact:

Susan Lyons, Director Washington International Tax Services Deloitte Tax LLP slyons@deloitte.com	-or-	Connie Angle Washington International Tax Services Deloitte Tax LLP cangle@deloitte.com

About Deloitte

Deloitte refers to one or more of Deloitte Global Services Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Global Services Limited and its member firms. Certain services may not be available to attest clients under the rules and regulations of public accounting.

"Deloitte" is the brand under which tens of thousands of dedicated professionals in independent firms throughout the world collaborate to provide audit, consulting, financial advisory, risk management, and tax services to selected clients. These firms are members of Deloitte Touche Tohmatsu Limited (DTTL), a UK private company limited by guarantee. Each member firm provides services in a particular geographic area and is subject to the laws and professional regulations of the particular country or countries in which it operates. DTTL does not itself provide services to clients. DTTL and each DTTL member firm are separate and distinct legal entities, which cannot obligate each other. DTTL and each DTTL member firm are liable only for their own acts or omissions and not those of each other. Each DTTL member firm is structured differently in accordance with national laws, regulations, customary practice, and other factors, and may secure the provision of professional services in its territory through subsidiaries, affiliates, and/or other entities.

Disclaimer

This publication contains general information only, and none of Deloitte Global Services Limited, its member firms, or its and their affiliates are, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your finances or your business. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. None of Deloitte Global Services Limited, its member firms, or its and their respective affiliates shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

Copyright ©2011, Deloitte Global Services Limited.
All rights reserved.