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In this issue:

Mexican Ministry of Finance analysis of the future of the flat tax

The Mexican Ministry of Finance presented its legislatively mandated analysis of the flat tax on 30 June 2011. The report, which was to examine whether the flat tax should be abolished, retained to operate in conjunction with the income tax, or replace the income tax as the primary system of direct taxation in Mexico, concludes that the flat tax should continue to apply in its current form for the foreseeable future. (The Congress ordered the analysis under the 19th provisional article of the Flat Tax Law and set 30 June 2011 as the due date for the report.)

The flat tax was introduced in 2008 to replace the asset tax and to operate as an alternative minimum tax, with a view to preventing tax avoidance/evasion and ensuring that taxpayers pay either income tax or the flat tax. Under the flat tax, corporations (including permanent establishments of foreign entities) and individuals must pay the sum of the income tax computed under the Income Tax Law and the excess of the flat tax. Flat tax liability is calculated on a cash-flow basis rather than on the profits of the taxpayer, and the tax mainly targets income derived from the sale of goods, the provision of independent services and the granting of rights to use certain assets. The tax base for purposes of calculating the flat tax liability is determined by reducing taxable revenue with limited deductions (e.g. no deduction is allowed for interest and royalties and, with respect to salaries, wages and fringe benefits, no deduction is allowed except for the portion that is subject to income tax).

From the outset, the flat tax was widely perceived as violating the Mexican constitution (specifically, the equal treatment and proportionality principles), and many challenges were brought before the courts because of the limited deductions and the different treatment of expenses (as compared to the income tax). The Supreme Court, however, concluded in 2010 that the flat tax is constitutional: the flat tax and the income tax are separate and distinct taxes, with Congress having discretion to configure and design taxes that are calculated on principles that differ from the principles under the income tax law. Taxpayers had argued that the features of the flat tax were not different enough from the income tax to support the elimination of deductions such as interest, wages and fringe benefits and related party royalties. The Court's decision was a huge disappointment to taxpayers.

In practice, the flat tax has created a huge compliance burden on taxpayers, who are required to maintain two sets of calculations – one for the income tax and the other for the flat tax – to determine which tax is to be paid (the higher of the two) on a monthly/annual basis. In addition, the flat tax distorts the investment decision process because it impacts immediate cash flow (as opposed to the earning of profits), thus driving taxpayers towards a system by which payment for goods and services must either be made or avoided (as the case may be) at the end of the month/year to effectively comply with the tax. Further exacerbating the situation for taxpayers was the 2009 elimination of a credit that could be applied against the income tax when the flat tax deductions exceeded flat tax accruable income.

Another flaw in the design of the flat tax is that, even though most of Mexico's tax treaty partners have confirmed that the flat tax is creditable in their jurisdiction, the issue is still being reviewed by the U.S. Treasury to determine the status of the tax under the U.S.-Mexico treaty. (The U.S. Internal Revenue Service announced in Notice 2008-3 that it is evaluating the status of the flat tax and will not challenge a taxpayer's position that the flat tax is an income tax until the study is complete.) Given the level of U.S. direct and indirect investment in Mexico, an adverse decision by the U.S. Treasury on this issue would certainly result in double taxation. An examination of past scenarios is not encouraging given a 1998 announcement by the U.S. Internal Revenue Service that a similar Italian tax (IRAP) was not creditable (IRAP was subsequently made partially creditable under the 1999 U.S.-Italy income tax treaty, which entered into force in 2010).

Analysis of the Ministry of Finance

Disappointingly, but as expected (weeks before the report was issued, the Ministry of Finance hinted that it would conclude that both the income tax and the flat tax would coincide for at least a few more years), the Ministry's analysis concludes that the flat tax is an important feature of the Mexican tax system that has met all of its intended goals and confirmed its efficiency as an alternative minimum tax. The Ministry's conclusion comes despite figures showing that flat tax net operating losses (about MXN 250 billion), significantly exceed actual amounts collected (about MXN 40 billion), according to the government´s own reports. (The flat tax allows a credit for net operating losses (where the allowed flat tax deductions against the taxable base exceed gross revenue for the year) that may be carried forward for up to 10 years.) At first glance, this comparison alone should have secured a death sentence for a tax that presumably was introduced to "complement" the income tax. At a minimum, one would have thought the NOL credits to be a pivotal element of any analysis in determining whether the flat tax should be retained, but such an examination is not included in the Ministry´s analysis. It also remains to be seen how much tax collection will be lost once taxpayers start applying the credit against their future flat tax liabilities, if any.

Even more difficult to understand is the Ministry's conclusion that the elimination of the flat tax in Mexico would be economically and legally inconvenient based on the fact that all countries – including, according to the report, the U.S. – have confirmed the creditability of the tax in their jurisdictions. As mentioned above, this assertion simply is not true – the U.S. has allowed for the creditability of the flat tax only inasmuch as the U.S. Treasury has not yet ruled on the matter. There is still a high likelihood that the flat tax may not be creditable in the U.S. given its differences as compared to the income tax.

Further, the Ministry states that replacing the income tax with the flat tax at this point would imply a radical structural modification to the Mexican tax system that may have a negative impact on public finances, legal certainty and fiscal simplification, among other areas.

The analysis also ignores the fact that the flat tax introduced a new variable in the thought process of CFOs in Mexico. That is, the tax has resulted in companies making monthly calculations to ensure that no flat tax basis exists to avoid incurring costly advance payments aimed only at the company's cash flow. Moreover, the flat tax is unlike a "typical" alternative minimum tax: it is determined on a very different basis than the income tax (as noted, it has limited authorized deductions) and aims at taxing the flow of cash rather than the creation of wealth or profit. The flat tax therefore targets taxpayers that do not match their payments to their income for any given month/year.

Conclusion

Given the facts discussed in this article, it seems improbable that any serious analysis of the flat tax could lead to a finding that the tax should continue to apply, but that was the conclusion reached by the Ministry of Finance. It also is unfortunate that the government's position before the flat tax was introduced, i.e. that the tax was being developed to replace the income tax, is effectively ignored in the Ministry's analysis.

In contrast to the government's expectations (and promises), the flat tax has not proven to be a robust method of tax collection or a "control tax" for income purposes. There is no objective data to show that the taxpayers that were otherwise reluctant to pay income tax now do, nor is there evidence to support the government´s claim that the flat tax has reduced opportunities for tax evasion. Further, the tax has failed to create a simple taxation system by which the taxpayer can easily calculate its tax burden.

The result of the Ministry's analysis is disappointing for anyone who thought that the three-year period would be taken as a serious trial for the flat tax and that the Mexican government would analyze all relevant variables to determine whether the flat tax was a viable alternative to the income tax as the main direct taxation source in Mexico. In fact, the analysis offers little depth on such key issues as low levels of collection and the risk of non-creditability of the flat tax in the U.S. Further, the analysis simply ignores the collection versus net operating loss ratio, which is a pivotal aspect in the consideration of the existence of any tax, and particularly so for a tax that was originally presented as the solution to low revenue collection levels.

With the presently ensured survival of the flat tax, taxpayers and their advisors may be tempted to hope (despite the at least short-term inconveniences to U.S. investors) that the U.S. Treasury eventually rules against the availability of a U.S. foreign tax credit, because this would probably convince the Mexican government to abolish the flat tax.

Another not-so-distant scenario is a changing of the guard in the Mexican government that may, with a possible majority in Congress, deal with the flat tax and finally establish a sound tax system that will secure adequate levels of taxation and a simplicity that would yield a high compliance level. Mexico will hold federal elections in 2012 for the executive and legislative branches. Tax reform has been, and will continue to be, a key topic of discussion during the elections and taxpayers can expect the flat tax to be part of this dialogue. In fact, the Senate opposition party submitted a proposed 2013 tax reform to the Mexican Congress on 10 March 2011 that includes a proposal to repeal the flat tax. Unlike the Ministry's analysis, the proposed reform comments that revenue from the flat tax has been decreasing over the past couple of years and the disallowance of a deduction for interest payments has negatively impacted the ability of companies to acquire necessary assets and possibly impeded the development of the Mexican economy. However, the disallowance of deductions for royalty payments and payroll would be transferred to the Income Tax Law under the reform, although a credit similar to the one under the flat tax on payroll would be incorporated.

In the meantime, Mexican taxpayers must continue to deal with a business environment that includes double calculations, cash-flow distorted decisions and the possibility of double taxation, at least for U.S. investors doing business in Mexico.

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Argentina:
Promotional regime for software industry extended

On 18 August 2011, the Argentine Congress enacted an amendment to extend the tax benefits available to the software industry to 31 December 2019, and to grant additional benefits. The regime, enacted in 2004, was scheduled to expire in September 2014.

Under the software promotional regime, qualifying entities and individuals are entitled to the following benefits:

- Fiscal stability with respect to taxes, i.e. the government cannot modify the tax burden once a taxpayer is within the scope of the regime;
- A fiscal credit bond of up to 70% of certain social security contributions paid by the employer, which may be set off against other taxes, including income tax due on the export of the software; and
- A 60% reduction of the income tax due on domestic and foreign-source income in respect of the promoted activities in each fiscal year.

These benefits will be available from the time a taxpayer registers for the regime, which will be effected through publication in the Official Bulletin.

The software promotional regime is applicable to entities and individuals based in Argentina whose main activities are related to the software industry. To qualify for the incentives, the software must be developed in Argentina and the taxpayer must satisfy two out of the following three conditions: (1) incur R&D expenditure; (2) own a quality standard applicable to the activity; and (3) export the software.

It is expected that the extension of the incentives for the software industry will further stimulate development, employment and the competitiveness of Argentina in this sector.

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Cyprus:
Austerity measures enter into force

Following approval by the House of Representative of Cyprus on 26 August 2011, a number of amending laws presented as a first package of austerity measures to increase state revenue and reduce expenditure entered into force with their publication in the government gazette on 31 August 2011.

Income Tax Law

A new personal income tax band has been introduced at a rate of 35% for income above EUR 60,000, effective from tax year 2011. Also, as from 1 January 2012, a 50% exemption will apply to the income of a nonresident person taking up residence in Cyprus to work for an employer in Cyprus. The exemption will apply for a five-year period starting from the first year of employment, provided the annual income of the employee exceeds EUR 100,000 per annum.

Special Defense Contribution Law

The rates of the Special Defense Contribution are increased, but the basis of taxation remains unchanged. Specifically, the following changes have been approved:

- The tax rate on interest income will increase from 10% to 15%; the rate increase applies to all interest arising, accruing or deemed to arise or accrue from the date the law was published in the government gazette.
- The tax rate on dividends will increase from 15% to 17% for dividend income received by Cypriot resident persons; the rate increase will apply to all dividends arising, accruing or deemed to arise or accrue from the date the law was published in the gazette, irrespective of year to which the dividends relate.

Immovable Property Tax Law

The existing bands are replaced and the rates increased from a maximum of 0.4% to a maximum of 0.8% paid by owners of immovable property situated in Cyprus based on the property values as at 1 January 1980. The new bands and rates applicable from 1 January 2012 are as follows:

Value of property as at 1 January 1980 (EUR)	Rate (%)
0-120,000	0
120,001-170,000	0.4
170,001-300,000	0.5
300,001-500,000	0.6
500,001-800,000	0.7
800,001 and over	0.8

Companies Law

A fixed annual levy of EUR 350 is introduced, which is imposed on every company, capped at EUR 20,000 for companies in a group (as defined in the Companies Law). This levy will not apply to dormant companies, companies that do not own any assets or companies that own property in a territory not controlled by the Republic.

The levy is payable by 31 December 2011 in relation to 2011 and by 30 June in respect of each subsequent year. Penalties will be imposed for late payment (a 10% penalty if the payment is made within two months of the due date and 30% if paid up to five months from the due date). Failure to pay after five months may result in a deregistration (strike-off) of the company by the Cyprus Registrar of Companies.

If a company is re-instated within a two-year period from its strike-off, a fixed penalty of EUR 500 (in addition to the outstanding amount of the levy) will be imposed. The fixed penalty will be increased to EUR 750 where a company is re-instated after the two-year period.

VAT Law

For the purchase or construction of an individual's first residence of up to 300 square meters, the VAT on the first 200 square meters will be subject to the reduced rate of 5%. Additionally, the special subsidy currently payable on a first residence is abolished. These changes will apply as from 1 November 2011.

Special contribution by government and semi-government employees and pensioners

A special contribution is payable by all government and semi-government employees and pensioners, depending on the level of their salary (pension), according to the following scale:

Monthly gross salary/pension of employees (excluding hourly paid workers) (EUR)	Monthly gross emoluments of employees (being hourly paid workers) (EUR)	Rate (%)
0-1,500	0-1,500	0
1,501-2,500	1,501 and over	1.5
2,501-3,500	N/A	2.5
3,501-4,500	N/A	3.0
4,501 and over	N/A	3.5

The special contribution applies from 1 September 2011 for a period of 24 months.

Contributions by government and semi-government employees to the government pension scheme

A 3% contribution is introduced on salaries, payable to the Government Pension Fund. Additionally, a contribution of 2% will be made to the Widows' Fund. These changes will apply as from the first day of the second month following the law's publication in the government gazette.

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Finland:
Budget proposal for 2012: Consumption in the crosshairs, corporate income tax rate expected to decrease

The Finnish Ministry of Finance published its budget proposal for 2012 on 22 August 2011. The state's overall tax intake is expected to increase by 6.5%, largely due to many tax hikes and subsidy cutbacks. For corporate taxpayers, the good news is the planned decrease of the statutory corporate income tax rate from the current 26% to 25%. Other significant proposed changes concern, for instance, investment income taxation and shifting the emphasis of taxation slightly more towards consumption taxes. It should be noted that the budget proposal is still a proposal *only* and has to be adopted in a plenary session of Parliament taking place in December 2011.

General outlines

The underlying goal of the budget proposal is to safeguard welfare services and to achieve stability in the national economy. The proposal entails a twofold shift in the center of gravity of taxation. First, the emphasis will be shifted from work and business towards an environment and health conductive taxation by increasing, for instance, alcohol and tobacco taxes, as well as taxes on sweets, ice cream and soft drinks. Second, the employment, growth and investment possibilities of companies will be improved by carefully transferring the focus of taxation of business profits from companies to shareholders.

In addition to tax hikes, the proposal also introduces subsidy cutbacks. Mortgage interest rate deductions, as well as the specific household cost-related tax credit that entered into force in its current form in 2001, will be reduced. On the other hand, the proposal brings relief to some: those dependent on basic security payments, like the fixed daily benefit rate for the unemployed and the labor market subsidy, can expect some support via increases in these payments.

As regards VAT, the most significant change concerns newspaper and magazine subscriptions that will be included in the 9% VAT bracket instead of the current 0% bracket.

In announcing its proposal, the Ministry admitted that the projected austerity measures will not bring any noticeable short-term improvement to the national economy. Therefore, despite the abundance of cuts and tax hikes outlined in the budget proposal, the contemplated measures still may not be enough to balance state finances.

The following summarizes some of the essential changes included in the budget proposal.

Corporate income tax

The relevant tax intake is estimated at EUR 3.8 billion. The estimate is based on the completed corporate income taxation of 2009 and estimates for the years 2010 and 2011, as well as on the predicted profit performance of companies in 2009-2012.

The corporate income tax rate is contemplated to be reduced from 26% to 25% starting from 2012. Along with some extended reliefs and other changes, this is expected to reduce the state's accumulation of corporate income tax by approximately EUR 440 million in 2012.

The government announced earlier this year that it intends to perform an in-depth analysis of the current corporate tax system to potentially reform the system. At the time of this writing, there is no further information on the status of the analysis and, therefore, the budget proposal may not give an exhaustive view on potential corporate tax related changes to be introduced in the future. An example of a potential reform that has been investigated by the Ministry of Finance in recent years is the potential limitation on interest deduction for corporate tax purposes.

Taxes on earned income and investment income

Taxation is based on the Income Tax Act (1535/1992) and it includes progressive taxes on earned income, investment income and taxes at source.

The tax base will be broadened and income disparity reduced, i.e. by increasing taxation on investment income and substantial inheritances. Taxation on earned income will be revised on an annual basis to prevent strain caused by inflation and the general rise in wage levels.

The proposal increases to some extent the tax burden on investment income of individual taxpayers. The investment income tax rate will rise from 28% to 30%. The tax will become partly progressive, since, instead of the current flat tax rate, the rate will be 32% for investment income exceeding EUR 50,000 per year. The maximum amount of tax-exempt dividends distributed by a private unlisted company to a domestic individual shareholder will be reduced from EUR 90,000 to EUR 60,000.

In Finland, homeowners have traditionally benefited from the possibility of deducting the annual interest on mortgages for tax purposes. This deduction will be limited gradually over the period from 2012 to 2014, by the end of which only 75% of the interest will be deductible.

From the point of view of foreign expatriates, it is worth mentioning that the Act on Withholding Tax for Foreign Employees (1551/1995), under which highly skilled professionals have benefited from favorable flat withholding tax instead of the domestic progressive tax on earned income, will be extended for four years according to the budget proposal.

Lastly, the tax rate concerning certain mutual taxpayers, such as road maintenance associations and fishery collectives, will be increased from 26% to 30%.

Value added tax

In Finland, subscribed newspapers and magazines have been, under certain circumstances, subject to a specific 0% VAT rate mainly due to educational reasons. Starting from 2012, this regime will be abolished and newspapers and magazines will be taxed at a 9% VAT rate. The measure is estimated to increase tax revenues by EUR 90 million annually, though in 2012 the effects are predicted as a smaller EUR 53 million increase mostly due to the two-month delay concerning the payment of VAT.

Excise taxes

An increase will take place in 2012. This will be the fifth increase within five years and is estimated to bring approximately EUR 50 million more in tax revenue. Alcohol taxation will also increase, being the fourth tax hike on alcohol in five years. Sweets, ice cream and soft drinks will accumulate an estimated EUR 1.8 billion of tax revenue, of which an estimated EUR 50 million will accumulate due to the proposed increase in tax.

Energy taxes also are in the taxman’s crosshairs, with approximately EUR 145 million attributable to tax increases. Carbon dioxide tax, along with fuel and road taxes, will be increased.

Inheritance and gift tax

The budget proposal introduces a new fourth tax bracket, so that the proportion of inheritances and gifts exceeding EUR 200,000 would be taxed at a 16% rate instead of the current third bracket 13% rate. This change is estimated to increase the tax intake in 2012 by about EUR 15 million and by about EUR 35 million in the years to follow.

Withholding tax on interests on deposits and bonds paid to individuals

In 2011, the tax rate on interest paid to a Finnish natural person on bank deposits or bonds is 28%. According to the proposal, the rate in question will rise to 30% starting from 2012. The change is expected to increase the intake by about EUR 20 million annually.

Other taxes

In Finland, car taxes have traditionally been high. Car taxation will be subject to further increases under the budget proposal. Car tax will be 12.2%-48.8% depending on the carbon dioxide emissions, which will bring an estimated EUR 90 million more in tax revenue in 2012.

Motor vehicle taxation rates will be revised to enhance environmental guidance. The revision that will take effect starting from 2013 will increase the revenue from motor vehicle tax by approximately EUR 140 million annually. Due to the fiscal year concerning motor vehicle taxation, the proposed revision will accumulate EUR 70 million in tax revenue in 2012 alone.

The Waste Tax Act (1126/2010) has been amended starting from 2011 so that it covers not only public but also private landfills. According to the proposal, the tax rate will be further increased from EUR 40 per ton of waste to EUR 50 per ton of waste in 2013.

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France:
Proposed austerity package includes tax and social measures

The French Prime Minister presented on 24 August 2011 a package of measures aim at reducing the country's deficit. Included are 19 measures to close loopholes and raise revenue, and that will affect company and personal taxation, indirect taxes, the social contribution and social security contributions. The measures will be implemented through three separate laws: the second Amended 2011 Budget Law, the ordinary budget law for 2012 and a law for financing social security.

The three laws will be debated by Parliament this fall, with a draft of the second Amended 2011 Budget Law (relating to five of the measures) released on 1 September 2011. The House of Representatives has already debated, amended and voted on the five measures, which are now before the Senate.

Measures affecting companies

Restriction on loss carryover – Currently, losses that cannot be offset against gains in the same year may be carried back for three years and carried forward indefinitely. It is proposed to restrict the loss carryback to one year, capped at EUR 1 million per year. Any remaining losses could be carried forward indefinitely but capped at EUR 1 million per year. Losses still remaining could only be set off against up to 60% of the income exceeding this limit. Therefore, the remaining 40% of income would be taxed at the general rate ("minimum taxation"). This measure would apply for fiscal years closing as from the promulgation of the second Amended 2011 Budget Law.

There is no provision concerning the tax consolidated group regime, meaning that each member company could carry forward up to EUR 1 million pre-consolidation losses per year against its own profits and group losses could be carried forward up to EUR 1 million per year.

Reduction of benefits under participation exemption for capital gains – Capital gains derived from participation shares (i.e. where the seller holds more than 5% of the capital of the subsidiary) currently are exempt from tax if the participation is held for more than two years. However, a lump sum equal to 5% of the capital gains, which is deemed to represent costs and expenses, is taxed at the standard corporate income tax rate (currently 33.33%). Under the proposed measures, the lump sum would be increased to 10% of the capital gains for fiscal years open from 1 January 2011, meaning that long-term capital gains would be 90%, rather than 95%, exempt. This would result in actual taxation at a rate of 3.44% instead of the current 1.72%.

Abolition of reduction of taxable income of companies in Overseas Territories – Currently, one-third of the earnings of companies derived from certain activities in Overseas Departments are excluded from the company tax base. This reduction would be abolished for fiscal years closing as from 31 December 2011.

Change in tax on company cars – French companies are liable for an annual tax on the company cars they own, rent or use. As from 2012, the rates of this tax would be modified, taking into account environmental criteria.

Indirect taxes

Excise duties on alcohol and tobacco would be increased and a tax on soft drinks would be introduced. While the Prime Minister's proposals also included extending the 19.6% standard rate of VAT to theme parks, this was rejected by the House of Representatives.

Personal taxes

Tightening of real property capital gains benefits – Capital gains derived from the sale of a main residence currently are not taxable, nor are gains derived from the sale of other real property that is held for at least 15 years. For the latter property, the taxable gain is reduced by 10% for each full year the property was held, starting at the fifth year. As a result of this rebate, gains are exempt after the 15-year holding period. As proposed, the austerity measures would have abolished the 10% annual abatement (and thus the holding period), with the capital gains computation taking into account the inflation rate. This measure would have applied to provisional sales agreements concluded after 24 August 2011. The exemption for the primary residence would remain intact.

In combination, the proposed abolition of the 10% annual abatement and the increase of social surtaxes due on capital gains (to 13.5%, as discussed below), would have led to a significant increase in French taxes due in connection to the sale of real property (other than the taxpayer's principal residence), leading to a global liability of 32.5% (including income tax of 19%). As part of the second Amended 2011 Budget Law, however, the measure was challenged and amended by the House of Representatives:

- The measure would apply for sales signed on or after 1 February 2012;
- An anti-abuse clause provides that the transfer of buildings to real estate companies owned by the owner of the building or his/her family would be taxed according to the new rules for deeds signed on or after 25 August 2011; and
- The 15-year holding requirement for the full exemption would be extended to 30 years, with a progressive rebate computed on the capital gain as follows:
  - 2% per year if sold in years 6 to 17;
  - 4% per year if sold in years 18 to 24;
  - 8% per year if sold in years 25 to 30; and
  - 100% if sold after 30 years of ownership.

Temporary contribution on high income – A new annual 3% contribution would apply to the fraction of income that exceeds EUR 500,000 per person. This measure would apply to income received in 2011.

Social contributions

Several changes are proposed to the social contribution (CSG):

- The allowance for professional expenses that is granted in computing CSG would be reduced from 3% to 2% and the allowance for non-salary income would be abolished;
- The CSG would be extended to apply to "CLCA" (a specific family income support); and
- The social contributions relating to exempt income (e.g. employee profit sharing or the bonus for value added sharing) would be increased from 6% to 8%.
- The social tax on passive income would be increased by 1.2 percentage points from 12.3% to 13.5% (to apply to 2011 income).

Social security

The "*Fillon* reduction" is a rebate of employers' social security charges (sickness, maternity, old age, disability, death and work accidents) and family allowances, calculated on wages and bonuses paid by the employer over the entire year. However, the fraction of salary related to overtime work is not taken into account in calculating this reduction. Under the proposals, the reduction amount would be calculated on a base including this fraction of salary. This measure would apply as from 1 January 2012.

Further, the partial exemption from the special tax on certain insurance contracts would be abolished.

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Luxembourg:
Compatibility of net worth tax reserve rules with EU law

The Administrative Court of Luxembourg has requested a preliminary ruling from the European Court of Justice (ECJ) as to whether Luxembourg's net worth tax reserve rule is compatible with the freedom of establishment principle in article 49 of the Treaty on the Functioning of the European Union. The ruling request was made on 13 July 2011.

Luxembourg levies an annual net worth tax of 0.5% on the adjusted value of all resident companies. However, the net worth tax due can be reduced in whole or in part if the taxpayer creates and maintains a special five-year reserve in its commercial accounts. The tax reduction amounts to one-fifth of the reserve and may not exceed the amount of corporate income tax liability before the imputation of the tax credit.

The case involves a private limited liability company (Sàrl) that had established a blocked reserve and benefited from the above reduction for 2004. In 2006, the company transferred its seat to Italy and then merged with an Italian company. The funds remained allocated to the special reserve. Following the migration, the Luxembourg tax authorities determined that the taxpayer no longer met the requirements to benefit from the net worth tax reduction because the company was not a Luxembourg resident and, thus, not subject to net worth tax. The previously granted relief was recaptured and the tax authorities denied the tax reduction for 2005 and 2006.

The taxpayer appealed the determination of the tax authorities. However, the Administrative Court referred the case to the ECJ for a preliminary ruling as to whether the freedom of establishment principle in the TFEU prohibits a rule that makes the right to a tax reduction dependent on the fact that a company remains subject to Luxembourg tax for the five tax years.

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Peru:
Tax rules on financial derivatives revised

Law 29773, published in the Official Gazette on 27 July 2011, reinstates the previous narrower regime on the tax treatment of gains obtained by nonresidents from financial derivatives in the Peruvian market. The new law restricts the scope of such derivatives that will be subject to Peruvian taxation in an effort to prevent a disruption of the negotiation of financial instruments.

Under Law 29492, which applied to financial derivative contracts entered into on or after 1 January 2010, results from financial derivatives obtained by nonresident taxpayers were considered sourced in Peru and, therefore, within the scope of the Peruvian tax net if the following criteria were met:

- The derivative contract was entered into with a Peruvian resident;
- The underlying asset to which the derivative was linked was exchange differences between the Peruvian currency and any foreign currency; and
- The effective term of the instrument was less than the "ceiling threshold" established by regulations, which in any case could not exceed 180 calendar days. Under Supreme Decree 011-2010-EF, the ceiling threshold for these purposes was established at 60 calendar days.

Subsequently, Law 29663, enacted on 15 February 2011, expanded the scope of the above regime to encompass *all* results obtained from financial derivatives contracts negotiated on a market located in Peru, whether or not centralized, in accordance with rules that were to be established by regulations, which have not yet been issued. As a result of Law 29633, it is possible to conclude that the results obtained from any financial derivative contract entered into by a nonresident that meets these criteria qualify as Peruvian-source income subject to tax in Peru.

The overly broad scope of the rules introduced by Law 29663 attracted severe criticism in Peru because of the obvious impact on decision-making regarding the negotiation of derivative instruments in the Peruvian market. The government has responded to this criticism by enacting the new law (Law 29773), which reinstates the tax treatment previously applicable to results obtained by nonresidents from financial derivatives. Thus, nonresidents will be subject to tax in Peru on results obtained from foreign exchange derivative contracts only where those contracts meet the Law 29492 criteria, as explained above.

The ceiling threshold (which may not exceed 180 calendar days) for bringing a foreign exchange derivative within the scope of Peruvian taxation is to be established by future regulations. In the meantime, agreements with an effective term of 181 calendar days or more should be excluded from the scope of application of the regime. This amendment to the income tax provisions will enter into effect on the day following that on which the applicable regulations are published. The new rules will apply only to financial derivatives contracts entered into on or after that date.

Because three different regimes potentially apply in 2011, it will be necessary to make a careful analysis of the tax treatment applicable to each derivative contract entered into:

- Agreements signed from 1 January 2010 through 15 February 2011 – Those agreements within the scope of Law 29492 with a ceiling threshold of 60 calendar days will fall within Peru's tax net;
- Agreements signed from 16 February 2011 through the date on which new regulations under Law 29773 are published – Those agreements within the scope of Law 29663 will fall within Peru's tax net; and
- Agreements signed from the date following that on which new regulations are published – Those agreements within the scope of Law 29492 (as reinstituted by Law 29773), with a still undetermined ceiling threshold (not to exceed 180 calendar days), will fall within Peru's tax net.

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Slovenia:
New bank tax passed

Slovenia's National Assembly passed a measure on 13 July 2011 imposing a new bank tax on both Slovene and foreign banks. The tax, levied at a rate of 0.1% on the total assets of a bank, will apply unless the bank expands its loans to non-financial institutions and sole proprietors. The tax came into effect on 1 August 2011, and in 2011 applies for the period from August to December.

The bank tax applies to:

- Licensed domestic banks;
- Banks from EU Member States that carry out banking and financial services either directly or through a branch in Slovenia; and
- Banks from third countries that carry out banking and financial services through a branch in Slovenia.

The tax base of the bank tax is comprised of a bank's total assets, calculated as the average value on the last day of each month in the calendar year. The 0.1% rate applies to the taxable base. For banks from other EU Member States that carry out banking services in Slovenia directly, the tax base is calculated as a proportion of total assets, taking into account the bank's volume of business in Slovenia.

A bank may reduce its tax obligation (up to the amount of the tax obligation) by 0.167% of its balance of loans granted to non-financial entities and sole proprietors.

Two exemptions from the bank tax are available:

- Where a bank's total loans to non-financial companies and sole proprietors in a taxable calendar year exceed the amount of loans from the previous calendar year by at least 5% of the bank's total assets of the previous year; and
- Where a bank's loans to non-financial companies and sole proprietors on 31 July 2011 are less than 20% of its total assets.

Although the bank tax applies to calendar year 2011, the tax does not have to be paid until 2012. Banks are required to file their returns by 31 March, with the tax due within 30 days of filing the return. This will give banks time to make appropriate changes so they qualify for the exemptions.

According to the government, the bank tax is expected to help the economy by encouraging banks to adopt a more proactive approach to lending to the non-financial sector and at the same time enable the non-financial sector to access funds needed for growth and development.

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In brief

Czech Republic – The government has approved a proposal for making significant tax, social security and health insurance reforms to simplify the tax system and create conditions for establishing the "Single Collection Point" (i.e. responsibility for collecting social security and public health insurance payments will shift from existing institutions – such as social security authorities and health insurers – to tax administration bodies. The proposed amendments to the Income Taxes Act seek to reassess/eliminate various tax exemptions.

Egypt – The 2011-2012 budget, approved on 26 June 2011 and published in the 28 June official gazette, introduces a new tax bracket of 25% for corporate taxable profits that exceed EGP 10 million per year. The 20% rate continues to apply to income up to EGP 10 million, except for companies engaged in the exploration and production of oil and gas, which are taxed at a rate of 40.55%. For individuals, rates are progressive up to 25% on income over EGP 10 million per year. Resident employees who derive income from sources other than their original place of employment and all nonresidents are subject to tax at a flat rate of 10%.

OECD – A report released by the OECD on 30 August 2011 examines some common loss schemes used to increase or accelerate tax relief in ways not intended by the legislator, or to generate artificial losses. The report, entitled "Corporate Loss Utilization through Aggressive Tax Planning," identifies three key risk areas: corporate reorganizations, financial instruments and non-arm's length transfer pricing. It summarizes various strategies used by countries to detect and respond to such schemes, and offers some suggestions for tax administrators and tax policy officials to capture potential revenue that would otherwise be lost as a result of such schemes.

Thailand – The Director General of the Revenue Department has announced the drafting of a tax law to be proposed to the new government that would reduce corporate income tax from 30% to 23% in 2012, and eventually to 20% in 2013. The proposed corporate income tax reduction is expected to reduce tax revenue collected by THB 1.5 trillion, but it also is expected that this will not affect total tax revenue collected because there will be increased investment into Thailand, which will increase revenue from VAT and personal income tax.

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Canada
Finance introduces new rules on repatriation from foreign affiliates, including loans of taxable surplus
The Department of Finance has released the final package of draft legislation related to the February 2004 proposals concerning the taxation of foreign affiliates. Finance proposes to introduce a new surplus account to track certain gains from the sale of foreign affiliates. [Issued: 22 August 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/f5043bd58e4f1310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_090911
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Canada
New foreign affiliate proposals on distributions, reorganizations and other transactions
The Department of Finance has released the final package of draft legislation related to the February 2004 proposals concerning the taxation of foreign affiliates. (Note, this alert discusses the remainder of the proposals from the draft legislation addressed in the 22 August 2011 alert.) [Issued: 25 August 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/b3c4bab518402310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_090911
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Spain
Changes made to corporate income tax and VAT rules
The government has issued a decree that makes temporary changes to the corporate income tax and VAT rules, including a restriction on the offset of NOLs carried forward, a reduction in the amount of financial goodwill and an increase in the prepayment of corporate income tax. [Issued: 24 August 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/46955bfc09bf1310VgnVCM3000001c56f00aRCRD.htm?id=us_email_Tax_WTA_090911
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_Spain_240811.pdf?id=us_email_Tax_WTA_090911

Switzerland
WHT proposed to be abolished on some debt instruments held by foreign investors
The government has submitted a technical explanation to a draft law currently before the Parliament that would effectively abolish withholding tax for foreign corporate and individual investors on interest payments on Swiss collective fund borrowings, such as bonds or money market papers. [Issued: 6 September 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/d44549614af32310VgnVCM1000001a56f00aRCRD.htm?id=us_email_Tax_WTA_090911
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Switzerland_060911.pdf?id=us_email_Tax_WTA_090911

United States

IRS rules that U.K. Remittance Basis Charge is creditable

The Internal Revenue Service has issued a ruling that the U.K.'s levy on long-term resident non-domiciliaries, including the Remittance Basis Charge of GBP 30,000, is an income tax for which a U.S. foreign tax credit is allowable.

[Issued: 7 September 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/d8f03c68ca442310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_090911

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