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International Tax

World Tax Advisor

14 October 2011

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Recent cases on the application of Taiwan sourcing rules

Taiwan's income sourcing rules have always been a controversial issue in cross-border transactions, particularly transactions relating to the provision of services. Despite a clear statutory mandate (article 8, item 3 of the Income Tax Act (ITA)) that income earned from the provision of services will be treated as Taiwan-source income only if the services are provided in Taiwan, the Taiwan tax authorities historically have taken the position that, where service fees are paid from Taiwan, the fees should be treated as "other income derived from Taiwan" (ITA article 8, item 11). In relation to that category of income, there are no criteria for determining which income is Taiwan-sourced. As a result, Taiwan payers of services fees generally have been required to withhold a 20% tax even if the payments related to services rendered entirely outside Taiwan or services rendered both onshore and offshore. The 20% tax is levied on the gross amount of the service fees without taking into consideration costs and expenses incurred to earn the service income. The tax authorities' broad interpretation of the rules has given rise to many disagreements with taxpayers.

Under Taiwan rules, a profit-seeking enterprise whose headquarters is outside Taiwan is subject to Taiwan income tax only if the enterprise earns Taiwan-source income. If the profit-seeking enterprise has a fixed place of business or business agent in Taiwan, i.e. a permanent establishment (PE) in Taiwan, the PE must file an income tax return and pay Taiwan income tax on its Taiwan-source income. If the enterprise does not have a PE in Taiwan, Taiwan income tax is collected through the withholding of tax at source.

The Ministry of Finance (MOF) published rules in 2009 (Assessment Rules for the Determination of Taiwan-Source Income under Article 8 of the Income Tax Act) to clarify the scope of Taiwan-source income and resolve the ongoing dispute regarding the classification of services income under ITA article 8. The principles under the Assessment Rules are largely consistent with the laws and practice of many other countries, particularly in that they provide that the place where services are carried out is the place where income should be recognized for tax purposes. In other words, service fees received by a foreign entity should not be considered Taiwan-source income if the foreign entity only provides services outside Taiwan.

The Assessment Rules also address the situation where a foreign entity provides services both onshore and offshore. In such circumstances, the foreign entity can divide its profits into Taiwan-source (i.e. "contribution rate") and non-Taiwan-source income, respectively, taking into account any assistance provided by a Taiwan entity. Similarly, if a foreign entity earns

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business profits in Taiwan and can provide documentation to specifically identify the onshore and offshore portions, the Taiwan tax authorities may calculate and assess profits attributable only to the Taiwan portion.

As noted above, a foreign entity with no fixed place of business or business agent in Taiwan must pay withholding tax on Taiwan-source income. Where the 20% withholding tax is levied on the gross amount of a service fee payment, the Assessment Rules provide that a foreign entity can claim a deduction for costs and expenses incurred in the providing the services and appoint a Taiwan agent to request a refund of excess tax withheld.

The Assessment Rules were broadly welcomed by the business community and tax practitioners in Taiwan. In practice, however, businesses continued to withhold 20% tax on the payments of services fees paid to offshore entities even where such payments could be classified as constituting non-Taiwan-source income under the Assessment Rules because it was unclear how the tax authorities would implement the rules. For example, there was concern that, under the Assessment Rules, any “assistance” provided by a service recipient could be regarded as contributing to the provision of the services. The extent to which the Taiwan tax authorities would rely on this rule to expand the scope of such “assistance” and consequently treat service charges as being Taiwan-source was unclear, even though the Assessment Rules state that the provision of facts, data and related information by the service recipient to the service provider, as well as giving notice, providing confirmation and liaison-related processes, would not be deemed to constitute the provision of assistance by the service recipient. If the tax authorities disagree with a taxpayer’s position that income is non-Taiwan source, the Taiwan payer may be subject to a substantial one-time penalty on the 20% tax that should have been withheld, resulting in an overall 40% withholding tax rate.

The business community’s concerns were not unfounded. In 2010, the Taiwan Supreme Administrative Court issued a decision in which it concluded that service fees paid by Sun Microsystems in Taiwan to affiliates in Australia and Singapore should be characterized as Taiwan-source income and, thus, subject to the 20% withholding tax. While both Australia and Singapore have concluded tax treaties with Taiwan, protection under the respective treaties was unavailable in the Sun Microsystems case. Because the Taiwan-Australia treaty contains an “other income” article similar to that in the UN model, the treaty affords no protection from taxation in the source state where a service fee is categorized as “other income,” even where the foreign enterprise in receipt of the fee has no PE in Taiwan. With respect to the Taiwan-Singapore treaty, treaty protection was denied because the taxpayer was unable to provide any documentation demonstrating it had no PE in Taiwan. Because Sun Microsystems was unable to invoke either treaty, it was in the company’s interest to argue that the fees did not constitute Taiwan-source income.

Having stated that sourcing considerations in relation to categories of income other than “services” income were also relevant to the analysis, the court ruled that the service fees fell within the scope of the definition of “business profits” in ITA article 8, item 9, and that business profits should be treated as Taiwan-source income if the services are “used” in Taiwan. Even though it could be argued that the Assessment Rules should be followed in open cases under dispute (regardless of when the relevant transactions took place), the Taiwan tax authorities have indicated that they regard the rules as applying only to transactions taking place after publication of the Assessment Rules, and the decision in the Sun Microsystems case, which involved transactions that took place in 1997, long before the Assessment Rules were issued, suggests that withholding the 20% withholding tax on cross-border service payments has been the prudent course.

Following the Supreme Administrative Court decision in Sun Microsystems, some taxpayers have attempted to rely on the Assessment Rules to argue that service income received by them was non-Taiwan source, but the tax authorities have either denied the applications or failed to respond. Considering the Supreme Administrative Court’s decision and the practical experiences of the business community, the question is: will the Taiwan tax authorities ever observe and enforce the principles enunciated in the Assessment Rules?

On the basis of our conversations with officials from the MOF, the position seems to be that the tax authorities will apply the principles laid down in the Assessment Rules, but the taxpayer bears the burden of substantiating its position and proving that the income concerned is non-Taiwan-source income. In fact, there are cases in which taxpayers have successfully reached agreement with the tax authorities and mitigated their Taiwan income tax exposure. This article focuses on four such cases, discussed below, which dealt with the following issues:

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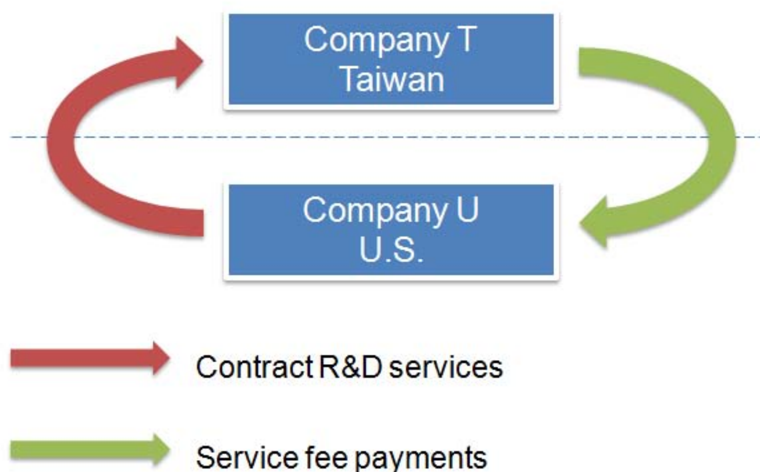
- Service fees paid to offshore contract R&D service provider (Case 1);
- Payments for profit-sharing on sales of online game points (Case 2);
- Incorporation fee for setting up offshore holding companies (Case 3); and
- Taiwanese-source income relating to storage and delivery of goods and identification of a PE by tax authorities (Case 4).

Case 1: Service fees paid to offshore contract R&D service provider

Company T is a Taiwan company specializing in IC design. To leverage the cost and manpower available in its U.S. subsidiary, Company U, the two companies entered into an agreement under which Company U would provide contract R&D services to Company T, for which Company T would pay quarterly service fees calculated on a 10% cost-plus basis.



There is no tax treaty between Taiwan and the U.S., so the business profits exemption is not available. Although Company U is taxed on its worldwide income in the U.S. and should be able to claim a tax credit for income tax paid in Taiwan, Company U should take reasonable steps to mitigate any Taiwan income tax exposure because the U.S. Internal Revenue Service will not give a tax credit for voluntary tax paid. This being the case, Company U was considering the possibility of treating the contract R&D service fees received from Company T as non-Taiwan-source income. However, because Company T was required to periodically communicate design ideas to Company U, the Taiwan tax authorities disagreed with Company U's position that all of the service fees were derived from the offshore provision of services. The tax authorities did agree to consider apportionment (i.e. contribution rate treatment) under ITA article 8 if the two companies could provide relevant supporting documentation.

The 10% mark-up on the service charge was supported by transfer pricing documentation, which was submitted to the Taiwan authorities to demonstrate the arm's length nature of the transaction. Both Company T and Company U were audited by reputable international firms and were able to provide their audited financial statements. Even though audited financial statements are not a prescribed document under the relevant rules, Company U was willing to work with the in-charge tax official and provided documents to prove the existence and reasonableness of the actual costs and expenses it incurred and, hence, the 10% mark-up. Combined with the fact that the representatives of the two companies were fully authorized to disclose all facts to the tax officers, a consensus was soon reached, followed by a formal approval letter from the tax authorities stating Company T's contribution rate of 50%. Although 50% may overstate the actual onshore portion of the services, the tax saving is significant because the tax authorities also approved the deduction of costs and expenses incurred by Company U. The withholding tax rate was effectively reduced from 20% on the gross payment to 1% (50% Taiwan contribution rate x 10% profit x 20% withholding tax rate).

Case 2: Payments for profit sharing on sales of online game points

Company A, a distributor of online games in Taiwan, signed a Memorandum of Understanding (MOU) with Company B, an offshore company that owns the games Company A distributes, as well as the IP with respect to the games. Under the MOU, Company A is responsible for the distribution of the games in Taiwan by sales of virtual game points. End consumers

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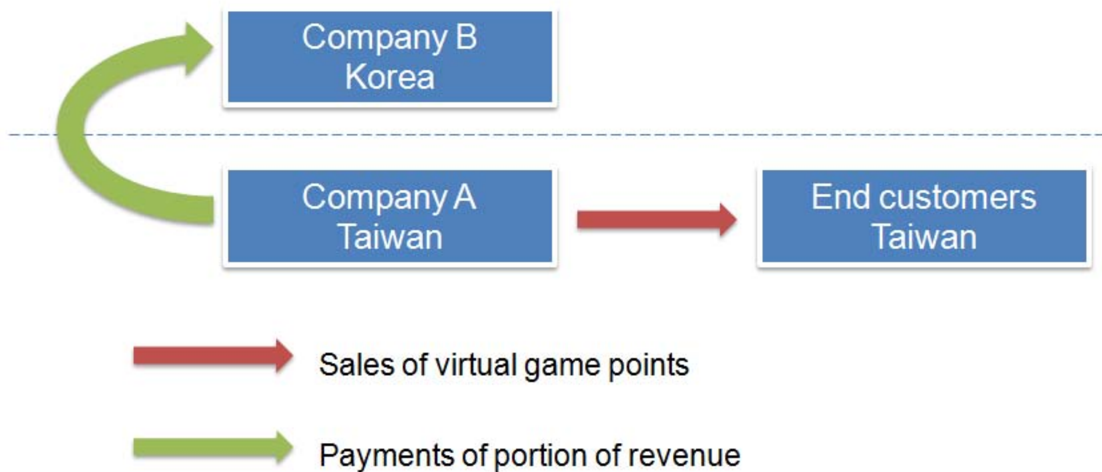
can acquire virtual game points by purchasing prepaid cards from chain stores or online stores and use the purchased points to play online games designed and owned by Company B. Company A is required to pay Company B an amount calculated by applying a predetermined percentage to the amount of its sales of virtual game points.



Under this transaction model, it appears that the income earned by Company B may not qualify for shrink-wrapped software treatment, under which the income would be regarded as profits from international trade and not Taiwan-source income and, therefore, as exempt from Taiwan withholding tax. Company B wished to clarify its tax position and determine whether there were any opportunities to mitigate its Taiwan income tax exposure under the Assessment Rules.

Following communications between Company B and the Taiwan tax authorities on an anonymous basis, the authorities made it clear that the transaction model would not qualify for exemption treatment for shrink-wrapped software. The companies subsequently adjusted their approach to seek contribution rate treatment under the Assessment Rules. The application involved a full disclosure of the facts of the transactions and lengthy negotiations and discussions. At one point, there was discussion as to whether the payments made by Company A to Company B were in the nature of royalties (in which case there would be no contribution rate treatment or deduction of costs and expenses). However, with the participation of the representatives of both Company A and Company B to ensure the transactions were fully understood by the tax officials, Company A eventually was able to obtain a contribution rate acceptable to the tax authorities. Consequently, the effective tax rate was reduced from 20% on the gross payment to a single digit percentage (i.e. 20% x contribution rate).

It should be noted that, in the case of this particular transaction, the tax authorities did not allow a deduction of costs and expenses because Company B was not willing to disclose its books and records, nor were the authorities willing to grant a deemed profit rate treatment. Had the deemed profit rate treatment been granted or had Company B been willing to provide its books and records to substantiate the actual costs, the tax savings would have been greater.

Case 3: Incorporation fee for setting up offshore holding companies

In the past, regulations prohibited Taiwan companies from making direct investments in China. Consequently, Taiwan companies had to use intermediary holding companies, historically located in the Cayman Islands and the British Virgin Islands, but more recently in Hong Kong and Singapore, for outbound investments. Initially, these intermediary holding companies were set up primarily to comply with regulatory requirements, but later on holding companies were established – usually with minimal or no substance – for tax planning purposes. Arguably, users of these services in substance are based in Taiwan, rather than in the intermediary holding company jurisdiction. Questions have arisen as to whether the 20% withholding should apply when a Taiwan company paid an incorporation fee and annual maintenance fee to the service agent outside Taiwan. The Taiwan tax authorities agreed in a private ruling that the incorporation fee and annual maintenance fee should not be considered Taiwan-source income and, therefore, should not be subject to the 20% withholding tax.

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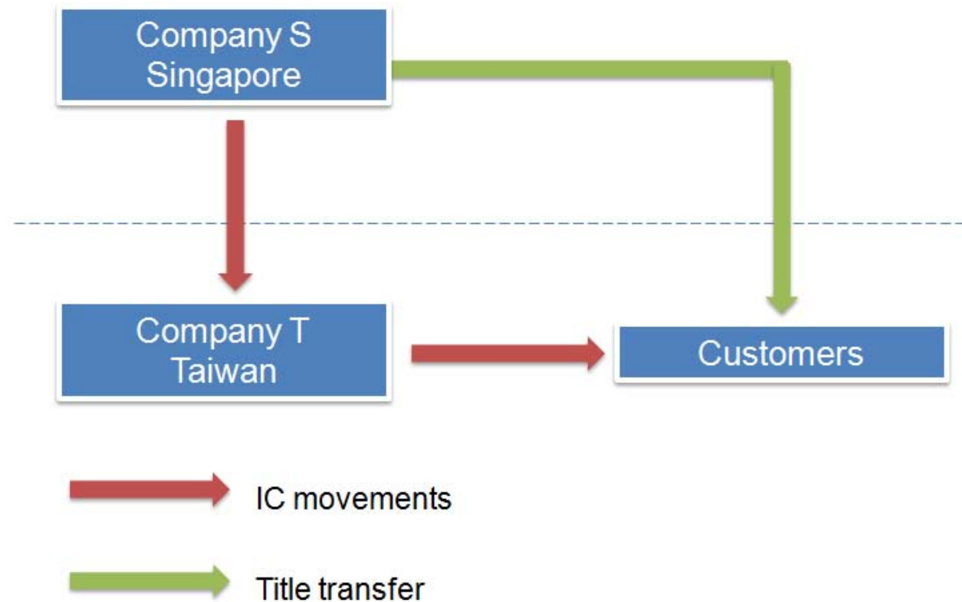
Case 4: Taiwan-source income relating to storage and delivery of goods

Company S, a foreign enterprise based in Singapore, engaged Company T, a Taiwan company, to perform toll manufacturing services. Based on instructions from Company S, Company T is required to deliver the finished products to customers in Taiwan. Ownership of the products remains with Company S throughout the manufacturing process and passes directly to the customers when the products are delivered. In other words, Company T never takes ownership of the products manufactured for Company S. The transactions are illustrated in the following diagram:



Under several rulings issued by the Taiwan MOF in 1998, a Taiwan company engaged by a foreign enterprise to import, store and deliver goods for a foreign enterprise is considered to be a business agent of the foreign enterprise in Taiwan. The business agent is required to issue a Taiwan version tax invoice, also known as a Government Uniform Invoice (GUI), for the sale of the goods sold by the foreign enterprise to customers and file an income tax return on behalf of the foreign enterprise, because the income earned by the foreign enterprise from the sale of goods is no longer regarded as income from international trade, but instead is treated as Taiwan-source income. The requirement for the business agent to issue a GUI for sales made to onshore and offshore customers and file an income tax return on behalf of the foreign enterprise with respect to the Taiwan-source income was confirmed by the Taiwan High Administrative Court in 2010. Consequently, absent the protection of a tax treaty (Taiwan does, however, have a treaty in effect with and Singapore), Company T would be regarded as a Taiwan PE of Company S under Taiwan's domestic rules. The question is, would the Taiwan tax authorities be able to identify or become aware of such a PE?

For tax compliance purposes, where a Taiwan company is regarded as a business agent in Taiwan, the foreign enterprise must notify the tax authorities through the business agent in order to obtain an acknowledgement from the authorities that they are aware that the Taiwan company is acting as a business agent. In the case at hand, however, Company S did not ask Company T to apply for any such acknowledgement. This being the case, Company T neither issued GUIs to the Taiwan customers nor filed an income tax return on behalf of Company S. Company S's potential PE issue came to light during a review by the Taiwan tax authorities of one of the Taiwan customers' income tax returns, when the Taiwan customer could only produce a commercial invoice issued directly by Company S and was unable to produce a valid GUI, which is generally required to claim an income tax deduction for goods purchased and to claim an input tax credit for VAT purposes. The direct tax examination section in the tax office informed the section in charge of the indirect tax section, which then investigated the flow of GUIs and discovered what would have been Company S's PE, had there been no treaty in place.

Under the Taiwan-Singapore tax treaty, facilities solely for the purposes of storage, display or delivery of goods or merchandise belonging to the Company S should not be considered a PE of Company S in Taiwan. On that basis, Company T was not considered a PE of Company S. As a result, Company S was able to obtain treaty protection and did not have to pay Taiwan income tax. The Taiwan tax authorities have not raised any further challenges against Company T for failing to issue the GUIs, even though the tax treaty only deals with direct tax. Nevertheless, a couple of points should be noted:

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- By conducting a tax examination of the last entity in a supply chain, the Taiwan tax authorities are able to trace a transaction through the various parties involved, back to the original offshore supplier. Thus, the Taiwan authorities are able to identify foreign entities with a PE in Taiwan that fail to issue GUIs or file income tax returns.
- If treaty protection is not available and a PE exists, there are a few arrangements that can mitigate Taiwan income tax exposure under the 1998 rulings. The most frequently explored option is a round-trip sale, which entails the goods concerned being exported to a warehouse outside Taiwan before the sales transaction takes place. In that case, since the sales transaction takes place without involving a PE in Taiwan, there will be no Taiwan income tax implications in relation to the goods sold (including the goods subsequently imported into Taiwan). The downside of this arrangement is the additional storage and delivery costs that it involves, as well as the additional customs clearing procedures and lead time necessary to meet the customers' needs. Alternatively, it is also possible to apply to the Taiwan tax authorities for an appropriate contribution rate under the 1998 rulings to reduce the effective tax rate in Taiwan.

Conclusion

Despite the issuance of the Assessment Rules in 2009, it would appear that the Taiwan tax authorities will not readily agree to a foreign entity's position that income is non-Taiwan-source and grant an exemption from withholding tax. Nevertheless, given the right facts and circumstances, it may be possible to successfully obtain either an exemption from the 20% withholding tax on certain types of service fee payments or apportionment treatment to reduce the effective tax rate in Taiwan. As illustrated in the first three cases discussed, the savings can be significant. The key is to have a seasoned representative engage in an open negotiation and discussion with the tax officers to help the tax officers understand the transactions.

The final case discussed above shows how the Taiwan tax authorities are able to identify Taiwan PEs of foreign enterprises specifically in relation to the sale of goods. Although there have not been any full scale audits in this area, it will be interesting to see how the Taiwan tax authorities deal with it in the future. This highlights the importance of having a tax advisor point out potential tax exposure and planning opportunities that may be available before any transactions take place. We suggest that multinationals selling goods to Taiwan proactively assess and evaluate their PE exposure in light of recent cases and determine the best solution to mitigate their exposure to Taiwan taxation.

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Austria:
Draft tax changes for 2012 announced

Austria's Ministry of Finance published draft amendments to various tax laws on 27 September 2011 that will be considered for inclusion in the 2012 federal budget. The draft includes changes to the Income Tax Act, Corporate Income Tax Act and Reorganization Tax Act. The following are the more significant proposed changes:

- To further foster R&D activities following an increase in the cash tax premium rate to 10% at the beginning of 2011, the draft amendments would broaden the expenses eligible for the premium. Expenses for subcontracted R&D work would no longer be subject to a cap if the principal, rather than the subcontractor, opts to claim the R&D premium. The subcontractor would have to be a qualifying EU/EEA institution and not a related party. As drafted, the principal could apply the amendment to business years starting after 31 December 2010.

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- Austrian law would be brought in line with the case law of the European Court of Justice. The Court held earlier in 2011 that the Austrian rules that only allow a deduction for donations to domestic research institutions are not compatible with EU law. As a result of the proposed change in Austrian law, comparable research institutions resident in other EU/EEA Member States or in countries that have concluded an administrative assistance agreement with Austria would be regarded as beneficial recipients for donations. The amendment would apply to all years not yet assessed.
- The new capital gains tax regime applicable to individuals previously was set to apply from 1 October 2011 but was postponed to 1 April 2012 earlier this year. Under the new regime, capital income (i.e. gains and income from certain capital assets) is subject to a flat 25% rate and may only be offset against certain losses in the course of the tax assessment procedure. Consequently, banks currently are set to withhold tax under the regime without taking into account any losses. The draft changes would require banks to offset losses (through that bank) with capital income in calculating the applicable withholding tax. Given that income and losses may not be concurrent, any excess tax withheld subsequently would be refunded by the bank. The amendment would enter into full effect as from 1 January 2013, with banks having until 30 April 2013 to rectify the period covering 1 April 2012 to 31 December 2012.
- The Reorganization Tax Act currently provides that, when a corporation is converted into a partnership, non-Austrian shareholders of the corporation may be eligible for a tax-neutral step-up of the Austrian tax basis of their partnership interests to fair market value upon conversion if Austria had no taxation rights with regard to the shares under an applicable tax treaty. The draft changes would abolish this opportunity and basically tax the built-in gain determined at the time of the conversion at a rate of 25% once the partnership interest is alienated.
- The tax spin-off regime in the Reorganization Tax Act would be abolished as from 1 January 2013 for spin-offs involving cooperatives. Corporations would continue to benefit from the spin-off provisions in the act.
- Although some lobbyists had requested tighter rules, the tax grouping rules will remain unchanged.

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Bulgaria:
Deadline for claiming withholding tax relief approaching

According to a law that became effective on 1 January 2010, companies resident in EU Member States that derive Bulgarian-source income subject to withholding tax are permitted to recognize related expenses against certain income and reassess the tax due on a net, rather than a gross, basis ("net tax regime").These companies can achieve material tax savings by opting for the net taxation scheme, but the opportunity for qualifying companies to reassess their tax due and obtain a refund of withholding tax in respect of 2010 income expires on 31 December 2011.

The net tax regime can be applied to the following types of income:

- Interest, royalties and technical services fees (including consultancy fees);
- Capital gains from the disposal of financial assets;
- Franchising and factoring fees;
- Rental fees for the hiring out of movable property;
- Fees for management and control of a Bulgarian legal entity; and
- Income (including capital gains) from the lease or disposal of immovable property.

(Dividends paid by a Bulgarian company to an EU resident company are not subject to withholding tax as from 1 January 2009 and, therefore, were not addressed under the tax scheme.)

To illustrate application of the net taxation regime, if interest earned by an EU company is subject to a 10% withholding tax in Bulgaria, the taxable base under the general tax rules would be the gross interest income. However, if the company opts for the net tax scheme, it can deduct related expenses (determined under the rules that generally apply to resident companies), so that the tax base would be limited to the profit margin. It should be noted that any credits granted in the

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company's state of residence will reduce the amount of excess withholding tax refunded, and a company opting for the regime must apply it to all income sourced in Bulgaria during the relevant year (i.e. "cherry picking" income is not allowed).

A company may elect into the net regime by filing a specific tax return with the Bulgarian tax authorities. The return is similar to the annual corporate income tax return applicable to Bulgarian companies, and the net taxable result reported should be calculated in accordance with Bulgarian tax legislation.

Election into the net tax scheme is made on a year-by-year basis. A company wishing to reassess its withholding tax for a given calendar year must file the relevant tax return by the end of the following calendar year. It can subsequently claim a refund of the difference between the withholding tax paid for the relevant year and the withholding tax reported in the return.

The option to elect into the net regime could be considered by companies that cannot apply an exemption from withholding tax under a tax treaty so that the amount of their withholding tax liability exceeds the tax liability that would arise upon the election. In cases where there is a risk that the tax authorities may deny treaty benefits (e.g. on beneficial ownership grounds), a company may mitigate the potential withholding tax exposure by electing into the net tax regime. The election itself does not prejudice the right of the company to continue claiming and ultimately applying tax treaty benefits for the relevant income. Therefore, the net regime can be used as an additional tool for managing withholding tax risks.

The net taxation regime was introduced to ensure that Bulgaria's rules do not violate EU law by discriminating against EU companies as compared to Bulgarian companies. Consequently, according to some interpretations of EU law, it is possible that the regime could be applied to income relating to 2007, 2008 and 2009 because EU nondiscrimination rules apply for Bulgaria as from 1 January 2007 (when Bulgaria joined the EU).

Due to inconsistencies in the relevant statutory provisions and the lack of established practice, however, some details associated with the application of the net taxation regime remain unclear. Interested companies should therefore ensure that they have ample time to prepare their claims in advance of the 31 December 2011 deadline.

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Indonesia:
New rules for use of Rupiah

A new currency law requires the mandatory use of the Rupiah for all transactions made within Indonesia, subject to certain exceptions, which came into effect on 28 June 2011 and, in practice, applies as from 1 July 2011 (although the implementing regulation has not yet been issued). The Rupiah must be used in any transaction that has the purpose of payment; settlement of an obligation that must be satisfied with a cash payment; and other financial transactions, subject to the following exemptions:

- Certain transactions related to the implementation of the state budget;
- Receipt of or conferring an offshore grant;
- International commercial transactions;
- Bank deposits in a foreign currency; and
- Offshore loan transactions.

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The new currency law is intended to cover the manner of payments made within Indonesia, and any payments for commercial purposes within the country must be made and transferred in Rupiahs. On the other hand, any payment from Indonesia to foreign entities not incorporated in Indonesia, or vice versa, can be made in a currency other than the Rupiah under the exemption for international commercial transactions.

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Netherlands:
District court approves fiscal unity in Dutch "*Papillon*" situation

The District Court of Haarlem recently ruled that the denial of a fiscal unity between a Dutch parent company and its domestic sub-subsidiary held through an intermediary subsidiary resident in another EU Member State ("*Papillon*" situation) infringes EU law.

Dutch legislation

The Dutch fiscal unity regime allows companies in a group to be treated as a single taxpayer for corporate income tax purposes. Under the regime, the results of all companies in the group are attributed to the parent company, with the result that losses of one group company can be offset against the profits of other companies within the fiscal unity. To qualify for a fiscal unity, several requirements must be met, including the following:

- The parent company must hold at least 95% of the shares in each group company;
- All companies in the group must apply the same rules for the determination of their profits;
- All companies in the group must have the same financial year;
- All companies must have a qualifying legal form; and
- All companies must be established in the Netherlands (which can include a Dutch permanent establishment (PE) of a foreign company).

Because of the last requirement, companies established in other EU Member States cannot benefit from the fiscal unity regime. The European Court of Justice (ECJ) ruled in the *X Holding* case that disallowing the inclusion of non-Dutch companies in a fiscal unity is not contrary to EU law.

Notably, the fiscal unity regime is not limited to first tier situations – indirectly held companies can be included, but *only* if all intermediary companies are included in the fiscal unity.

Facts of the case

The recent case before the District Tax Court of Haarlem concerned a Dutch company that held 100% of the shares in its German subsidiary, which, in turn, held 99% of the shares in another Dutch (sub-) subsidiary. The Dutch parent company submitted a request to the Dutch tax authorities to form a fiscal unity with its Dutch second tier subsidiary without the German intermediary company being included in the fiscal unity.

The Dutch tax authorities denied the request on the grounds that the intermediary company was not included in the fiscal unity. According to Dutch corporate income tax law, all intermediary companies must be included in a fiscal unity. In the case, the intermediary company could not be included because it was a resident of another EU Member State and it did not have a PE in the Netherlands.

ECJ decision in *Papillon*

The Dutch case is comparable to the situation that led to the 2008 decision of the ECJ in the *Papillon* case. Under the French tax consolidation regime, a parent company can form a group to consolidate the profits and losses of the group companies. However, like Dutch tax law, the French rules require all companies in the consolidated group to be resident in

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France and any intermediary companies also must be part of the group (meaning that they must be French resident companies). The French parent company in *Papillon* held all of the shares in its sub-subsidiaries through its Dutch resident intermediary company. The French tax authorities denied the consolidation of the French resident companies.

The case was brought before the ECJ, which concluded that a denial of a tax consolidation infringed EU law. Had the intermediary company been a French resident company, the results of the French parent company and its sub-subsidiary could have been consolidated (including the results of the intermediary company).

District Court of Haarlem decision

Relying on the *Papillon* decision, the taxpayer in the Dutch case argued that the denial of a fiscal unity between the Dutch parent and its nonresident second tier sub-subsidiary is incompatible with the freedom of establishment principle in article 43 of the EC Treaty (currently, article 49 TfEU). The District Court of Haarlem agreed. The fact that a fiscal unity without the intermediary company would not be allowed in a purely domestic situation is not considered relevant, since in that situation, the companies at least have the choice of entering into the fiscal unity.

The District Court of Haarlem acknowledged that the potential for double loss compensation could exist in certain cases. However, because of the possibility for the relevant countries to exchange information, any infringement of EU law cannot be justified. Consequently, the court ruled that the denial of the fiscal unity request infringes EU tax law and that the request should be granted by the Dutch tax authorities provided the other requirements for a fiscal unity are met.

Comments

The conclusion reached in this Dutch case comports with a similar decision issued by the District Court of Haarlem on 9 June 2011. It appears that the Dutch tax authorities will appeal these decisions. It should be noted that the European Commission (referring to the *Papillon* decision) has initiated an infringement procedure against the Netherlands requesting that the government extend the fiscal unity regime to Dutch resident sister companies of EU parent companies.

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In brief

Czech Republic   Reforms to the tax authorities that aim to streamline and simplify administration with a view to achieving greater specialization in individual offices and more centralized management will come into effect on 1 January 2012. The changes include the creation of a Specialized Tax Office for large taxpayers (legal entities and certain groups with a turnover exceeding CZK 2 billion) and entities from specified industries (including banks, savings and loan associations and insurance and reinsurance companies).

European Union   The European Court of Justice (ECJ) has held that Portugal's rules on the taxation of dividends received by pension funds violates the free movement of capital. Under the Portuguese provisions, dividends paid to pension funds set up and operating in accordance with Portuguese legislation are wholly exempt from corporation tax. However, dividends paid to nonresident pension funds are subject to corporation tax at a rate of between 10% and 20% withheld at source, depending on whether there is a bilateral agreement between Portugal and the state of residence of the pension fund and the terms of any such agreement. The Court rejected Portugal's arguments justifying the restriction based on the need to preserve the coherence of the tax system to guarantee effective supervision of the tax system.

Lebanon   The income tax law has been amended (effective as from 3 September 2011) to provide equality between men and women by allowing married women to benefit from family deductions in respect of their husbands and children. Under general rules, tax is applied on actual or deemed income after deducting for each individual an annual amount of LBP 7.5 million for an individual, LBP 2.5 million for a non-working spouse and LBP 500,000 for each legitimate dependent child up to a maximum of five children. Previously, the law limited the ability of women to take deductions in instances where both spouses were employed or where only the wife was employed.

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Mexico Changes to the General Foreign Trade Rules and their Appendices, which apply as from 1 October 2011, modify the rule on sales by nonresidents to Mexican residents where a delivery of goods in Mexico is made through a certified company with an approved Manufacturing, Maquiladora and Export Service Industry (IMMEX) program. Such sales are deemed to be performed in Mexico, so that the transaction is subject to VAT, and as a result, Mexican resident companies must withhold VAT from the payment to the foreign resident, in addition to the VAT paid at import.

Netherlands As envisaged in the 2012 budget plan, the Ministry of Finance has announced that, as from 1 January 2012, a research and development (R&D) deduction will be introduced. Under the deduction, taxpayers (both corporate and individual entrepreneurs) will be allowed an additional deduction of 40% of total R&D costs (excluding wage costs). Companies subject to corporate income tax (at a rate of 25%) will receive a benefit of 10%; the benefit for individual entrepreneurs will depend on their applicable rate. The R&D deduction will operate in tandem with the existing innovation box and the reduced wage tax available for employees engaged in R&D activities.

United States Individuals who properly deferred filing their 2009 and prior year foreign bank account reports (form TD F 90-22.1 or “FBARs”) in reliance on certain prior guidance have until 1 November 2011 to file those FBARs. The deferred filing for those years applied to individuals with signature authority over, but no financial interest in, a foreign financial account. The deferral did not apply to 2010 FBARs, which were due on 30 June 2011. Under general rules, “U.S. persons” are required to file FBARs annually if they have a financial interest in or signature authority over financial accounts, including bank, securities or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds USD 10,000 at any time during the calendar year.

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