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Offshore income in China can benefit from preferential EIT rate for high-new tech enterprises

Under China's Enterprise Income Tax (EIT) Law that took effect on 1 January 2008, enterprises qualifying for the High-New Technology Status (HNTS) regime are entitled to a preferential EIT rate of 15%, rather than being subject to the normal rate of 25%.

Many enterprises are interested in applying for HNTS in order to enjoy the 15% rate. However, for enterprises that operate both within and outside China, until recently, there was no clear guidance on how to apply for HNTS or whether non-China-source income would qualify for the reduced tax rate. A circular issued on 31 May 2011 (Circular 47), and which applies retroactively as from 1 January 2010, addresses some of these issues.

According to Circular 47, if an enterprise applies for and is granted HNTS based on its entire business operations and various criteria (such as R&D expenses, gross revenue, total sales, revenue generated from high-tech products and services, etc.) in connection with its business within and outside China, the following rules apply:

- The enterprise may apply the 15% preferential rate in calculating its EIT liability on its offshore income;
- The 15% rate may be used for calculating the foreign tax credit (FTC), based on the worldwide taxable income of the enterprise; and
- Other FTC issues continue to be governed by a circular issued in 2009 (Circular 125).

High-new tech enterprises (HNTEs), most of which only conduct domestic business, currently may not be affected by Circular 47. Nevertheless, as the first wave of HNTE certificates near expiration and their renewal is put on the agenda (an enterprise currently is certified as an HNTE for a three-year period, and must successfully renew its status before the end of that period to continue receiving benefits), Circular 47 should be examined, in particular, by enterprises wishing to formulate and implement a "go overseas" strategy.

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Recap of prior regulations on high-new tech enterprises and FTCs

High-new tech enterprises – In addition to an enterprise meeting proprietary IP ownership and business activities requirements, the following requirements must be met to apply for HNTS in accordance with the prevailing regulations:

- At least 30% of the employees of the enterprise must be technical personnel holding college diplomas or higher degrees. R&D personnel included in this highly educated technical personnel base must represent more than 10% of the total workforce.
- The ratio of qualifying R&D expenditure to sales revenue for the last three financial years must reach a specified percentage of the total revenue of the enterprise (3% to 6%, depending on the amount of revenue).
- The ratio of qualifying R&D expenditure for activities actually carried out in China must be at least 60% of the total qualifying R&D costs for the last three financial years, or for the actual years of operation, if fewer.
- Income generated from high-new tech products and services must be more than 60% of the total revenue of the enterprise.

FTC related rules – According to the EIT Law and accompanying implementation rules, a direct and indirect FTC is available for foreign income tax actually paid by an enterprise, provided the tax is in the nature of an EIT. The FTC is subject to a per-country limitation, but excess FTCs may be carried forward for the subsequent five years.

Impact of Circular 47 on HNTEs with offshore income

Circular 47 is designed to enhance the tax incentives available to HNTEs with offshore income, and is in line with the spirit of China's 12th Five-Year Plan, which encourages high-tech enterprises and R&D activities.

As noted above, qualifying HNTEs can apply the lower 15% tax rate to both domestic and foreign-source income when calculating their total EIT payable, as well the FTC limit.

According to Circular 125, the actual EIT to be paid after taking the FTC into account is calculated as follows:

Actual EIT to be paid (D) = Total EIT payable on both onshore and offshore income (A) – tax incentives or reduction (B) – FTC (C)

The implementation of Circular 47 may affect both the FTC and the actual EIT to be paid. Below is an example that illustrates the potential implications:

<table>
<tr><th></th><th>Onshore income</th><th>Offshore income</th><th>A</th><th>B</th><th>C</th><th>D</th></tr>
<tr><td colspan="7">Before Circular 47</td></tr>
<tr><td>Tax rate in foreign jurisdiction is less than 25%, e.g. 18%</td><td rowspan="2">100</td><td rowspan="2">200</td><td rowspan="2">75 = (100+200) x 25%</td><td rowspan="2">10 = 100 x (25%-5%)</td><td>The lesser of
36 = 200 x 18%
or
50 = (100+200) x 25% x 200/(100+200) (limit)</td><td>29</td></tr>
<tr><td>Tax rate in foreign jurisdiction is equal to or more than 25%, e.g. 30%</td><td>The lesser of
60 = 200 x 30%
or
50 = (100+200) x 25% x 200/(100+200) (limit)</td><td>15</td></tr>
</table>

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<table>
<tr><th></th><th>Onshore income</th><th>Offshore income</th><th>A</th><th>B</th><th>C</th><th>D</th></tr>
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<tr><td>Tax rate in foreign jurisdiction is less than 25%, e.g. 18%</td><td rowspan="2">100</td><td rowspan="2">200</td><td rowspan="2">75 = (100+200) x 25%</td><td rowspan="2">30 = (100+200) x (25%-15%)</td><td>The lesser of
36 = 200 x 18%

or

30 = (100+200) x 15% x 200/(100+200) (limit)</td><td rowspan="2">15</td></tr>
<tr><td>Tax rate in foreign jurisdiction is equal to or more than 25%, e.g. 30%</td><td>The lesser of
60= 200*30%

or

30 = (100+200) x 15% x 200/(100+200) (limit)</td></tr>
</table>

The example illustrates that a qualifying HNTE under Circular 47 will have its overall EIT reduced if it derives foreign-source income from jurisdictions where the actual tax rate is less than 25%. However, if the foreign tax rate exceeds 25%, its EIT exposure may remain unchanged. Such enterprises need to further consider the utilization of excess FTCs, which would be increased due to the implementation of Circular 47. As a result, Circular 47 may be favorable for HNTEs with overseas operations in jurisdictions with an effective income tax rate below 25%.

Further clarification needed

While the issuance of Circular 47 is generally welcome as it clarifies certain issues, further guidance from the State Administration of Taxation is still needed, in particular, on the following:

- **The meaning of "related to the entire business activities in and outside China" as used in article 1 of Circular 47** – Since a Chinese enterprise and its offshore subsidiaries are separate legal entities, should the Chinese enterprise include the business activities of its offshore subsidiaries in its application for HNTS or only the operations of its offshore branches?
- **Dividends from foreign subsidiaries** – If only the operations of branches are to be included in the application, would dividends received by qualifying HNTEs from foreign subsidiaries be considered normal business income of the HNTE and, therefore, be entitled to the reduced rate?
- **Re-application for benefits** – If a Chinese enterprise has obtained an HNTS certificate without including offshore business activities in its application, can the enterprise now elect to include those activities to qualify for the benefits outlined in Circular 47? For example, is it possible for the enterprise to renew the HNTS before expiration of the three-year period to include the overseas operations or must the enterprise initiate a new application based on domestic and foreign information to obtain a new HNTS certificate? If a new application is required, is it possible for the enterprise to apply for an HNTS certificate that combines both onshore and offshore activities even before an existing HNTS expires?
- **Amendment of EIT return** – Circular 47 was issued on 31 May 2011 and applies retroactively from 1 January 2010. However, since the 2010 annual EIT return already has been completed, can an enterprise that did not take the offshore business activities into account reapply for HNTS for year 2010 and then claim the reduced EIT rate by amending its 2010 return?

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Czech Republic:
Investment incentives to be revamped

Following discussions on 19 October 2011, the Czech Republic government has approved amendments to the Investment Incentives Act in an effort to make the incentive regime more competitive on the international stage. If approved by the parliament, the amended rules would establish more convenient eligibility requirements for existing incentives and introduce new incentives.

Changes to current tax incentives

The principal change that would be made in relation to the manufacturing industry is an increase from five to 10 years in the period during which recipients of investment incentives may avail themselves of tax relief. Further, two of the general conditions for obtaining such relief would change: (1) the amount required to be intended for the acquisition of machinery would be reduced from 60% to 50% of the minimum investment required for the region concerned, and (2) that amount also would have to represent at least 50% of eligible costs. The existing incentives for new job creation would increase from CZK 50,000 to CZK 200,000, and the direct subsidy for requalification (i.e. retraining of existing employees in general) would be extended to most regions.

New tax incentives for technology and services centers

A new incentive would be available for technology centers and services centers. One of the general conditions for qualifying as a technology center would be investment in tangible fixed assets of no less than CZK 10 million (no less than 50% in machinery) and the creation of at least 50 new jobs. To qualify as an eligible services center, the investor would need to create no less than 100 new jobs (40 for software development centers) and the activity of the services center would have to cover the territory of at least two states.

New tax incentives for large investment

The amendments would introduce a new category of direct capital subsidy for large investors. To be eligible for the subsidy, an investor in a manufacturing industry would have to make a minimum investment of CZK 500 million in fixed assets (of which no less than CZK 250 million would have to be invested in new machinery) and would have to create at least 500 new jobs. An investor that met these and other requirements set out in the legislation would be able to obtain a direct subsidy of up to 5% of total eligible costs related to the investment, subject to a maximum of CZK 1.5 billion.

The amendments also would create a subsidy for large investments in technology centers. In this case, a minimum of CZK 200 million would have to be invested in fixed assets, with no less than CZK 100 million being invested in new machinery, and no less than 200 new jobs would have to be created. If these requirements are met, a direct subsidy would be available of up to 5% of the total eligible costs of the investment, subject to a maximum of CZK 500 million. If the investment involved both increasing manufacturing production and, at the same time, expanding a technology center, the direct capital subsidy for the investor could be increased to up to 7% of total eligible costs.

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Dominican Republic: 2012 budget increases tax rates on companies

The 2012 budget recently presented to the Dominican Republic Congress implements measures provided in Law No. 139-11 (published in the Official Gazette of 24 June 2011). The most important tax changes, which generally apply retroactively as from 25 June 2011, made by Law No. 139-11 are as follows:

- The corporate income tax and withholding tax rates on payments abroad to non-domiciled entities or individuals are increased from 25% to 29% for a two-year period.
- Companies established in free trade zones in the Dominican Republic are subject to corporate income tax at a rate of 2.5% on gross income earned from sales on the local market. Such companies are now permitted to sell all of their goods or provide all of their services to the local market (previously limited to 20%). In addition, local sales and/or the provision of services will be subject to VAT and excise duty if applicable under the relevant laws.
- The old tax on financial net assets is abolished and replaced with a 1% tax levied on financial entities with net productive financial assets exceeding DOP 700 million. The tax on assets exceeding DOP 700 million will be deductible for corporate income tax purposes. As is the case with the corporate income tax and withholding tax, the assets tax will apply for two years.
- Other taxes are levied on lotteries and gambling (in the latter case, even when the gambling is carried out online).

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Germany: Court rules on tax treatment of income from U.K.-based private equity fund

Germany's Federal Tax Court (BFH) published a decision on 26 October 2011 (dated 24 August 2011), concluding that income derived by German tax resident investors in a U.K.-based private equity fund is exempt from German taxation. The decision is likely to have a significant impact on the taxation of German investors in domestic and foreign private equity funds, as well as on the taxation of German-source income received by nonresident investors via private equity funds.

In its decision, the BFH commented on the criteria to distinguish between business partnerships and asset management partnerships and, for the first time, expressed doubts that the criteria applied by the German tax authorities are correct.

Background of the case

The case involved two German tax resident limited liability companies (GmbHs) that were – amongst other institutional investors – limited partners of a U.K.-based private equity fund in the form of a limited liability partnership (E-LP).

E-LP owned shares in several portfolio companies, which it held on average for about four years. E-LP did not have its own office premises in the U.K.; instead, it concluded a management agreement with EV-Ltd., which belonged to the same group as the general partner of E-LP and which had office premises and personnel in the U.K. The directors of the general partner of E-LP also were directors and non-executive directors of EV-Ltd. EV-Ltd. or its directors, respectively, obtained the necessary permission to arrange financial transactions for E-LP.

The GmbHs did not file U.K. tax returns because the U.K. does not levy tax on the income of investors in a U.K. private equity fund. However, the GmbHs claimed in their German tax returns that the income derived from the participation in E-LP is tax exempt in Germany because it is allocable to a U.K. permanent establishment (PE) and, therefore, the U.K. would have the exclusive right to tax the PE income under the Germany-U.K. tax treaty.

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BFH ruling

The BFH agreed with the GmbHs, concluding that the income from the participation in E-LP is business income that is allocable to a U.K. PE and, therefore, tax exempt in Germany under the treaty.

The BFH held that the acquisition, management and disposal of the portfolio companies by E-LP qualified as "own business activities," and that the activities exceeded what would be considered a pure asset management function; in particular, the length of time of the holdings (i.e. four years) and the leverage at the fund level supported the conclusion that E-LP traded the shares in the portfolio companies. In addition, E-LP used the premises, personnel and regulatory authority of EV-Ltd.

According to the BFH, the business activities of E-LP are allocable to a U.K. PE, the results of which are attributed pro rata to the limited partners of E-LP. The BFH attributed the office premises of the management company to E-LP and, therefore, to the investors. Hence, it is not necessary for the fund itself to be the owner or lessee of the office premises to create a PE.

The BFH also made it clear that a German domestic treaty override rule (section 50d paragraph 9 of the German Income Tax Act), which seeks to allow German taxation where income is exempt under a treaty but is not taxed in the other contracting state, does not affect the U.K.'s exclusive right of taxation with respect to any income deriving from a U.K. PE, even if the income will not be taxed in either state. The scope of the treaty override rule is limited to situations in which the contracting states have different interpretations of the provisions of the treaty. As a result, Germany will not be able to claim taxation rights if the non-taxation of income is based on a unilateral measure.

Potential impact for private equity funds

In addition to clarifying the international taxation issues, the decision of the BFH is important because, for the first time, the court has commented on the criteria for classifying a private equity fund as either a business fund or as an asset management fund for German tax purposes. This classification is significant for German-based private equity funds because business partnerships are subject to the German municipal Trade Tax, and certain investor groups may be subject to tax disadvantages when investing in business partnerships.

In a decree issued in 2004, the German tax authorities set out the criteria for qualifying as a pure asset management fund:

- No leverage at the fund level;
- No comprehensive organization needed at the fund level to manage the portfolio companies;
- No use of a market and no use of own professional experience;
- No offerings of the portfolio companies to a broader public;
- No short-term holding of the portfolio companies;
- No reinvestment of the proceeds from the disposal of portfolio companies; and
- No active involvement in the (day-to-day) management of the portfolio companies.

The BFH has taken the position that the typical business model of a private equity fund is not pure asset management ("buy and hold"), but rather the realization of capital gains from the disposal of portfolio companies ("buy to sell"). Without providing any further explanation, the BFH analogized the tax treatment of private equity funds to that of aircraft leasing funds, which are regarded as business partnerships by both the German tax authorities and the BFH. Hence, it is likely that the BFH will classify as business funds private equity funds that, under the criteria developed by the German tax authorities in the past, would qualify as asset management funds.

If, in future, private equity funds are treated as business partnerships simply on the basis of their business model (which represents a departure from the current practice of the German tax authorities), German Trade Tax would apply at the level of the fund if the fund is deemed to have a PE in Germany. This may have detrimental tax consequences for German tax-exempt investors, private individual investors and nonresident investors of domestic private equity funds.

Foreign private equity funds should be examined to determine whether they create a PE in Germany, the results of which would be attributed to their investors, especially where the investors have entered into management agreements with German resident entities.

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Market participants will have to await the reaction of the German tax authorities, as the view taken by the BFH contradicts the view taken by the German tax authorities as set out in decrees that are still in effect. Although there is no need for immediate action to restructure existing fund structures, structures should be reviewed to analyze the potential impact resulting from a potential re-qualification for the funds and their investors.

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Indonesia: Guidance issued on tax treatment of Shariah banking and financial services

The Indonesian Minister of Finance (MOF) issued long-awaited guidance on 19 August 2011 on the income tax treatment of Shariah-based banking and financial activities (PMK-136 and PMK-137, respectively). The new rules apply as from the date of issuance.

The two regulations implement general rules issued in 2009 (PMK-25) on the tax treatment of income from Shariah-based business activities. PMK-25 defines Shariah-based business activities as those conducted in accordance with Shariah principles, including Shariah banking, insurance, pawning and financial services. Such activities are subject to the normal income, expense and withholding tax rules in the Indonesian Income Tax Law, and the new regulations clarify that those rules also apply to Islamic banking and finance businesses.

PMK-136 addresses the tax treatment of specified income (banking activities), while PMK-137 sets out the tax treatment of specific transactions (financing activities). The following tables summarize the income tax treatment of Shariah banking and financial services:

Shariah banking		
	Tax treatment	
Type of income	Bank	Investor/Depositor customer
Bonus, profit sharing and profit margins from transactions of the facilitated customer	Interest	
Bonus, profit sharing and other income from funds placed with an Indonesian Shariah bank or an Indonesian branch of an offshore Shariah bank		Interest
Other income	Treated in accordance with the normal income tax rules that would apply to the relevant transaction	Treated in accordance with the normal income tax rules that would apply to the relevant transaction

Shariah financial services	
Type of transaction	Tax treatment
Leasing (Ijarah)	Normal operating lease and leased asset is not depreciable
"Ijarah" refers to a fund allocation agreement for the transfer of rights (benefits) to goods for a specific period of time with a lease payment passing between the Shariah financing company as the lessor and the lessee, without a transfer of ownership to the goods.	
Finance lease (Ijarah Muntahiyah Bittamlik)	Similar to a finance lease with an option and the leased asset is not depreciable
"Ijarah Muntahiyah Bittamlik" refers to an agreement for the distribution of funds for a transfer of rights (benefits) to goods for a specific period of time with a lease payment passing between the Shariah financing company as the lessor and the lessee, in addition to an option for the transfer of ownership of the leased goods to the lessee at the end of the lease period.	

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<table>
<tr><th colspan="2">Shariah financial services</th></tr>
<tr><th>Type of transaction</th><th>Tax treatment</th></tr>
<tr><td>Factoring (Wakalah bil Ujrah)</td><td>Gain or profit treated as interest</td></tr>
<tr><td colspan="2">“Wakalah bil Ujrah” refers to the delegation of authority from one party to another for matters in which representation is allowed in return for the provision of benefits.</td></tr>
<tr><td>Consumer financing (Murabahah, Salam, Istishna)</td><td>Gain or profit margin treated as interest</td></tr>
<tr><td colspan="2">“Murabahah” refers to a financing agreement for the procurement of goods where the purchase price is set and confirmed with the buyer, and the buyer will pay the purchase price in higher amounts on an installment basis, the difference being the profit.
“Salam” refers to a contract for the purchase of goods by way of an order and advance payment under an arrangement agreed to by the parties.
“Istishna” refers to a financing agreement for made-to-order products with criteria, terms and price agreed between the buyer and the seller.</td></tr>
<tr><td>Credit card</td><td>Fees or other income treated in accordance with the normal income tax rules that would apply to the relevant transaction</td></tr>
<tr><td>Other Shariah financing</td><td>Fees or other income treated in accordance with the normal income tax rules that would apply to the relevant transaction</td></tr>
<tr><td>Corporate financing from investor (Mudharabah, Mudharabah Musytarakah, Musyarakah)</td><td>Gain or profit sharing treated as interest</td></tr>
<tr><td colspan="2">“Mudharabah” refers to funding activities undertaken through a cooperation agreement between a company and other parties acting as fund provider where the fund provider will finance 100% of the capital for project activities that are not determined by the company or for a project determined by the company, with the business profits divided in accordance with the terms of the agreement.
“Mudharabah Musytarakah” refers to funding activities undertaken through a cooperation agreement between the company and other parties acting as funder where the funder and the company as the fund manager contribute to the capital of the investment, and the profits are divided in accordance with the terms of the agreement.
“Musyarakah” refers to financing activities conducted through a cooperation agreement between the company and other parties of a certain business, whereby each party contributes funds on the condition that benefits and risks will be borne together in accordance with the terms of the cooperation agreement.</td></tr>
<tr><td>Delivery of assets (considered directly delivered from supplier to end user)</td><td>Treated in accordance with the normal income tax rules that would apply to the relevant transaction</td></tr>
</table>

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Poland:
Rules for tax number of foreign branch and head office revised

The Polish tax authorities have revised their position on the requirement for branches of foreign companies and their head offices that are VAT payers to obtain a general tax number (NIP).

Businesses in Poland must obtain a NIP for corporate income tax, personal income tax and social security contribution purposes. The NIP also is essential to obtaining a VAT number. Until recently, if a foreign entity set up a Polish branch, a NIP was granted for the branch. If the company subsequently decided to become a VAT payer in Poland, the tax authorities often claimed that the NIP of the branch could not be used as a basis for the entity’s VAT number and that a second NIP for the entity was required. The tax offices now seem to have changed this practice following court decisions in which it was stated that issuing a second NIP is incorrect; the NIP should be granted only once.

Foreign branches of entities that are Polish VAT payers and that have a separate NIP number for the branch should review their registration structure to ensure that only one NIP has been issued.

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Portugal: 2012 Budget released

The draft Portuguese budget for 2012, presented to Parliament on 17 October 2011, contains a number of measures that will affect nonresident investors and expatriates. The draft law will be debated in Parliament and is expected to be passed before the end of November.

Corporate income tax

- The 12.5% corporate tax rate imposed on taxable profits of less than EUR 12,500 will be eliminated. As a result, the corporate tax rate will be set at 25% (increased by any applicable national or municipal surcharge).
- For the two accounting periods commencing on or after 1 January 2012, a national surcharge of 3% will apply to profits between EUR 1.5 million and EUR 10 million. Where profits exceed EUR 10 million, a progressive scale will apply: no surcharge will be levied on the first EUR 1.5 million, the next EUR 8.5 million will be liable at 3% and the remainder at 5%. Taken together with the 1.5% municipal surcharge, the final maximum aggregate tax rate will reach 31.5% (for taxable profits exceeding EUR 10 million).
- In light of the above changes to the national surcharge, the applicable rate for special advance surcharge payments ("additional payments on account of the final corporate income tax payable") will be 2.5% where the taxable profits of the previous accounting period are between EUR 1.5 million and EUR 10 million and 4.5% where it exceeds EUR 10 million.
- The withholding tax on the payment of investment income to nonresident entities subject to a privileged tax regime will be increased from 21.5% to 30%.
- The four-year carryforward limit for tax losses introduced in 2011 will be reversed in part, with an increase in the carryforward period to five years for losses incurred on or after 1 January 2012. However, losses utilized in any year may not exceed 75% of the taxable profit of the accounting period. The requirement for losses carried forward for three or more years to be certified by a statutory auditor will be eliminated, retroactive to 1 January 2011.
- The five-year carryforward for unused foreign tax credits on controlled foreign company (CFC) dividends will be eliminated.
- The nondeductibility of payments made to nonresidents subject to a privileged tax regime will be extended to payments made indirectly where the taxpayer should know the ultimate destination of the payment. Such knowledge will be presumed where there is a special relationship between the taxpayer and the nonresident (whether a company or individual) or between the taxpayer and an agent, a trustee or an intermediary who passes the payment to a nonresident.
- The CFC legislation also will be expanded to cover CFCs held by agents, trustees or intermediaries on behalf of Portuguese residents. The percentage ownership thresholds (25% or 10% if the direct or indirect global participation of Portuguese shareholders exceeds 50%) will be broadened from share capital to include voting rights and rights to assets on a winding up, and similar rights held by related parties will be aggregated in applying this ownership test. The CFC provisions will not apply when the nonresident entity is resident or established in another EU/EEA Member State (in the case of residence in an EEA state, provided the Member State is bound by an administrative cooperation obligation in the field of taxation equivalent to that prescribed in the EU) and the taxpayer demonstrates that the establishment and operation of the entity are for valid economic reasons and that it carries on an economic activity of an agricultural, commercial or industrial nature or is engaged in the provision of services.

Tax incentives

- Several tax incentives that are due to expire on 31 December 2011 will be extended, the most important of which are incentives for the pure holding company (SGPS) tax regime, the net job creation incentive, the exemption for capital gains of nonresidents on the disposal of Portuguese shares and securities, the exemption on loans and lease payments for imported equipment, the elimination of double taxation of dividends received from African

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Portuguese speaking countries and East Timor and transactions between nonresident and Portuguese resident financial institutions.

- The incentives to support companies located in the interior of Portugal and those for companies licensed to operate in the Portuguese free zones before 2007 will not be extended.

Personal income tax

- The tax rate bands and rates will be maintained at 2011 levels (rates up to 46.5%), but a surcharge of 2.5% will be introduced for taxpayers earning more than EUR 153,300 in taxable income in 2012 and 2013.
- A new flat rate final withholding tax of 30% will be introduced for investment income paid to entities resident in jurisdictions with a privileged tax regime and included in the blacklist published by Ministerial Order.
- The 15% withholding tax levied on payments made to a nonresident for the rent of Portuguese property will be increased to 16.5%.
- The 20% tax on net capital gains derived from the disposal of shares or securities will be increased to 21.5%.
- A 20% withholding tax will be introduced for income paid to employees and self-employed taxpayers eligible for the non-habitual resident tax regime and carrying on in Portugal activities regarded as having high added-value.
- The look-through rules under the CFC regime that attribute income of certain low-taxed nonresident companies to their Portuguese resident shareholders will be extended to include shares held on their behalf by agents, trustees or interposed persons.
- A time limit of one year will be set for refunding excess withholding due under tax treaties. Refunds made outside this period will begin to accrue interest at the same rate as compensatory interest charged by the government on payments due to it.
- Nonresident recipients of Portuguese-source income and Portuguese tax residents who move to another EU/EEA Member State will no longer be obliged to appoint a Portuguese resident tax representative. This obligation also has been removed for companies.

Value Added Tax

- The VAT burden will increase as a result of the application of higher rates to selected food and entertainment items, with some products moving: from the 6% rate to the standard 23% rate (or from 4% to 16% in Madeira and the Azores); from the 6% rate to the intermediate 13% rate (or to the 9% rate in Madeira and the Azores); or from the 13% rate to the standard rate.
- Rules that deem a market value in related party transactions will apply but may be set aside where the taxpayer demonstrates that the use of a non-market price was due to factors other than the special relationship between the parties.
- The VAT exemption regime for exports will be simplified.

Municipal property taxes

- The annual municipal property tax rates will increase by one tenth of a percent, increasing the maximum rates from 0.4% to 0.5% (new and recently valued property), and from 0.7% to 0.8% (older property that generally has a much lower rateable valuation).
- The municipal property tax rate applicable to property owned by tax haven entities will be increased from 5% to 7.5%.
- The rate on property acquired by tax haven entities will be increased from 8% to 10%.

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Russia:
Application of corporate tax rules in cross-border transactions clarified

Russia's Ministry of Finance (MOF) issued three letters in October 2011 on the application of the corporate tax rules in various cross-border transactions. The clarifications are of an advisory nature and are not legally enforceable or binding on taxpayers.

Letter 03-08-05 (dated 5 October 2011) provides clarification on the obligation of a Russian entity to withhold taxes upon payment for a purchase of Eurobonds from a foreign entity. The letter clarifies that, according to article 246 of the Russian Tax Code, a foreign entity is subject to corporate income tax in Russia only if it has a permanent establishment (PE) in Russia or receives Russian-source income (as addressed under article 309). Article 309 states that income received by a foreign entity that does not have a PE in Russia from sales of Eurobonds issued by a foreign entity is not taxable in Russia because the income cannot be considered Russian-source income.

In Letter 03-03-06/1/618 (dated 3 October 2011), the MOF commented on the taxability of income received by a foreign entity that does not have a PE in Russia for the provision of services to a Russian entity related to the participation of the Russian entity's representatives in exhibitions held outside Russia. The MOF noted that, according to articles 246 and 247, income earned by foreign entities from their activities are taxable in Russia if the activities are performed in Russia and lead to the formation of a PE in Russia. If the activities are performed outside Russia, the income earned does not constitute Russian-source income and is not taxable in Russia.

Letter 03-03-06/1/645 (dated 10 October 2011) provides clarification on the use of foreign documents by a Russian entity to prove its expenses for tax deduction purposes. The letter clarifies that three requirements must be met for an expense to be deductible for Russian corporate income tax purposes:

- The expenses must be incurred in the course of a taxpayer's income-generating activity;
- They must be economically justifiable; and
- They must be supported by relevant documentation.

Expenses are considered properly documented if they are confirmed by documents executed in accordance with Russian legislation or are in compliance with business practices normally used in the country in which the expenses were incurred or by documents indirectly confirming the expenses incurred. The MOF also noted that sections 1, 2, and 7 of article 9 of the Law on Bookkeeping establishes the requirement that all business operations of a legal entity should be confirmed with supporting documents that serve as primary documents for the entity's bookkeeping.

The Ministry of Finance letters can be viewed as a part of the efforts made by the Russian government to attract foreign investment into Russia. These letters generally portray a favorable approach towards foreign entities.

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Australia

Australian government announces transfer pricing reform

The government has issued transfer pricing reform announcements, including its intent to retroactively amend the law to assert the position that the transfer pricing rules in Australia's income tax treaties operate independently from the domestic transfer pricing provisions. [Issued: 4 November 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/transfer-pricing/68c518be0ee73310VgnVCM3000001c56f00aRCRD.htm?id=us_email_Tax_WTA_111111

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/transfer-pricing/dttl_tax_tpalert_2011-020_041111.pdf?id=us_email_Tax_WTA_111111

France

Surcharge to be levied on corporate income tax liability

The government has proposed a temporary 5% exceptional surcharge on the corporate income tax liability of companies whose turnover exceeds EUR 250 million. [Issued: 8 November 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/ebe3c89bf8383310VgnVCM3000001c56f00aRCRD.htm?id=us_email_Tax_WTA_111111

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_France_081111.pdf?id=us_email_Tax_WTA_111111

United States

Year-end deadline to preserve taxpayer rights to MAP assistance approaches

This alert summarizes the notification/action requirements and applicable time limitations for requesting competent authority assistance between the U.S. and all of its treaty partners. [Issued: 3 November 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/transfer-pricing/b3e01cacc0f63310VgnVCM3000001c56f00aRCRD.htm?id=us_email_Tax_WTA_111111

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/transfer-pricing/dttl_tax_tpalert_2011-019_031111.pdf?id=us_email_Tax_WTA_111111

IRS issues proposed §892 regulations

The Internal Revenue Service has published proposed regulations providing guidance on income of foreign governments and international organizations, including changes to the definition of "commercial activities" and an inadvertent error exception, both for purposes of reducing the risk that a government-owned investment entity will become a "controlled commercial entity." [Issued: 8 November 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/2e5bbf51f8f63310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_111111

URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_United%20States_081111.pdf?id=us_email_Tax_WTA_111111

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