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## Detailed implementation rules released for China's VAT reform pilot program in Shanghai

Following the State Council's 26 October 2011 decision to launch the VAT reform pilot program in Shanghai, China's Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued guidance on 16 November 2011 to provide detailed implementation rules for the program. Although the guidance does not address all issues, it does clarify many questions.

The MOF/SAT guidance on the pilot program is in the form of two Circulars:

- *Notice for the Introduction of the Pilot Scheme to Convert Business Tax to VAT* (Circular 110)); and
- *Notice for Converting from Business Tax to VAT in the Transportation Industry and Certain Modern Service Sectors in Shanghai* (Circular 111). Circular 111 is accompanied by three appendices:
  - Appendix 1: *Measures for Implementation of Converting Business Tax to VAT in the Transportation Industry and Certain Modern Service Sectors* (Implementation Measures);
  - Appendix 2: *Regulations on Relevant Issues for Converting Business Tax to VAT in the Transportation Industry and Certain Modern Service Sectors* (Relevant Issues); and
  - Appendix 3: *Regulations for the Transitional Policy for Converting Business Tax to VAT in the Transportation Industry and Certain Modern Service Sectors* (Transition Rules).

Under China's current indirect tax system, VAT is levied on the supply of goods, the provision of repair, processing and replacement services, and on imports at the standard rates of 13% or 17%, while Business Tax (BT) is levied on the provision of other services and the transfer of intangibles and real property at rates of 3% or 5% (with a maximum 20% rate applying to the entertainment industry). The co-existence of the VAT and BT systems has led to a number of issues, such as double (or multiple) taxation because of the availability of an input tax credit for VAT payers with no such mechanism available under the BT system. The pilot program aims to resolve the double taxation issues under the prevailing system and to foster the development of specified modern service industries by gradually transitioning these industries from liability to BT to liability to VAT. The pilot program is considered a milestone for Chinese VAT reform and will have a significant impact on affected industries and companies in China.

## Highlights of Circular 110

Circular 110 outlines the general principles for the overall VAT reform pilot program in China (although no date for the full reform pilot program is mentioned). The Circular clarifies that the VAT reform pilot program will be carried out in two phases:

- *Phase 1:* The initial pilot applicable to specific sectors in Shanghai; and
- *Phase 2:* Roll out of the pilot to other regions, or nationwide, for specified sectors when conditions permit.

Once the two pilot programs are completed, the VAT reform is expected to be rolled out nationwide for all service sectors – the third and final phase of the reform.

Circular 110 states the general principles of the overall reform pilot program, which include:

- Confirmation that the pilot program will commence on 1 January 2012 and, when conditions permit, it is expected that the VAT reform will be expanded nationwide. Applicable VAT rates:
    - Leasing of moveable and tangible goods: 17%;
    - Provision of transportation and construction services: 11%; and
    - Provision of other specified modern services: 6%.
- Financial and insurance services, as well as services provided to consumers for their daily needs, generally will be taxed using the simplified taxing method, while other service sectors will be taxed using the ordinary taxing method. (Under the simplified taxing method, tax due is calculated by multiplying the sales amount by the VAT levying rate (3%), but input VAT is not recoverable. By contrast, under the ordinary taxing method, the standard VAT rate will apply and input VAT is creditable against output VAT.)
- Services provided from overseas and received in China will be subject to VAT at the above rates. The provision of services from China to overseas customers will be exempt or zero rated for VAT purposes.
- With respect to cross-region taxation, taxpayers covered by the pilot program must pay VAT at the location where their organization is situated. BT paid in other regions can be deducted when calculating the VAT due. Taxpayers that do not fall within the scope of the pilot program will continue to pay BT even if they are operating in the pilot regions.

## Highlights of Circular 111

Circular 111 sets out detailed implementation rules for the initial pilot in Shanghai and these rules generally follow the principles set out in Circular 110. Some of the principles in Circular 110 (such as the taxing method for construction, telecommunication, financial and insurance services) will not be implemented in the initial pilot in Shanghai, but may be implemented at a later stage.

Circular 111 addresses the Shanghai pilot – specifically, the application of VAT in the transport and certain modern services sectors. The appendices primarily provide details on three main topics: the scope and application of VAT, the right to deduct input VAT and preservation of the current BT incentives. Circular 111 is drafted to follow the current VAT rules, so the mechanisms for an input VAT credit or simplified taxing method, the point of taxation, classification of taxpayers and administrative measures, remain unchanged.

The following focuses on the main features of the appendices.

## Appendix 1 – Implementation measures

This Appendix aims to clarify the scope of the charge to VAT. The Implementation Measures are applicable to entities and individuals located in the pilot region (i.e. Shanghai) and foreign entities and individuals that provide taxable services to entities and individuals located in the pilot region. The Implementation Measures address the relevant issues within eight chapters, including the definition of taxpayers and withholding agents, the definition of VAT taxable services, applicable tax rates, calculation of VAT liabilities, the point of tax and location of the tax payment, tax reduction and exemption, tax collection and administration and supplementary articles.

*Scope of service sectors selected for the pilot program*

- Transportation services involving cargo or passengers, including transportation by land (excluding railway transportation), water, air and pipeline;
- R&D and technology services, such as transfers of technology and technology consulting;
- Information and technology services, including software related services, circuit design and testing services, IT system services and process and procedure management services;
- Creative cultural services, including design, transfers of copyrights and trademarks, services related to intellectual property rights, advertising, and conference and exhibition services;
- Logistics and ancillary services;
- Leasing (including operating and finance leasing) of moveable and tangible goods; and
- Attestation and consulting services.

An attachment to Appendix 1, referred to as "Annotations to the VAT Items," provides detailed explanations of the scope of each service category.

*Treatment of provision and receipt of services within and outside China*

If either the service provider or the service recipient is located in China, the provision of the relevant services will be considered to be provided in China and, thus, subject to VAT. The following services, however, will not be deemed to be provided in China, so no VAT will be due:

- The provision of the relevant services by overseas companies or individuals to Chinese companies or individuals and the services are used entirely outside China;
- The leasing of moveable and tangible goods by overseas companies or individuals to Chinese companies or individuals and the goods are used entirely outside China; and
- Other situations as stipulated by the MOF and the SAT.

*Services within the scope of VAT*

The provision of transportation and certain modern services free of charge, except those provided for the benefit of public welfare, will fall within the scope of VAT, as will other situations stipulated by the MOF and the SAT.

*Applicable VAT rates*

The following VAT rates will apply:

- Leasing of moveable and tangible goods: 17%
- Transportation services: 11%
- Certain modern service sectors (excluding the leasing of moveable and tangible goods): 6%
- Other taxable services stipulated by the MOF and the SAT: 0%
- VAT levying rate used under the simplified taxing method: 3% (as is currently the case).

*Input VAT*

The input VAT that can be recovered is as follows:

- Input VAT amount stated on the special VAT invoice;
- Import VAT amount stated on the Import VAT Payment Certificate issued by Customs;
- 13% on the purchase voucher for agricultural products;
- The recipient of transportation services can deduct input VAT based on the special VAT invoice obtained for transportation services purchased. In cases where no VAT special invoice is obtained, the recipient of the services can claim an input VAT deduction at the deduction rate of 7% based on the transportation fee specified in the transportation fee receipt;

- Where services are provided by overseas entities or individuals and received in China, the VAT withheld by the recipient in Shanghai will be eligible for recovery if supported by a tax payment clearance certificate. Written contracts, payment certificates and debit notes, or invoices issued by the overseas entities must be provided to support the claim.

## Appendix 2 – Relevant issues

Appendix 2 aims to clarify certain issues with regard to pilot taxpayers, withholding agents and current VAT payers.

*Right to deduct payments to non-pilot companies*

- For industries that are allowed to be taxed on a net income basis under the current BT rules, if the taxpayer under the pilot program makes a payment to a non-pilot company that qualified for deduction under current BT rules, in calculating the VAT output for the taxpayer, the payment still could be deducted from the income for VAT purpose to achieve consistent treatment.

*Clarification of right to deduct for current general VAT payers*

- Input VAT incurred for VAT taxable services provided by taxpayers in the pilot program is creditable. The creditable amount is the input VAT amount shown on the special VAT invoice.
- Input VAT incurred for transportation services provided by small-scale taxpayers in the pilot program is creditable (7% on the invoice amount).
- Input VAT incurred for VAT taxable services provided by overseas suppliers is recoverable by current VAT payers participating in the pilot region. The creditable amount is the input VAT amount shown on the tax payment certificate.
- Input VAT that is not eligible for deduction includes the receipt of passenger transportation services, transportation services related to purchased goods, works-in-progress and finished goods that are in an abnormal loss situation.
- Transportation fee settlement receipts issued in Shanghai on and after 1 January 2012 cannot be used to claim an input VAT credit because a special VAT invoice must be issued for the provision of transportation services in Shanghai.
- Input VAT incurred through 31 December 2011 that is associated with the original VAT taxable activities cannot be credited against the output VAT associated with new taxable services after 1 January 2012.

*VAT registration threshold for the pilot*

- The annual service revenue threshold for general VAT payers is CNY 5 million (inclusive).
- Small-scale VAT payers that have sound accounting systems and are able to provide accurate documentation for tax filing purposes can apply for general VAT payer status even if their sales revenue does not reach CNY 5 million; this is consistent with current VAT rules.
- It will not be necessary to reapply for recognition of general VAT payer status if a current general VAT payer also engages in VAT taxable services and meets the CNY 5 million threshold.
- General VAT payers may not convert to small-scale taxpayer status unless so stipulated by the SAT.

## Appendix 3 – Transitional rules

Appendix 3 mainly aims to provide VAT incentives, by introducing a VAT exemption or VAT collection with an immediate refund mechanism, to preserve the BT incentives currently enjoyed on certain services.

*Exemption from VAT*

- Technology transfers, technology development and related technology consulting and technical services provided by taxpayers in the pilot program;
- Qualified offshore outsourcing services provided by companies established in Shanghai during the period 1 January 2012 to 31 December 2013; and
- Ship inspection services provided by the Shipping Classification Society, direct flights between Taiwan and the Mainland and other miscellaneous items

*VAT collection with an immediate refund*

- Domestic cargo transportation services, warehousing services and loading and unloading services provided by taxpayers in the pilot program and registered in the Yangshan Free Trade Port Area;
- Taxpayers that hire a specified number of handicapped persons and provide VAT taxable services;
- Pilot general VAT payers that provide pipeline transportation services (eligible for a VAT refund in excess of 3% of their actual VAT burden); and
- Authorized finance leasing companies included in the pilot program (eligible for a VAT refund in excess of 3% of their actual tax burden for the provision of finance leasing services of moveable and tangible goods).

Comments

An analysis of Circulars 110 and 111 and the appendices reveals issues that need to be examined further to fully understand their impact.

Services covered – Although Circular 111 clarifies the scope of particular modern service sectors in the Shanghai pilot that will be carried out as from 1 January 2012 and provides detailed information on these taxable items within the Annotations, taking into account the diversity and complexity of typical business arrangements, it is possible that the rules will not cover all situations. Affected companies should begin immediately to take a proactive approach and seek clarification from the competent tax authorities.

Service sectors that are not covered in Circular 111, such as construction, telecommunication and financial and insurance services, may be included in the pilot at a later stage. As such, companies in these sectors should closely monitor developments.

Threshold for VAT registration – The mandatory VAT registration requirement for general VAT payers is set at CNY 5 million of annual sales revenue, as compared to the existing CNY 800,000 or CNY 500,000 for manufacturing or trading companies, respectively. The higher threshold is welcomed because more taxpayers will be classified as small-scale taxpayers subject to the lower rate of 3% without suffering an additional compliance burden.

Place of supply rules for services – Both circulars address the place of supply of services. Circular 110 provides the general principle for services supplied in various regions throughout China and for services supplied from, and received in, China. Circular 111 provides certain detailed implementation rules.

- Cross-region supplies

1. Taxable services supplied by a pilot taxpayer in Shanghai to an entity located outside of Shanghai

    - VAT will be due and the pilot taxpayer in Shanghai will be able to issue a special VAT invoice to the service recipient provided the recipient is a general VAT payer;
    - A service recipient that is a general VAT payer will be able to recover the input VAT charged by the pilot taxpayer;
    - According to Circular 110, where services are provided by a pilot taxpayer outside Shanghai, if the taxpayer has paid BT for the service in the location in which the services are provided, the amount of BT paid may be deducted when calculating VAT due for the pilot taxpayer. However, it is still unclear how the deduction mechanism would work in practice and this may require further clarification.

2. Taxable services supplied by an entity outside of Shanghai to a pilot taxpayer located in Shanghai

    - BT will apply on the services provided by the entity located outside of Shanghai;
    - Such BT will not be recoverable by the pilot taxpayer located in Shanghai.

    On a related issue, since taxpayers are determined based on the place in which their organization is located and given that a head office and its branch offices are different taxpayers, it is reasonable to conclude that branches located in other places will not be affected by the pilot program in Shanghai even if the head office located in Shanghai is affected, and vice versa. This will give rise to managerial complications for companies operating nationwide, but also may create some tax planning opportunities to shift affected businesses between an affected entity and an unaffected entity.

- Supplies from and received in Shanghai from overseas

1. Taxable services supplied from overseas

   The general rule is, if either the service provider or the service recipient is located in China, the provision of services under the pilot will be considered to be provided in China and, thus, subject to VAT. Thus, all services supplied from overseas to Shanghai are taxable in Shanghai. This is consistent with the current BT rules. Nevertheless, the pilot program aims to address a long-standing debate on the taxation of services provided and enjoyed overseas, i.e. whether some form of zero rating should apply when services are provided and enjoyed outside China. The new exceptions are for:

   - Services provided by overseas suppliers and used entirely outside China by China entities or individuals; and
   - The leasing of moveable and tangible assets provided by overseas suppliers and used entirely outside of China by China entities or individuals.

   Circular 111 also provides a withholding mechanism for charging VAT on services provided by overseas suppliers in Shanghai where a VAT charge applies but there is no VAT-registered organization in Shanghai. In these circumstances, the pilot taxpayer will have to withhold the VAT payable on behalf of the overseas supplier at the applicable rate. Such VAT can be recovered by service recipients that have general VAT payer status. For taxpayers that are unable to recover VAT at all, the burden in these circumstances likely will increase where the applicable VAT rate is higher than the current BT rate (e.g. 6% VAT as opposed to the current 5% BT).

2. Taxable services supplied from Shanghai to overseas

   Circular 110 confirms an important change that services supplied to an overseas recipient are without VAT. However, it is unclear whether such supplies will be exempt or zero rated. Understanding the correct VAT treatment is critical as it will have an immediate impact on whether the input VAT associated with the services is recoverable (as costs attributable to a zero rated supply) or not (as costs attributable to an exempt supply). Neither Circular 110 nor Circular 111 answers this question.

BT incentives – A welcomed confirmation is that, as promised in the State Council's initial announcement of the pilot program, the current BT incentives (e.g. R&D and technology-related activities and qualified offshore outsourcing services) will remain intact during the pilot. The survival of the BT incentives has been implemented through a VAT exemption mechanism that effectively achieves the same result as a BT exemption. Moreover, the tax collection with an immediate refund method will be used to achieve the effect of tax-exempt treatment for certain industries.

Compliance – The VAT compliance requirements generally follow the current VAT rules. However, enterprises that are new to VAT and unfamiliar with VAT compliance obligations will need more practical guidance and information, but will still need to ensure they are prepared for the following:

- The actions required to be compliant, such as registration procedures (forms and documents needed to support the application). Based on past experience, it is likely that the Shanghai tax bureau will assist with the practicalities by holding training sessions and issuing communications with affected taxpayers;
- Timeline for approval of applications;
- Unless there are simplifications, VAT returns generally must be submitted on a monthly basis with a submission date of the 15th of the following month. Therefore, companies will need to ensure that data is available to comply with the first return due on 15 February 2012;
- The special VAT invoice will continue to be required to claim an input VAT credit. However, this rule indicates that affected services provided by non-taxpayers covered by the pilot program will not be recoverable by taxpayers in the program because the non-taxpayers are unable to issue a special VAT invoice for the provision of such services. Such non-recoverable taxes would become a cost to taxpayers in the pilot program.

Planning – Some of the rules announced in the two circulars could provide immediate planning opportunities and it is important to take action now as there is a small window of opportunity. Where commercially possible, companies should consider the following:

- *Current BT payers:* deferring the purchase of assets to 1 January 2012 when they fall within the scope of the VAT scheme to allow a deduction of the 17% VAT;
- *Current BT payers that will become VAT payers:* take into account customers within and outside of China:
    - *For services within China* – consider billing before 1 January 2012 to avoid the additional tax now because the contract price is fixed (5% BT vs. 6% VAT). This also will help to reduce the local surcharges that are calculated based on the VAT or BT due.
    - *For services supplied outside China* – consider deferring billing to after 1 January 2012 to mitigate the charge to VAT. This will be especially effective for inter-company transactions, as it will reduce the existing BT burden paid by the overseas party.
    - *For services payable by China* – advance the point of taxation if the company cannot recover VAT at all so the tax payable remains a 5% BT rather than a 6% VAT.
    - *For companies charging service fees (especially for affected services) to affiliate companies within China* – consider aligning the charge scheme with the pilot program to maximum VAT taxable service revenue.
    - *For companies actively engaged in service activities in Shanghai without an establishment* – consider the establishment of an organization in Shanghai to take advantage of opportunities.
    - *For companies in the process of centralizing service function (especially for affected services) into Shanghai* – consider accelerating the reorganization process to take advantage of opportunities.
    - *For companies in the pilot program that are subject to different VAT rates or that provide both BT and VAT taxable services* – consider restructuring internal and external operating arrangements to maximize benefits under the pilot program, i.e. clearly identify assets to be used for VAT-related activities.

Conclusion

Taxpayers that are able to recover VAT under the current system will reap an immediate benefit under the pilot program, but taxpayers that will be subject to a high VAT rate as compared to the current BT rate without much VAT input may benefit less from the pilot program.

With only a month and a half before the pilot commences in Shanghai, affected taxpayers should begin to act now to prepare for the pilot, particularly for compliance purposes (e.g. register for VAT, apply for general VAT payer status, etc.). A strategic and methodological approach is essential for companies to make a successful transition from BT payer status to VAT payer status.

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## Gibraltar:
## Regional selectivity position undisturbed by ECJ ruling on abandoned reform proposals

The European Court of Justice (ECJ) issued a decision on 15 November 2011 in the joined appeal of *Commission and Spain v. Gibraltar and United Kingdom*, concluding that a 2002 proposed Gibraltar tax reform that was never implemented would have constituted illegal state aid because it was "materially selective" in that it would have granted advantages to offshore companies.

Even though Gibraltar abandoned the proposals several years ago, the case is significant for Gibraltar, an overseas territory (OST) of the U.K., in that the ECJ did not disturb the 2008 decision by the ECJ's Court of First Instance ("CFI," now the General Court) or the Advocate General's (AG's) opinion in the appeal hearing on regional selectivity. Both the CFI and AG had concluded that the tax reform proposals submitted by the Gibraltar government in 2002 did not constitute unlawful state aid on either regional selectivity or material selectivity grounds. (Regional selectivity refers to the ability of Gibraltar to have a separate tax system to that of the U.K. and material selectivity refers to aspects of the proposed tax system that could be construed to favor certain companies.)

The conclusions reached with respect to regional selectivity were based on the three principles established by the ECJ in its 2006 *Azores* decision (*Portugal v. Commission*), i.e. institutional autonomy, procedural autonomy, and economic and financial autonomy. In relation to these principles, the CFI ruled in 2008:

- Institutional autonomy – The competent Gibraltar authorities that devised the tax reform have, from a constitutional perspective, a political and administrative status separate from that of the U.K. central government.
- Procedural autonomy – The procedural autonomy condition is satisfied if the tax reform was devised without the ability of the central government of the U.K. to intervene directly with respect to the content of the reform. The CFI found that the U.K.'s residual power to legislate for Gibraltar and the various powers granted to the governor of Gibraltar must be interpreted as enabling the U.K. to assume its responsibilities towards the population of Gibraltar and to carry out its obligations under international law, rather than as granting the U.K. the ability to intervene directly in the content of tax measures adopted by the Gibraltar authorities, particularly given that the residual powers have never been exercised in tax matters.
- Economic and financial autonomy – This condition requires that the financial consequences for Gibraltar of introducing the tax reform not be offset by aid or subsidies from other regions or from the U.K. central government. The CFI found that none of the financing referred to by the European Commission serves to offset any financial consequences that the tax reform would have entailed for Gibraltar.

Because Gibraltar satisfied the three conditions, the CFI concluded that the reference framework for assessing whether the tax reform at issue was regionally selective corresponded exclusively to the geographical limits of the territory of Gibraltar and, therefore, no comparison could be made between the tax system applicable to companies established in Gibraltar and that applicable to companies established in the U.K. for the purpose of determining whether there was a selective advantage favoring the former.

AG Jääskinen, in a legal opinion published on 7 April 2011, agreed with the CFI's conclusion that the territory of Gibraltar constituted the territorial reference framework to be used for assessing the selectivity of the intended reform.

Both opinions established that the principle of regional selectivity does not apply to disentitle Gibraltar from having a different and more favorable tax regime than the U.K. It is important to note that the European Commission did not appeal the CFI ruling on regional selectivity. Notably, however, the ECJ did not uphold the CFI and AG opinions on the issue; instead, the ECJ found there was no reason to consider the issue of regional selectivity because the case could be disposed of on the basis of material selectivity.

Given that Gibraltar abandoned the proposals considered by the ECJ in favor of a 10% corporate income tax rate for all companies, the ruling is not expected to have any impact on Gibraltar's current tax rules.

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## Malta:
## 2012 budget proposals announced

Malta's budget plan for 2012, published on 16 November 2011, contains tax proposals designed to make Malta more attractive for local and foreign investment. The 2012 budget focuses on incentives to bolster existing industries (including the pharmaceutical and life sciences industries), the management and generation of clean energy and the attraction of highly skilled human resources to the country.

The Minister of Finance announced in his budget speech that Malta had positive growth figures regarding employment (2.5% increase) and the economy (2.6% increase in GDP, with 2012 growth expected to be approximately 2.3%) that compare well to growth in the rest of the Euro Zone.

Extension of royalty exemption

Since 2010, Malta has granted an income tax exemption on royalties derived from patents on inventions. Under this scheme, royalties and similar income (including amounts paid for the grant of a license to exercise rights) derived from registered patents in respect of qualifying inventions, whether registered in Malta or elsewhere, are exempt from tax in Malta. The exemption applies regardless of where the underlying R&D is carried out.

The Ministry announced that the royalty exemption would be expanded to cover works protected by copyright, including books, film scripts, music and art. The proposed exemption would consist of a tax exemption on income derived from copyrights with a view to attracting international artists to Malta, making Malta more attractive to the film industry and creating broader economic benefits in various sectors. Guidelines outlining the conditions to qualify for the exemption and any restrictions have not yet been prescribed.

Royalties and other income derived from other intangibles would remain taxable in Malta at an effective corporate tax rate of 5%. This rate falls to 0% if the Malta resident entity is not incorporated under the laws of Malta and the royalty income has a foreign source and is not physically received in Malta.

Reduction in tax rate on expatriates

Non-Malta domiciled individuals resident in Malta deriving qualifying employment income received in respect of activities carried out in Malta, or in respect of any period spent outside Malta in connection with such work or duties, may opt to be taxed at a flat rate of 15%. The 15% flat rate currently applies to qualifying individuals working in the financial services and (as recently enacted with retroactive application to 1 January 2010) online gaming (I-gaming) industries. The 15% flat rate is now proposed to be extended to qualifying individuals working in the manufacturing sector.

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## New Zealand:
## Treaty with Hong Kong in force

The 2010 treaty signed between New Zealand and Hong Kong entered into force on 9 November 2011 and will apply generally as from 1 April 2012. According to the New Zealand Revenue Minister, the treaty will provide greater certainty on the tax treatment of cross-border income, reduce compliance costs for investors in both jurisdictions and will lower withholding tax rates on dividends, interest and royalties in line with New Zealand's treaties with Australia and the U.S.

When in effect, the treaty provides for a 0% rate on dividends paid to a company that holds directly or indirectly at least 50% of the voting power of the payer company and the recipient company (1) has its principal class of shares listed and regularly traded on a recognized stock exchange; (2) is owned directly or indirectly by one or more companies (a) whose principal class of shares is listed and regularly traded on a recognized stock exchange, or (b) which, if that company or each of those companies owned directly the holding in respect of which the dividends are paid, would be entitled to equivalent benefits in respect of the dividends under a tax treaty between the contracting party of which that company is a resident and the contracting party in which the payer company is resident; or (3) does not meet the requirements of (1) or (2) but the competent authority of the first-mentioned contracting party determines that there is no motive to take advantage of the dividends article. The rate will be 5% where dividends are paid to a company that holds directly at least 10% of the voting power of the payer company; and the rate in all other cases will be 15%. The rate on interest will be 10% and that on royalties, 5%.

The treaty also contains an OECD-compliant information exchange article, allowing New Zealand and Hong Kong to request and exchange information with their respective tax authorities.

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## Russia:
## Consolidated group rules introduced/investment rules eased

The Russian president signed a law introducing the concept of a consolidated group of taxpayers on 16 November 2011. The law, published on 21 November and applicable as from 1 January 2012, will treat a qualifying group of companies as a single taxpayer for profits tax purposes and will allow group members to consolidate (offset) profits (losses).

In a separate development, the rules governing foreign investment in strategic sectors have been eased. According to a law issued on 16 November 2011, it will no longer be necessary to obtain approval from the Government Commission on Foreign Investments for transactions that involve a purchase of shares (or participation units) in strategic companies by an offshore company that belongs to a Russian investor. In addition, the threshold for requiring approval for the purchase of a company that holds a license for the development of natural resources deposits of federal significance has been increased from 10% to 25%. This law was published on 21 November 2011 and will come into effect on 18 December 2011.

Requirements for consolidation

The following major requirements, *inter alia*, must be met to establish a consolidated group:

- Only Russian entities may participate in a consolidated group of taxpayers, that is, foreign companies and permanent establishments in Russia of foreign companies may not join a Russian group. Subsidiaries of foreign companies may participate as long as they have some form of establishment in Russia, i.e. if they are registered as legal entities in Russia and there are two or more legal entities for consolidation;
- A parent Russian company must hold (directly or indirectly) at least 90% of a subsidiary that is to be part of the group;
- The sum of profits tax, VAT, excise duties and mineral extraction tax paid to the government in the calendar year preceding the year in which the consolidation documents are filed must exceed RUB 10 billion (approximately USD 322 million);
- The revenue computed in accordance with Russian accounting standards for the calendar year preceding the year in which the consolidation documents are filed must exceed RUB 100 billion (approximately USD 3.2 billion); and
- The total value of assets according to Russian accounting standards as at the end of the calendar year preceding the year in which consolidated documents are filed must exceed RUB 300 billion (approximately USD 9.7 billion).

There are also several major restrictions on participation in a consolidated group:

- Companies that are resident in special economic zones in Russia and companies that benefit from a special Russian tax regime may not be part of a group;
- Banks, insurance companies, non-state funds and professional participants in the securities exchange market may create a consolidated group only with other entities in the relevant industry; and
- A member of one consolidated group may not be a member of another consolidated group;

It is important to note that companies that enter a consolidated group will not be able to utilize any tax losses accumulated before they become a group member. This rule also will apply to companies that will be merged or affiliated with a company that already became a member of a consolidated group.

Consolidated groups must be created for a period of at least two calendar years. Russian legal entities that wish to join a group must conclude a special contract for the creation of the group. The contract must appoint one entity as the "responsible participant company" that will file a tax return on behalf of the group companies and act as a liaison with the Russian tax authorities. This contract must be registered with the tax authorities in the location where the responsible participant company is registered for tax purposes. A consolidated group will be deemed to be registered from the beginning of the corporate tax period following the date the consolidation contract is registered.

A consolidated group will be deemed to be liquidated in the following circumstances:

- The term covered by the consolidation contract has expired (unless the term is extended in accordance with established procedures);
- The group members decide to terminate the consolidation contract; or
- The contract is invalidated.

The responsible participant company must submit to the relevant tax authorities the decision on the dissolution of the consolidated group within five days of the adoption of such a decision. A dissolved consolidated group will cease to operate from the first day of the corporate tax period following the period in which any of the above events occurred, unless the Tax Code stipulates otherwise.

A consolidated group member will be permitted to withdraw voluntarily from the group, provided the conditions in the consolidation contract are satisfied.

Comments

The consolidation regime represents a step forward in converging Russian tax and international accounting standards. The ability to consolidate profits and losses will allow companies to optimize and control tax costs. Although the regime will only be available to large Russian businesses, it is likely that the caps established by the law will be lowered.

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## In brief

Indonesia – With a view to stimulating the trading of government securities (state debentures and Sharia securities) on the international market, the Ministry of Finance recently issued a regulation that provides for a tax incentive in the form of income tax borne by the government for the following transactions: (1) interest income or fees, including discounts and premiums derived from government securities issued on the international market; and (2) income received by third parties from the payment of fees and remuneration related to services rendered to the government for the issuance of government securities in the international markets. The incentive is only available until the end of December 2011.

Philippines – The Bureau of Internal Revenue (BIR) has formally issued new versions of the annual income tax return for individuals earning purely compensation income; self-employed individuals, estates, and trusts (including those with both business and compensation income); and corporations, partnerships and other non-individual taxpayers. The enhanced forms require the declaration of additional information, such as income subject to final tax, income exempt from tax and exclusions from gross income under the Philippines Tax Code. The requirement to file an annual return has been eliminated for certain individuals, including those whose sole income has been subjected to final withholding tax, regardless of whether that tax has been remitted to the BIR. This includes employees of regional or area headquarters and regional operating headquarters subject to the 15% final tax.

United States – Members of the Joint Select Committee on Deficit Reduction acknowledged on 21 November 2011 (the effective deadline) that they would not recommend a deficit reduction package (targeted at a minimum of USD 1.5 trillion over 10 years) due to fundamental differences in opinion. Any deficit reduction plan agreed to by a simple majority of the committee would have been advanced to the House and Senate and considered under expedited procedures. Consequently, expiring provisions that committee members were reportedly considering as part of the package will not benefit from expedited procedures. Further, under the Budget Control Act, the committee's failure to reach any kind of deal will lead to USD 1.2 trillion in automatic spending cuts between January 2013 and the end of federal fiscal year 2021. These automatic cuts are in addition to the statutory caps that were placed on discretionary spending by the Budget Control Act.

United States – President Obama signed legislation 21 November 2011 that, among other effects, repeals a 3% withholding requirement for payments by federal, state and local government entities to persons providing certain property or services. The requirement, which was enacted in 2006, was scheduled to take effect beginning in 2013.

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## Tax treaty round up

At the end of each month, the World Tax Advisor provides an update on recent tax treaty developments, with a focus on items that directly affect the withholding tax rates of the key jurisdictions covered by the Deloitte International Tax Source (DITS). Additional coverage may include stated negotiating priorities and other important tax treaty trends. For updates on tax information exchange agreements, visit our DITS special feature.
URL: http://www.dits.deloitte.com
URL: http://www.dits.deloitte.com/Administration/ManageHomePage/Popup.aspx?ChildPage=InfoExchange

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

China-Syria – The 2010 treaty entered into force on 1 September 2011 and will apply from 1 January 2012. When in effect, the withholding tax rate on dividends will be 5% if paid to a beneficial owner that holds at least 25% of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 10%.

Czech Republic-Barbados – When in effect, the treaty signed on 26 October 2011 provides that the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 15%. The rate on interest will be 5%, with an exemption for interest paid in connection with the sale on credit of merchandise or equipment or on any loan or credit granted by a bank. The rate on royalties will be 5% if paid for a literary, artistic or scientific work, including cinematograph films, and films or tapes for radio or television broadcasting; and the rate will be 10% if paid in connection with any patent, trademark, design or model, plan, secret formula or process, computer software, or any industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

Czech Republic-Belarus – The 2010 protocol to the 1996 treaty entered into force on 31 May 2011 and will apply as from 1 January 2012. When in effect, the withholding tax on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 10%. In addition to the existing 5% rate on interest, interest paid on a bank loan or credit will be exempt. The rate on royalties will be 5%.

European Union – The EU Commissioner for Taxation and Customs Union has suggested that Germany and the U.K. may have breached their European treaty obligations by signing bilateral tax agreements with Switzerland. The Commissioner suggested the agreements could cover aspects already covered by the EU Savings Directive and/or the EU-Swiss agreement. To the extent the agreements may cover areas of exclusive EU competence, the Commission would take corrective action if necessary.

Germany-Mauritius – When in effect, the treaty signed on 7 October 2011 to replace the existing treaty dating from 1978 provides that the withholding tax on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 15%. Interest will be taxable only in the residence state and the rate on royalties will be 10%.

Hong Kong-Malta – When in effect, the treaty signed on 8 November 2011 provides that dividends and interest will be exempt from withholding tax. The rate on royalties will be 3%.

Hong Kong-New Zealand – See article in this issue.
URL: http://newsletters.usdbriefs.com/2011/Tax/WTA/a111125_4.html

Ireland-United Arab Emirates – The 2010 treaty entered into force on 6 February 2011 and applies retroactively from 1 January 2011 (for other than the shipping and air transport article, which applies to taxes falling due after 11 June 2009). The treaty exempts dividends, interest and royalties from withholding tax.

Luxembourg-Panama – The 2010 treaty entered into force on 1 November 2011 and will apply from 1 January 2012. When in effect, the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 15%. The rate on interest and royalties will be 5%.

Netherlands-Barbados – The 2009 protocol entered into force on 13 November 2011 and will apply as from 13 December 2011. When in effect, dividends will be exempt from withholding tax if paid to a company that holds directly at least 10% of the capital of the payer company provided (1) the shares of the recipient company are regularly traded on a recognized stock exchange; or (2) at least 50% of the shares of the recipient company are owned directly or indirectly by one or more individuals who are a resident of the other contracting state or by one or more companies, the shares of which are regularly traded on a recognized stock exchange. This latter provision will only apply to companies that are a resident of the other contracting state, another EU country, a NAFTA country, Jamaica or Trinidad and Tobago, provided the company would be entitled to similar or more favorable benefits under a treaty or multilateral agreement between their state of residence and the contracting state from which the benefits of this protocol are claimed. The exemption also will apply to the following: (1) a bank or insurance company established and regulated under the laws of the contracting state in which it is resident; (2) a contracting state, a political subdivision or local authority; (3) a pension fund; and (4) a headquarter company of a multinational group that holds at least 10% of the capital of the payer company if it provides a substantial portion of the overall supervision and administration of the group and has and exercises, independent discretionary authority to carry out those functions. A company will be considered a headquarter company if (a) the corporate group consists of corporations resident in, and engaged in active business in, at least five countries or five groupings of countries and the business activities carried on in such countries generate at least 10% of the gross income of the group; and (b) not more than 50% of the gross income of the group is derived from a state other than the contracting state of which the headquarter is a resident. If a company does not qualify for the 0% rate, the competent authority may still decide to grant the exemption if the company does not have as one of its main purposes obtaining treaty benefits. Finally, dividends paid in respect of a substantial shareholding of 5% held by an individual, alone or together with his spouse or direct relative, may be taxed in the state in which the company in which the shares are held is a resident provided the individual has been a resident of that state at any time during the previous 10 years. The rate in all other cases will be 15%.

Poland-Isle of Man – The treaty signed on 7 March 2011 entered into force on 28 October 2011 and will apply as from 1 January 2012. When in effect, the treaty will apply only to individuals and does not contain withholding tax provisions covering dividends, interest or royalties, which will remain subject to the domestic rate.

Poland-Switzerland – The 2010 protocol to the 1991 treaty entered into force on 17 October 2011 and applies as from 1 January 2012. When in effect, dividends will be exempt from withholding tax if paid to qualifying pension funds (or similar) or where the beneficial owner is a company (other than a partnership) that directly holds at least 10% of the payer's capital on the date the dividends are paid and has done so or will have done so for an uninterrupted 24-month period in which that date falls; otherwise, the rate will be 15%, as currently applies. The rate on interest and royalties will be 5%, with an exemption provided for payments between associated companies (provided the beneficial owner of the interest or royalty is not a partnership).

Singapore-Spain – The treaty signed on 13 April 2011 will enter into force on 1 February 2012 and will apply as from 1 January 2013. When in effect, dividends will be exempt from withholding tax if paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company; otherwise, the rate will be 5%. The rate on interest and royalties will be 5%.

Slovakia-Georgia – When in effect, the treaty signed on 27 October 2011 provides that the withholding tax rate on interest and royalties will be 5%. The treaty does not provide for a withholding tax rate on dividends, so the domestic rate will apply.

South Africa-United Kingdom – The 2010 protocol to the 2002 treaty entered into force on 13 October 2011 and applies as from that date. The 5% withholding tax rate applies to dividends paid to a company that holds directly at least 10% of the capital of the payer company; the 15% rate applies on qualifying dividends paid to a property investment company that is resident of a Contracting State; and the rate in all other cases is 10%.

Switzerland-Tajikistan – The 2010 treaty entered into force on 26 October 2011 and will apply as from 1 January 2012. When in effect, the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership) that holds directly at least 20% of the capital of the payer company; otherwise, the rate will be 15%. The rate on interest will be 10% and 5% on royalties.

United Nations – The 2011 update to the UN model treaty and commentary – the first in 10 years – was adopted on 28 October 2011. The UN model aims, in particular, at facilitating the conclusion of tax treaties by developing countries and typically preserves a greater share of tax revenue to the country where investment takes place (as compared to the OECD model treaty, which preserves a greater share to the country where the investor is resident). The updated version contains the following changes: (1) an alternative version of the mutual agreement procedure (MAP) article that allows for countries to include mandatory binding arbitration when a dispute under a tax treaty cannot be resolved under the MAP; (2) a new version of the exchange of information provision that confirms and clarifies the importance of such exchanges; (3) a new article on assistance in the collection of taxes, which provides rules under which states may agree to assist each other in tax collection (similar to the provision in the OECD model treaty); (4) changes to the capital gains provision to address tax evasion; and (5) updates to the commentary to the permanent establishment (PE) addressing situations where countries do not want to include an independent personal services article, but instead want such services to be covered by the PE or business profits articles to bring the UN model in line with the OECD model treaty, which eliminated the independent personal services article in 2000.

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France
Large taxpayers may face increased advance payments due to tax law changes
Recent changes to the rules governing the amount of NOLs that can be offset against taxable income of a subsequent year and the recently announced increase in the French corporate income tax rate could impact the advance tax payment installment due on 15 December. [Issued: 18 November 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/7a7c68696d8b3310VgnVCM2000001b56f00aRCRD.htm?id=us_email_Tax_WTA_112511
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