International Tax

# World Tax Advisor

13 January 2012

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## Canada's Supreme Court upholds lower courts' decisions and applies GAAR

Canada's Supreme Court issued on 16 December 2011 a clear decision in *Copthorne Holdings v. Canada* on the general anti-avoidance rule (GAAR), reestablishing the Court's unanimity of approach to analyzing the GAAR as expressed in its 2005 decisions in *Canada Trustco* and *Mathew*. However, as expected, the Supreme Court did not provide general certainty as to the application of the GAAR or the determination of the existence of a series of transactions.

The *Copthorne* case involved the restructuring of a corporate group whereby, *inter alia*, a Netherlands incorporated entity converted a wholly owned Canadian subsidiary (Copthorne I) and its wholly owned Canadian subsidiary (VHHC Holdings) into sister corporations that were subsequently amalgamated (Copthorne II). This was achieved by the sale of the shares in VHHC Holdings by Copthorne I to the Netherlands incorporated parent, followed by a horizontal amalgamation of the two Canadian corporations. The result of this restructuring was that the sizeable paid-up capital (PUC) of VHHC Holdings was preserved on the horizontal amalgamation. As such, the PUC of the amalgamated corporation was significantly greater than the PUC would have been on a vertical amalgamation. Significant tax savings were subsequently realized on the redemption of shares due to this "doubling up" of PUC.

In affirming the decisions of the Tax Court and the Federal Court of Appeal, Justice Rothstein concluded that the GAAR was applicable to the series of transactions. Relying on the principles established by the Court in *Canada Trustco*, he addressed the following issues:

- Did a tax benefit result from the transaction?
- If yes, was the transaction an avoidance transaction?
- If yes, was the transaction an abuse or misuse of the Income Tax Act (Act)?

### Tax benefit

As "tax benefit" is broadly defined in the Act to include a reduction, avoidance or deferral of tax, it is perhaps not surprising that the Court found that a tax benefit arose from the restructuring that increased the amount of PUC eligible for tax-free repatriation. The Court stated that the existence of a tax benefit is determined by comparing the transactions undertaken with an alternative arrangement that might reasonably have been carried out but for the existence of the tax benefit. By comparing the simpler option of a vertical amalgamation with the chosen option of a horizontal amalgamation, Justice Rothstein determined that a tax benefit resulted and that the taxpayer did not meet the onus of refuting this finding.

### Avoidance transaction

For GAAR purposes, a transaction is defined to be an avoidance transaction if, whether alone or as part of a series of transactions, it results in a tax benefit and is not undertaken primarily for bona fide non-tax purposes. Justice Rothstein considered the transactions in question in light of this definition, the common law definition of series and subsection 248(10) of the Act, which deems a series of transactions to include any related transactions completed "in contemplation of" the series.

As the tax benefit resulted from a number of transactions, i.e. the restructuring and the redemption of shares approximately a year later, it was necessary for the Court to first determine whether the transactions constituted a series. The common law definition of series was summarized as requiring each transaction to be "pre-ordained to produce a final result." This narrow test is expanded by subsection 248(10), which Justice Rothstein concluded should be read both prospectively and retrospectively in determining whether a transaction is part of a series of transactions.(This interpretation was applied in *Canada Trustco* and the 2001 Federal Court of Appeal decision in *OSFC Holdings Ltd.*) Therefore, it was concluded that the subsequent share redemption was completed "in contemplation of" the earlier restructuring.

Consistent with the approach taken by the Federal Court of Appeal, Justice Rothstein stated that a "strong nexus" between the transactions is not needed for subsection 248(10) to apply; however, the "because of" or "in relation to" test established in earlier cases interpreting the application of subsection 248(10) (*Canada Trustco* and the 2006 Tax Court decision (affirmed by the Federal Court of Appeal) in *MIL (Investments) S.A.*) does require more than a mere possibility or a connection with an extreme degree of remoteness. Each case would be determined after a review of the specific facts.

The next issue to be considered was whether the series of transactions included an avoidance transaction. The Court found that the taxpayer failed to prove a bona fide non-tax purpose for the sale of the subsidiary to the Netherlands incorporated parent. Consequently, there was a series of transactions that resulted in a tax benefit and an avoidance transaction that was a part of the series.

### Abuse or misuse of the Act

Justice Rothstein, citing *Canada Trustco*, noted that it is necessary to determine the "object, spirit or purpose" of the relevant provisions to identify whether a transaction abuses or misuses the Act. This should be undertaken using the "unified, textual, contextual and purposive approach" to statutory interpretation, with due regard to the fact that, in a GAAR analysis, understanding the underlying rationale of a provision is the key objective. Abusive tax avoidance will be found "(1) where the transaction achieves an outcome the statutory provision was intended to prevent; (2) where the transaction defeats the underlying rationale of the provision; or (3) where the transaction circumvents the provision in a manner that frustrates or defeats its object, sprit or purpose." The burden lies with the tax authorities to establish that an avoidance transaction is abusive.

In this case, at issue was the application of subsection 87(3) of the Act, which deals with the determination of the PUC of the shares of an amalgamated corporation. Specifically, this subsection provides that the PUC of the shares of the amalgamated corporation may not exceed the PUC of the shares of the predecessor amalgamating corporations. However, for this computation, the shares of an amalgamating corporation that were owned by another amalgamating corporation are to be excluded. Thus, if a vertical amalgamation had been undertaken, the PUC of VHHC Holdings would not have carried forward to the amalgamated corporation.

As part of the contextual analysis of the object, spirit and purpose of subsection 87(3), Justice Rothstein noted that Parliament has enacted a number of provisions aimed at preventing an inappropriate PUC increase or preservation. He considered the "implied exclusion" argument, i.e. whether the fact that a particular transaction is not caught by these PUC provisions should lead to the conclusion that the transaction is not inconsistent with the purpose of these provisions. While he did not rule out the possibility that in some cases the underlying rationale of a provision would be no broader than the words of the statute, he rejected that argument in this case. He rationalized subsection 87(3) on the basis that a return of capital from an amalgamated company to its shareholders should only be possible to the extent that such payment reflects the investment made with tax-paid funds.

In his purposive analysis, Justice Rothstein noted that one cannot find abuse based on a broad statement of policy, such as anti-surplus stripping, which is not grounded to the provision in question. He concluded that the object, spirit and purpose of subsection 87(3) is to preclude preservation of the PUC of the shares of a subsidiary corporation upon amalgamation where it would result in a return of PUC in excess of the amounts invested in the amalgamating corporations with tax-paid funds.

Justice Rothstein found that the transactions resulted in an abuse of subsection 87(3) of the Act. The sale of the shares of VHHC Holdings to the Netherlands incorporated parent to protect the corporation's PUC was determined to have circumvented the intended outcome of subsection 87(3) in a manner that frustrated or defeated its objective. As such, he affirmed the findings of the lower courts by concluding that assessment based on the GAAR was appropriate.

### Applying the GAAR going forward

*Copthorne* reaffirms the principles set out in *Canada Trustco* that require a court to consider not only the words of a provision but also the context of the provision and the provision's object, spirit and purpose, in deciding whether a transaction or series of transactions is subject to the GAAR. The decision is very clearly written and provides an analytical roadmap for the GAAR. However, not surprisingly, it falls short of creating certainty as to when the GAAR would apply to a particular set of facts and circumstances. The very nature of statutory interpretation, especially in the context of the GAAR, likely makes certainty elusive, if not impossible.

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## China provides guidance on availability of zero rating or exemption under Shanghai pilot VAT reform

China's Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued two sets of guidance on 29 December 2011 that clarify a number of issues relating to the pilot VAT reform program that commenced in Shanghai on 1 January 2012. Circulars 131 and 133, which apply as from 1 January 2012, specifically address the tax treatment of exported services provided to overseas entities that are eligible for the zero VAT rate or exemption.

The aim of the pilot program in Shanghai generally is to resolve the double taxation issues that arise with the co-existence of VAT and Business Tax (BT) and to foster the development of specified modern service industries by gradually transitioning them from liability to BT to liability to VAT. Under Chinese rules, most enterprises that provide services do not pay VAT; instead, they pay BT based on their revenue. Unlike a general VAT taxpayer, which is entitled to an input tax credit for VAT it incurs, no such mechanism is available to BT taxpayers. Thus, service companies are often in a disadvantageous tax position as compared to VAT taxpayers. The pilot program in Shanghai brings specified service industries (initially the transport and modern service industries) within the scope of VAT. The program will be rolled out nationwide when conditions permit.

The authorities issued two circulars in November 2011 (Circulars 110 and 111) that set out details of the VAT pilot program and that stated that services provided to overseas entities would either be zero rated or exempt, with the MOF and the SAT to provide further specifics on which services would fall within one category or the other. Circular 131 has been widely anticipated as, after Circular 110 and Circular 111, probably the main question is whether zero rating or tax exemption will apply on services provided to overseas entities.

Whether a service is zero-rated or exempt from VAT is critical because it affects the ability to recover input VAT incurred on a transaction, as illustrated in the following table:

| Zero rating | Exemption |
| --- | --- |
| No VAT is charged on the invoice to the overseas customer, but input VAT associated with the services provided to the customer is *fully recoverable*. | No VAT is charged on the invoice to the overseas customer and the input VAT associated with the services provided to the customer is *not recoverable*. |

Circular 131

Based on the general principles applicable to services provided to overseas entities under Circular 110 and VAT taxable services under Circular 111, Circular 131 lists the scope of services that are eligible for zero rating or exemption when provided by a pilot taxpayer in Shanghai:

Zero-rated services – The following services are zero-rated:

- Licensed international transportation services relating to the transport of cargo and passengers from China to overseas, from overseas to China and outside China. A relevant international transportation operation license is required to support eligibility for zero rating;
- R&D services provided to overseas entities; and
- Design services provided to overseas entities (excluding design services relating to immovable property in China).

Exempt services – The following services are exempt from VAT:

- International transportation services not supported by an international transportation operation license;
- Geotechnical investigation, surveying and exploration services for projects and mineral resources located outside China;
- Convention and exhibition services, provided the conferences and exhibitions are located outside China;
- Warehousing services, provided the storage sites are located outside China;
- Other services provided to overseas entities, including:
    - Technology transfers, technology consulting, energy performance contracting services (except services relating to a contract object located in China), software-related services, circuit design and testing services, information systems services, business process management services, the transfer of trademarks and copyrights, intellectual property services and logistics and ancillary services (excluding warehousing services);
    - Certification, attestation and consulting services (except services relating to goods/immovable property located in China); and
    - Advertising services for ads published outside China.

Circular 131 also stipulates that the VAT "exempt, credit, refund" method (under this method that applies to exports of most manufactured products, export sales are exempt from output VAT, input VAT on exported goods may be credited against the output VAT on domestic sales and the excess of input VAT over output VAT will be refunded) will apply to zero-rated services if VAT is to be levied under the general taxation method. Under the general taxation method, VAT payable is calculated as output VAT minus input VAT. If another method is applied (i.e. the simplified taxation method, where VAT payable is calculated using the sales turnover multiplied by the 3% reduced rate, but input VAT is not deductible), an exemption will apply. The VAT refund and/or exemption should be requested on a monthly basis.

The mechanism for obtaining a VAT refund in respect of services invoiced to an overseas recipient is the exempt, credit, refund method. Thus, Circular 131 seems to align the refund mechanism for services provided to an overseas recipient with that for the export of goods. However, whether the current system for the export of goods will be adopted for the "export" of services as well and the types of supporting documentation that would be required to support a claim for the zero rate still must be determined by the MOF and the SAT. These detailed measures are expected to be issued in the near future because the first VAT return is due in mid-February 2012 (for January 2012).

In addition, since the VAT refund rate for qualified services is the applicable VAT rate, the input VAT associated with the zero rated services will be fully recoverable, so such services provided would carry no China VAT. This is a considerable improvement in China's VAT system because, under the current system relating to the export of goods, there is normally an irrecoverable VAT cost due to the fact that the VAT refund rate is normally lower than the applicable tax rate of the export goods.

Under the simplified taxation method, services eligible for zero rating would be exempt, which is consistent with the treatment of export goods by small-scale VAT taxpayers. Under the simplified method, the VAT due and thereafter exempt would be calculated based on the service income multiplied by the reduced rate of 3%, but with no input VAT deduction.

## Circular 133

Circular 133 clarifies the following issues:

- Sales of self-used fixed assets by pilot taxpayers that are general VAT payers:
    - If the fixed assets are purchased or self-manufactured on and after 1 January 2012, the standard VAT rate of 17% will apply;
    - Otherwise, the rate will be 2% (i.e. a 50% reduction of the 4% rate);
- Where a pilot taxpayer that is a general VAT payer is engaged in both the sale of goods/processing, repair and replacement services and the VAT taxable services, the general VAT taxation method will apply on the total income generated, unless otherwise specifically stipulated;
- Transitional rules for certain cross-year transactions:
    - For BT imposed on a net income basis, if the deduction amount exceeds the sales turnover, the excess deduction amount may not be used to offset the sales turnover after 1 January 2011. Instead, the taxpayer must request a refund of the BT;
    - Where BT has been paid by the end of 2011, if the sales amount is reduced because of the return of the service proceeds after 1 January 2012, the taxpayer may request a BT refund on the reduced sales amount;
    - BT will apply if there are any underpaid taxes as a result of a tax audit or inspection in respect of services provided before 1 January 2012;
- The VAT rate (rather than the VAT levying rate) will apply for VAT withheld on behalf of overseas service providers; and
- The VAT treatment of vessel agency services (subject to VAT under the category of port services), as well as the treatment of air transportation services.

## Comments

Circular 131 limits the zero rating treatment to three main groups of services and it is no surprise that these correlate to industries encouraged by China. However, read together, Circulars 111 and 131 give rise to some issues that require clarification:

- Definition of services – It would appear that, for most services under the pilot program, as long as the service recipient is a foreign entity (as defined in the relevant contract), the provision of the specified services would be exempt or zero rated. In practice, the contractual relationship, service recipient and payment flow should be reviewed for consistency to mitigate any potential risks.
- Detailed application procedures and requirements – Specific procedures and requirements typically have to be met to apply for tax incentives. Circular 131 is silent on the application requirements, so it is likely that further clarification or guidance will be published.
- Overlap of the tax incentives in Circular 131 with other existing tax incentives – For example, under the BT rules, contract R&D services are eligible for a BT exemption if certain conditions are satisfied. Circular 111 confirms that such services will continue to be exempt from VAT during the pilot to ensure continuity of the tax incentive. However, Circular 131 provides for a zero rate for contract R&D services provided to overseas customers. The authorities will need to clarify whether taxpayers themselves may choose between an exemption and a zero rating.

Circular 133 clarifies the VAT treatment of certain transactions, among which, the following issues are of common interest:

- Taxation methods for pilot taxpayers that are general VAT payers and engaged in both the sale of goods/processing, repair and replacement services and the VAT taxable services – The general taxation method normally is applicable to general VAT payers and the simplified taxation method will apply to small-scale taxpayers. When a general taxpayer engages in manufacturing or trading activities and also provides taxable services, it has been unclear whether the simplified taxation method could be used for the taxable service portion if the amount of the taxable service is less than RMB 5 million (the threshold specified under the pilot program for a service provider to qualify as a general VAT payer). Circular 133 clarifies that the general taxation method will apply on the total income generated by a general VAT payer, regardless of whether the stand-alone service revenue is below RMB 5 million. This clarification is important because it indicates that a taxpayer can only have one taxpayer status, i.e. either a general VAT payer or a small-scale VAT payer, and the tax treatment is aligned with the taxpayer's status.

Thus, if a company is recognized as a general VAT payer for sales of goods/processing, repair and replacement services and it also provides VAT taxable services, the general taxation method will apply to the service portion as well, regardless of the scale of the service portion, and the input VAT associated with the VAT taxable activities will be recoverable.

- Applicable VAT rate on VAT withheld – Circular 111 stipulates that the applicable VAT rate on specific services will apply for the VAT withheld on behalf of overseas service providers. Circular 133 confirms this treatment (as opposed to the 3% VAT levying rate for withheld VAT). In this connection, it is clear that the applicable VAT rate (i.e. 11% for transportation services, 17% for the leasing of movable and tangible goods and 6% for other VAT taxable services) will apply, regardless of the amount of the service fees for services provided by overseas suppliers.

- VAT/BT treatment on cross-year transactions – Circular 133 stipulates the VAT/BT treatment on certain cross-year transactions, indicating that the principle to determine whether VAT or BT is due depends on whether the services are provided before or after 1 January 2012. It appears that if the services are provided during 2011, BT will apply; otherwise, VAT will apply. However, there are other issues to be clarified for services provided during 2011. For example, it is common practice for service revenue not to be recognized at the time the services are provided, but rather when the service fee is confirmed by the service recipient. As a result, it is possible that services are provided in 2011, but the service revenue is not recognized until 2012 as it may take time for the service fee to be confirmed by the service recipient. In such a case, it is unclear whether VAT or BT will apply. Moreover, if BT applies, the taxpayer would have to issue BT invoices and pay BT in 2012. Although SAT Bulletin [2011] No. 77 stipulates that pilot taxpayers are allowed to use BT invoices before 31 March 2012 if necessary, it does not clarify the situations under which BT invoices still can be used, e.g. whether a BT invoice could be issued in the above situation. Affected businesses should track developments of the relevant rules and seek clarification from the relevant tax bureaus.

As well as the obvious benefit of immediate tax savings, the availability of exemption or zero rate VAT treatment will create tax planning opportunities for affected taxpayers. Pilot taxpayers should take the following steps:

- Review current business and contractual arrangements and assess eligibility for zero rating or exemption for services provided to overseas customers;
- Review the entire supply chain relating to transactions with domestic customers and explore the possibility of restructuring transactions where commercially feasible to benefit from zero rating or exempt treatment; and
- Taxpayers providing services to both domestic and overseas recipients should map the transactions carefully to utilize the tax incentives for qualified service exports.

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## European Union:
## Commission proposes measures to tackle cross-border inheritance tax issues

Following a recent public consultation on obstacles to cross-border inheritance taxation within the EU, the European Commission has proposed measures to address the issue.

The levy of inheritance taxes on foreign property can result in double taxation due to a lack of harmonization of inheritances taxes, an incomplete network of (bilateral) inheritance tax treaties and differences between determined taxable objects. For example, with respect to the latter, cross-border double taxation can arise when one EU Member State taxes the shares in a company that holds real property in another EU Member State, while the other Member State recharacterizes the shares as (domestic) real estate for inheritance tax purposes.

According to the Commission, the two main cross-border inheritance tax issues that arise in the EU are (1) when more than one Member State claims taxing rights on the same inheritance, and (2) when the law of a single Member State contains discriminatory provisions.

To address double taxing rights issues, the European Commission recommends a broader and more flexible application of existing double taxation relief measures. The Commission does not propose any specific harmonization measures for inheritance tax purposes – the adaptation of unilateral anti-avoidance measures should be sufficient to tackle any inheritance double taxation problems. The Commission also has encouraged Member States to expand their inheritance tax treaty network to counter double taxation as an additional solution or that Member States add inheritance taxes to existing income tax treaties.

The second problem, i.e. that arising from unilateral discrimination, has to be eliminated through other measures. Discrimination can exist because the tax rates may be different when the deceased, the heir and/or the property is located abroad (as compared to the rates applying to residents of the relevant Member State). Discrimination is incompatible with the nondiscrimination and free movement of capital principles in the Treaty on the Functioning of the European Union. According to the European Commission, harmonization is not the appropriate solution to tackle discrimination problems. Member States should amend their legislation to bring it in line with EU law, and the Commission will continue to monitor the domestic laws of the Member States and initiate infringement procedures where necessary.

Even though no harmonization of inheritance taxes is proposed, the European Commission will start discussions between Member States to resolve double taxation issues The Commission will assist Member States in removing obstacles due to differences in interpretation or between allocations of taxing rights by amending domestic administrative procedures and unilateral measures for the avoidance of double inheritance taxes, and by increasing the number of inheritance tax treaties between Member States.

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## India:
## Scope of foreign investors in equity market liberalized

In a press release issued 1 January 2012, the Indian government announced that “qualified foreign investors” (QFIs) may now invest directly in the Indian equity market. This move is expected to broaden the class of investors, attract more foreign funds, reduce market volatility and help increase the depth of the Indian capital market. Previously, QFIs were permitted to invest directly only in Indian mutual fund schemes.

A QFI for these purposes includes individuals, groups and associations that are resident in a foreign country that is compliant with the Financial Action Task Force (FATF) and a signatory to the International Organization of Securities Commissions multilateral memorandum of understanding. Foreign institutional investors and their sub-accounts are not affected by these new rules.

According to the announcement:

- The Reserve Bank of India (RBI) will grant general permission to a QFI to hold up to 5% of the paid-up capital of an Indian company, and all QFIs in the aggregate cannot hold more than 10% of the paid-up capital.
- A QFI is allowed to invest only through a Securities and Exchange Board (SEBI)-registered Qualified Depository Participant (DP) and will be permitted to open only one dematerialized account and a trading account with a qualified DP. The purchase and sale of equity may only be made through that DP.
- A QFI must meet all "know your customer" and other regulatory requirements as prescribed in relevant SEBI regulations and must remit funds through normal banking channels.
- The DP is responsible for withholding applicable tax at source.

The government has directed SEBI and the RBI to issue relevant circulars so that the announcement is operational by 15 January 2012.

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## International:
## VAT rate changes for 2012

A number of European countries have increased their VAT rates for 2012 or announced planned increases.

- While it was initially announced that Cyprus would increase its standard VAT rate (from 15% to 17%) from January 2012, the proposed implementation date has been postponed to 1 March 2012 (with official confirmation expected shortly).
- The Czech Republic increased the reduced rate from 10% to 14%.
- France has increased the reduced rates from 5.5% to 7%.
- Hungary increased its standard rate from 25% to 27% on 1 January 2012 (reduced rates have not changed). Hungary now has the highest standard rate in the EU, being the first member state to have a rate exceeding 25%.
- Ireland's standard rate increased from 21% to 23% on 1 January; however, there are no planned changes in the reduced rates or the scope of zero-rated sales.
- The VAT rate applicable to the supply of e-books in Luxembourg is the super reduced rate of 3% (there is no longer a distinction between supplies of books in hard copy or digital format).
- The Netherlands and Portugal have amended the scope of the reduced rates.
- The Swedish VAT rate for restaurant services and catering services is reduced from 25% to 12%.

In addition to the above changes to the standard and reduced rates, Poland is discussing an increase in VAT rates to 24%, 9% and 6% as from July 2012. The Czech Republic is planning to introduce a flat rate scheme under 17.5% as from January 2013, and Italy will likely increase the VAT rates to 23% and 12% as from September 2012, with a further increase of 0.5% as from January 2013.

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## Korea:
## Various changes made to tax rules affecting cross-border transactions

Amendments to Korea's tax laws enacted on 31 December 2011 include changes to the corporate and individual income tax rates and the controlled foreign company regime (CFC), an adjustment to the indirect foreign tax credit regime, new requirements to benefit from a reduced tax rate under a tax treaty and an easing of the tax burden on taxpayers arising from a discrepancy between the taxable import price for customs duty purposes and the transfer price for income tax purposes. Some changes also have been made to the tax incentive rules.

## Corporate and individual tax rates

Three corporate income tax brackets apply for fiscal years starting from 1 January 2012:

| Tax base (KRW) | Tax Rates | |
|---|---|---|
| | 2010 – 2011 | 2012 |
| Up to 200 million | 10% (11%) | 10% (11%) |
| 200 million – 20 billion | 22% (24.2%) | 20% (22%) |
| Above 20 billion | 22% (24.2%) | 22% (24.2%) |

* The corporate income tax rates in parenthesis include the 10% local income surtax.

A top marginal tax rate of 38% is introduced for a personal income tax base over KRW 300 million. The applicable rates for each tax bracket are as follows:

| Tax base (KRW) | FY 2011 | FY 2012 onwards |
|---|---|---|
| Up to 12 million | 6% (6.6%) | 6% (6.6%) |
| 12 million – 46 million | 15% (16.5%) | 15% (16.5%) |
| 46 million – 88 million | 24% (26.4%) | 24% (26.4%) |
| 88 million – 300 million | 35% (38.5%) | 35% (38.5%) |
| Over 300 million | 35% (38.5%) | 38% (41.8%) |

* The individual income tax rates in parenthesis include the 10% local income surtax.

## Indirect foreign tax credit

Previously, a Korean parent company receiving dividend income from its foreign subsidiary was able to claim a foreign tax credit for foreign tax paid by a qualifying foreign subsidiary. If a tax treaty between Korea and the country in which the foreign subsidiary was resident allowed for an indirect foreign tax credit, 100% of the foreign tax could be claimed as an indirect foreign tax credit; otherwise, only 50% of the foreign tax was available for purposes of the indirect foreign tax credit. The amended rules abolish the 50% limitation, so that a full indirect foreign tax credit will be granted regardless of the provisions of a tax treaty. (The 50% limitation continues to apply, however, to foreign tax paid by a grandchild or second-tier subsidiary.) The change is effective from the fiscal year in which the change was promulgated, i.e. fiscal year 2011.

## Reduced rates under tax treaties

The revised Corporate Income Tax Law (CITL) introduces a new rule requiring a foreign company that is the beneficial owner of Korean-source income and that wishes to obtain a reduced tax rate under a relevant tax treaty to submit an application form (to be prescribed in a Presidential Decree of the CITL) to the withholding agent before the income is paid. If the Korean-source income is paid to the beneficial owners through an offshore investment vehicle, the offshore investment vehicle must receive the application form from the beneficial owners and submit a report on the offshore investment vehicle, including a detailed schedule of the beneficial owners.

If the withholding agent is not provided with the application form (or the report of the offshore investment vehicle) from the beneficial owner (or the offshore investment vehicle), or is unable to verify the beneficial owner of the Korean-source income based on the information provided, the withholding agent should withhold tax at the Korean domestic withholding tax rate. The beneficial owner has three years from the end of the month in which tax was withheld to claim a tax refund based on the reduced treaty tax rate if it did not claim the reduced rate at the time of withholding. The new application requirement applies with respect to tax to be withheld on or after 1 July 2012.

## CFC rules

Two changes are made to Korea's CFC rules:

- The International Tax Coordination Law (ITCL) provides an exception to the CFC rules with regard to a qualified foreign holding company that satisfies certain conditions prescribed by the ITCL. One of the conditions was that subsidiaries of the foreign holding company be located in the same region or country as the foreign holding company. If some of the subsidiaries were located in a different country or region and the effective tax rate of the foreign holding company was 15% or less, the CFC rules applied since the conditions for the exception could not be satisfied, and, thus, all of the CFC income was deemed to be distributed as dividend income by the holding company to its domestic parent company.

  Under the revised rules, even if a foreign holding company has a subsidiary located in a different country or region, the foreign holding company still can qualify for the same region holding company exception if the passive income (i.e. dividends and interest income) derived by the foreign holding company from subsidiaries located in the same country or region as the foreign holding company is 90% or more of the foreign holding company's total income (excluding income derived from an active business).

- The direct or indirect shareholding ratio required to constitute a CFC is reduced from 20% to 10%. Previously, where a domestic company held directly or indirectly 20% or more of shares in a foreign company located in a country or region that has an effective tax rate of 15% or less, income of the CFC would be subject to the CFC rules.

## Reconciliation of taxable import price with transfer price

New provisions are introduced to alleviate the tax burden on taxpayers arising from a discrepancy between the taxable import price for customs duty purposes and the transfer price for income tax purposes. If the taxable import price for customs duty is different from the transfer price for income tax due to an adjustment made by the Korea Customs Service (KCS) after the relevant income tax return was filed, the taxpayer can file an amended return with the Korean tax authorities within two months of the date the taxpayer becomes aware of the adjustment or receives the notice of the adjustment. The tax authorities should then notify the taxpayer as to whether they will allow an adjustment of the relevant transfer price within two months from the date the amended tax return is filed.

A taxpayer can request a reconciliation between the taxable import price for customs duty purposes and the transfer price for income tax purposes from the Ministry of Strategy and Finance (MOSF) within 30 days of the date the taxpayer receives the notice from the tax authorities. In this case, the MOSF can recommend an adjustment of the price to the tax authorities or the KCS and should notify the taxpayer of an implementation schedule received from the tax authorities or the KCS within 90 days of the date the request for adjustment was submitted.

## Tax incentives

- Under the revised Tax Incentive Limitation Law (TILL), when a foreign-invested company that enjoys the foreign investment tax exemption increases its capital via a stock dividend (which transfers distributable earnings to the statutory capital account), it also may be eligible for the tax exemption for foreign investment, but only according to the same exemption schedule and scheme as the initial foreign investment. Further, when fixed assets used in a business for which a previous tax exemption period had expired are used in a business newly eligible for the tax exemption based on a new capital increase ("new business of capital increase"), the tax exemption amount will be decreased to the amount multiplied by a specified fixed asset ratio [i.e. the decreased tax exemption amount = original tax exemption amount × (fixed asset amount newly acquired or installed after the registration date of the capital increase / total fixed asset amount in the new business of capital increase)] under the revised TILL.
- The revised TILL replaces the temporary investment tax credit with an employment creation investment tax credit, with the latter rates applying to new investment amounts.
- The scope of the R&D tax credit is extended to expenditure incurred on the development of new services and service delivery systems. However, the eligibility of such expenditure for the R&D tax credit is limited to that incurred for the *self*-development of new services and service delivery systems. The R&D tax credit can be calculated and claimed either on a current year spending basis or on an incremental spending basis, whichever is higher. The revision makes it clear that the incremental spending basis method cannot be selected if no R&D

expenditure was incurred in the previous four years.

Further, large companies are now subject to the minimum tax with respect to the qualifying salary costs of researchers that have master or doctorate degrees; previously, the minimum tax did not apply to such costs of large companies. This has a potential impact on large companies that claim significant tax credits and exemptions so that the minimum tax applies.

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## South Africa:
## New Dividends Tax gazetted

The new Dividends Tax that will replace South Africa's Secondary Tax on Companies (STC) was published in the government gazette on 20 December 2011 and will apply as from 1 April 2012. The legislation relating to the Dividends Tax was initially enacted in 2008 and substantially revised in 2009.

Unlike most countries, where dividends are taxed at the shareholder level, the STC is a tax levied on a company declaring a dividend. The replacement of the STC with a dividend withholding tax is intended to align the taxation of dividends in South Africa with international practice.

The Dividends Tax will be levied at a rate of 10% on dividends paid by South African resident companies and the rate may be reduced under a tax treaty. The recipient of the dividends will be liable for the tax, which will be collected via withholding obligation by the dividend-paying company (although that obligation will be shifted to an intermediary, such as a nominee, in certain cases). Certain beneficial owners will be exempt from the dividend tax, including South African resident companies, the South African government, certain tax-exempt institutions and headquarters companies.

Credits remaining from the STC can continue to be used for a period of five years from the date the Dividends Tax is introduced (i.e. from 1 April 2012).

The deadline for payment of the Dividends Tax will be determined with reference to the date of payment of the dividend.

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## Thailand:
## Corporate tax rate reduced

Royal Decree No. 530 issued on 21 December 2011 provides for a reduction of Thailand's corporate income tax rate as follows:

- The rate for companies and juristic partnerships is reduced from 30% to 23% for the first accounting period starting on or after 1 January 2012, and 20% for the subsequent two accounting periods starting on or after 1 January 2013.
- For companies and juristic partnerships with paid-up registered share capital at the end of the relevant accounting period not exceeding THB 5 million and revenue from sale of goods or services not exceeding THB 30 million, an exemption will apply to net taxable profits not exceeding THB 150,000. For net taxable profits exceeding THB 150,000 but not exceeding THB 1 million, a 15% rate will apply for accounting periods starting on or after 1 January 2012, increasing to 23% for net profits exceeding THB 1 million before reducing to 20% for the accounting period starting on or after 1 January 2013.

- The rate for companies listed on the Stock Exchange of Thailand on 31 December 2009 that were subject to the 25% rate is reduced to 23% for the first accounting period starting on or after 1 January 2012, and 20% for the subsequent two accounting periods starting on or after 1 January 2013.

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## Vietnam: Government clarifies incentive policies

Vietnam's Ministry of Finance issued a circular on 11 November 2011 (Circular 154) that clarifies previous guidance issued on 4 November relating to the government's tax incentives for 2011.

Circular 154 does not provide any further guidance on the requirements to qualify for the 30% reduction in corporate income tax. To benefit from this incentive, qualifying enterprises must separately recognize profit from activities that are subject to the corporate income tax reduction. If this is not possible, the taxpayer can determine the corporate income tax reduction amount by prorating revenue from activities entitled to the reduction over total corporate revenue in 2011.

Circular 154, however, specifically provides calculation and declaration details with respect to the reduction amount:

- Enterprises can declare the reduction on a quarterly basis, which can be finalized at year end;
- If the assessment year is different from the calendar year, the reduced corporate income tax amount is determined based on the proportion of qualifying quarters. Otherwise, the reduction is determined on a pro rata basis, i.e. by 12 months or the actual number of months depending on the operation period of the taxpayer; and
- If there is a difference between the quarterly declared reduction amount and the final amount, a reconciliation must be made upon finalization.

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## In brief

Argentina – The government passed a law (effective 26 October 2011) requiring oil, gas and mining companies to repatriate all future export revenue in pesos before being distributed locally or abroad. Previously, mining companies were exempt from having to repatriate their export revenue, unlike companies in the oil and gas sector, which were required to repatriate 30% of their export revenue. The new law requires that all three industries repatriate 100% of their future export revenue. The President of Argentina stated that the new law aims to encourage companies to maintain capital in Argentina to aid the country's central bank efforts to sustain a gradual depreciation of the peso and to stem inflation.

Colombia – Under Colombian rules, services provided in Colombia and used or consumed abroad by companies or individuals without a business or activities in Columbia are exempt from VAT if the service provider remains in Colombia. The tax authorities have clarified that this exemption applies regardless of whether the beneficiary of the services is (in whole or in part) an affiliate, a subsidiary, a branch, a representative office, a headquarters or any other related party of the resident person. However, for the exemption to apply, the service must be used outside Colombia by the nonresident company.

India – The Companies Bill, 2011 introduced in the Parliament on 14 December 2011 will replace the current act, dating from 1956. The proposed bill includes the following changes: the maximum number of members in a private company would be increased from 50 to 200; consolidation of financial statements would be mandatory; the mandatory transfer of profits to reserves for a dividend declaration would be abolished and Indian companies could merge with foreign companies. The bill still must be approved by Parliament before it can come into force.

Luxembourg – The 0.8% crisis contribution that applied to professional income, "replacement" income and all categories of non-professional income was repealed by the state budget law for 2012. The crisis contribution was introduced on 1 January 2011 and was expected to apply until the end of 2012.

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Australia
Government announces final stage of investment manager regime
The government has announced that it will implement the final stage for the introduction of a comprehensive investment manager regime that is expected to remove tax-related impediments to international investment into Australia by foreign-managed funds and impediments to the use of Australian intermediaries by such funds. [Issued: 21 December 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/fe00f4b2e4464310VgnVCM2000001b56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Australia_211211.pdf

Denmark
High Court rules for taxpayer in beneficial ownership case
The Eastern Division of the Danish High Court has ruled that a Luxembourg holding company was the beneficial owner of dividends distributed by a holding company resident in Denmark. As a result, the dividends could be paid from Denmark free of Danish withholding tax. [Issued: 23 December 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/a3c9205650b64310VgnVCM2000001b56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Denmark_231211.pdf

Finland
Change-in-control rules referred to ECJ on state aid grounds
The Supreme Administrative Court has requested a preliminary ruling from the European Court of Justice as to whether an exception to the forfeiting of tax losses where there has been a change in control of a company constitutes state aid under the EU rules. [Issued: 2 January 2012]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/c3d8b58695f94310VgnVCM2000001b56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Finland_020112.pdf

France
Parliament approves change to transfer tax base on acquisition of shares in property-rich companies
A measure definitively approved by Parliament will increase the taxable base on which registration duties are computed when shares of a French real estate company (including a foreign company qualifying as such) are sold.
[Issued: 22 December 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/1d9a71afee664310VgnVCM1000001a56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_France_221211.pdf

New proposal would eliminate cap on registration duty on sale of shares
An amendment included in the draft Finance Bill for 2012 would abolish the EUR 5,000 cap on registration duties due upon the sale of shares in a French joint stock company. [Issued: 18 December 2011]
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/403cc501fc454310VgnVCM1000001a56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_France_181211.pdf

## Japan

### Proposal to limit interest expense deductions paid to foreign related parties

The Japanese government has released its proposals for 2012 Tax Reform. Included in the tax proposals is a restriction on the deductibility of interest paid to certain foreign affiliates. [Issued: 17 December 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/f30cf3cabf454310VgnVCM1000001a56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Japan_171211.pdf

## Spain

### Tax measures introduced to tackle public deficit

The newly elected government has published a decree containing urgent budgetary, tax and financial measures to control the massive public deficit. The austerity measures increase a number of tax rates and are effective as from 1 January 2012. [Issued: 4 January 2012]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/7652bd513f9a4310VgnVCM1000001a56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_Spain_040112.pdf

## United States

### IRS releases final cost sharing regulations

The Internal Revenue Service has released final cost sharing regulations that adopt virtually all of the provisions contained in the temporary regulations issued in January 2009. Most of the taxpayer-friendly changes commentators hoped would be adopted are not included in the final regulations. [Issued: 23 December 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/cross-border-tax/transfer-pricing/transfer-pricing-alerts/5e4dae47dab64310VgnVCM3000001c56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/transfer-pricing/dttl_tax_tpalert_2011-021_231211.pdf

### Temporary regulations under §954(d) branch rules finalized

The Internal Revenue Service has finalized, with three key changes, 2008 temporary regulations for determining whether a controlled foreign corporation will recognize foreign base company sales income where it conducts selling, purchasing or manufacturing activities outside its country of incorporation. [Issued: 16 December 2011]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/5543715f18744310VgnVCM3000001c56f00aRCRD.htm
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dttl_tax_alert_United_States_161211.pdf

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