Deloitte.

International Tax

World Tax Advisor

24 February 2012

In this issue:

Singapore Budget 2012 focuses on the future

Singapore's Deputy Prime Minister and Minister for Finance delivered his 2012 Budget Statement on 17 February 2012. He reported that Singapore's economy grew by 4.9% in 2011, within the 4% to 6% range that the government had expected at the start of 2011. For 2012, the government expects GDP growth to be between 1% and 3%. The Minister commented that the principal focus of this year's budget is not on providing a countercyclical boost to the economy, but is instead a "Budget for the Future," addressing Singapore's longer term challenges and building a better future for its people.

The proposals have to be passed into law to be effective, and this will take place sometime in the last quarter of 2012 or early 2013.

Unless otherwise noted, the changes discussed below are effective as from 17 February 2012.

Corporate income tax

Rate and chargeable income – No changes are proposed to the 17% corporate tax rate. The first SGD 300,000 of normal chargeable income, however, would be partially exempt from tax as follows: for every dollar of the first SGD 10,000, 75% of the chargeable income will be exempt, and 50% will be exempt for every dollar of the next SGD 290,000.

Cash grant for SMEs – A one-time small and medium-sized enterprise (SME) cash grant would be available for YA 2012, equal to 5% of the SME's revenue for YA 2012 or SGD 5,000, whichever is lower. The SME cash grant would be made available only to companies that have made Central Provident Fund (CPF) contributions for at least one employee in YA 2012.

Productivity and Innovation Credit scheme – The PIC scheme is a broad-based tax scheme granting a total of a 400% tax deduction or allowance for the first SGD 400,000 of qualifying expenses incurred for five years from YA 2011 to YA 2015 on specified activities along the innovation value chain. The Minister has proposed the following enhancements effective beginning YA 2012 (YA 2013 for the increase in the cash payout conversion rate):

- Cash payout – Increasing the cash payout conversion rate from 30% to 60% as from YA 2013; extending the cash payout option to YA 2014 and YA 2015 (subject to certain limitations); allowing the cash payout claim to be made after the end of each financial quarter (instead of after the taxpayer's financial year end); and allowing the cash payout option for qualifying automation equipment acquired on hire purchase with a repayment schedule straddling two or more financial years from YA 2012.
- Training – Removing the certification requirement for qualifying in-house training expenditure incurred up to SGD 10,000 per YA, and including as qualifying expenditure training provided by a principal to its agents (e.g. financial advisers and real estate agents) if certain conditions are satisfied.
- R&D – Removing the multiple sales requirement to facilitate R&D in software development not intended for sale and extending the PIC scheme to cover expenditure incurred on R&D cost-sharing agreements.

Bank withholding tax (WHT) regime – The WHT regime applying to approved banks and financial institutions ("qualifying entities") would be further enhanced to provide that qualifying entities need not withhold tax on interest and certain payments made to permanent establishments (PEs) in Singapore. This measure would apply for payments made from 17 February 2012 to 31 March 2021 (with respect to contracts existing before 17 February 2012) and for all payments relating to contracts that are effective on or after 17 February 2012 to 31 March 2021.

WHT filing and payment deadlines – For certain payments (such as interest and royalties) made to a nonresident on or after 1 July 2012, the payer would be allowed one additional month to file and pay the tax to the Comptroller of Income Tax, i.e. by the 15th of the second month following the date of the payment to the nonresident.

WHT exemption for OTC financial derivative payments – A WHT exemption currently is available for payments a financial institution in Singapore makes on qualifying over-the-counter financial derivatives to a person who is neither a resident in Singapore nor a PE in Singapore if the contract (or its extension or renewal) for such derivatives took effect within a certain time frame (the outer date for payments and contracts being 19 May 2012). The Minister has announced that the exemption would be further extended until 31 March 2021 for all qualifying OTC financial derivatives made by financial institutions (with details of the effective date to be announced in April 2012).

Designated investment and specified income – The list of specified income and the list of designated investments used in certain financial sector tax incentive schemes would be simplified. The list of specified income would be revised into an exclusion list (i.e. unless specifically excluded, all income derived from designated investments by qualifying entities would qualify for the tax exemption under the relevant financial sector tax incentive schemes) and the designated investments list would be rationalized and expanded. The effective date is given as 17 February 2012, unless otherwise stated in an upcoming MAS circular.

Collective impairment provisions – Banks and finance companies are required to recognize impairment losses by reducing the carrying amount of each loan or groups of similar loans assessed by the banks or finance companies as impaired. For income tax purposes, qualifying impairment losses made by banks and finance companies are allowed as a deduction and any reversal amount is subject to tax. Under certain circumstances (relating to the quality of data and loss estimation processes), collective impairment provisions must be made, but mandatory collective impairment provisions for loan losses are allowed as a deduction subject to caps for such period of time as the Minister may allow, with the concession currently set not to apply after YA 2013 (or YA 2014 in some cases). The Minister would extend the tax concession for a further three years (until YA 2016 or YA 2017, as the case may be).

Enhancements to M&A scheme – The existing merger and acquisition (M&A) scheme allows an acquiring company to claim an M&A deduction and stamp duty relief on a qualifying M&A completed from 1 April 2010 to 31 March 2015. The M&A scheme would be enhanced with a 200% tax allowance to be granted on transaction costs incurred on qualifying acquisitions completed from 17 February 2012 to 31 March 2015, subject to an expenditure cap of SGD 100,000 per YA.

Additionally, qualifying acquisitions would include acquisition by the acquiring company through multiple tiers, instead of one tier, of its wholly owned subsidiaries, and the relevant conditions that a target company previously must satisfy could instead be satisfied by any of the multiple tiers of wholly owned subsidiaries of the target company. The M&A scheme would be available as an added feature, on a case-by-case basis, to existing headquarter incentive schemes. Given that companies under headquarter incentive schemes are held by an ultimate holding company incorporated and tax resident outside Singapore, the condition that the acquiring company must be held by an ultimate holding company incorporated and tax resident in Singapore may be waived subject to conditions by the Economic Development Board (EDB). The existing terms and conditions of the M&A scheme would continue to apply.

Gains on share disposals by companies – Singapore currently does not have capital gains tax. If a gain is regarded as a capital gain, it is not subject to income tax; if a gain is regarded as a revenue gain, it is subject to income tax. However, the Income Tax Act (ITA) does not specifically define capital or revenue gains. For disposals effected on or after 1 June 2012, the Minister would establish guidelines specifying when a company would not be taxed on gains from the disposal of shares; specifically, such gains would not be taxed if the divesting company holds at least 20% in the company whose shares are being disposed and maintains that shareholding for at least 24 months prior to the disposal.

Integrated Investment Allowance (IIA) scheme – Currently, a person carrying on a trade, profession or business who incurs capital expenditure on the provision of machinery or plant for the purposes of that trade (etc.) may claim an initial allowance of 20% and an annual allowance at prescribed rates. In lieu of such allowance, the person may claim an annual allowance of 33 1/3% or 100% (depending on the type of machinery or plant) in respect of the capital expenditure incurred. In addition, where a company incorporated and resident in Singapore proposes to carry out a project through an overseas subsidiary for the manufacture or increased manufacture of a product or for the provision of specialized engineering or technical services, the company may apply to the Minister for approval of an integrated industrial capital allowance in respect of the fixed capital expenditure for the project (with no approval granted to any company on or after 1 March 2013).

The Minister would withdraw the existing integrated industrial capital allowance incentive and introduce the IIA scheme, under which the company could apply to the EDB for an additional allowance (on top of capital allowance) on fixed capital expenditure incurred on or after 17 February 2012 for productive equipment placed overseas on approved projects. The IIA scheme will be administered by the EDB and will last for five years. The change would be effective for YA 2013.

DTD scheme for market/investment development activities – Under the double tax deduction (DTD) scheme, qualifying companies or firms can claim double or further tax deductions on qualifying expenses (if pre-approved in some circumstances) incurred for market development and investment development activities. The scheme has a sunset date of 31 March 2016. The Minister proposes allowing a double or further tax deduction on qualifying expenditure up to SGD 100,000 per YA incurred on the following activities, without having to obtain approval from International Enterprise Singapore or the Singapore Tourism Board: overseas business development trips and missions; overseas investment study trips and missions; participation in overseas trade fairs; and participation in approved local trade fairs. Claims on qualifying expenditure incurred on other qualifying activities or those in excess of SGD 100,000 would continue to be granted on an approval basis. The effective date for the enhancements is 1 April 2012.

REIT transparency – Real estate investment trusts in Singapore are, in general, unit trusts established with the objective of owning and investing in real estate, whether directly, or indirectly through the ownership of companies whose primary purpose is to hold or own real property. An S-REIT (a REIT whose units are listed on the Singapore exchange) can request a tax transparency ruling from the Inland Revenue Authority so that no tax will be imposed on its statutory income (instead, tax will be assessed on the distribution received by unit holders). The tax transparency rulings granted to S-REITs thus far generally provide that the trustee is not taxable on certain otherwise taxable income if at least 90% of such income is distributed to the unit holders and the distributions are made fully in cash. The distributions (in the hands of the unit holder) are then either exempt from tax or subject to tax (depending on the type of unit holder). Effective 1 April 2012, the Minister has proposed that the tax transparency treatment be accorded to S-REITs that make distributions to unit holders in the form of units subject to the following conditions: before the distribution, the trustee of the S-REIT grants the unit holders the option to receive the distributions either in cash or in units in that S-REIT; and on the date of distribution, the trustee of the S-REIT has sufficient cash to make the entire distribution fully in cash had no option been given to those unit holders to receive the distribution in units in that S-REIT. It is further proposed that unit holders that elect to receive distributions in units be taxed in the same manner as if they had received the distributions in cash.

Proposals related to shipping and aircraft

WHT exemption on charter fee payments – Bareboat, voyage and time charter payments made to nonresidents (excluding PEs in Singapore) for the use of ships would be exempt from WHT. Where the payments are made to a PE in

Singapore and an upfront waiver of WHT applies, the charterer would not need to withhold tax, but the nonresident lessor or ship owner would be assessed tax on the charter fees received when it files its annual income tax return.

Aircraft Leasing scheme (ALS) – An aircraft leasing company approved as such is entitled to, among other benefits, a 5% or 10% concessionary tax rate on income accruing in or derived from Singapore from the leasing of aircraft or aircraft engines or other prescribed ancillary activities for a period not exceeding five years. It is proposed to extend the scheme beyond its 29 February 2012 sunset date to 31 March 2017. Further, the WHT exemption currently granted on a case-by-case basis for interest and qualifying related payments arising from qualifying foreign loans taken to finance the purchase of aircraft and aircraft engines would be granted automatically, subject to certain conditions. Payments would be required to be made on or after 1 May 2012 by existing and new ALS recipients in respect of qualifying foreign loans entered into on or before 31 March 2017 to finance the purchase of aircraft or aircraft engines.

Gains from disposal of vessels – A concession has been granted since YA 2005 to provide certainty on the tax treatment of gains derived from the disposal of vessels registered with the Singapore Registry of Ships (SRS) and vessels (both Singapore and non-Singapore flag) owned or operated under the Approved International Shipping Enterprise (AIS) Scheme (the Maritime Sector Incentive AIS (MSI-AIS) with effect from 1 June 2011). Under the concession (which does not apply to vessels under construction and new building contracts), gains derived from the disposal of vessels are not taxed. Additionally, with effect from 1 June 2011, qualifying shipping entities have had to make a one-time irrevocable election to opt into the concession by submitting an election form with their income tax returns. After opting into the concession, the entity will remain under the concession until YA 2014.

The Minister would automatically grant qualifying ship operators and ship lessors (without opting for the concession) under the following schemes the tax exemption on the gains derived from the disposals of vessels: MSI-Shipping Enterprise SRS (MSI-SRS) or MSI-AIS if, in either case, the entity is in the business of shipping operations; or MSI-Maritime Leasing (Ship) (MSI-ML (Ship)) if the entity is in the business of ship leasing. The concession would be further enhanced to provide a tax exemption for gains from the disposal of vessels under construction (including new building contracts) and gains from the disposal of foreign vessels for ship lessors under the MSI-ML (Ship) scheme. The changes would apply as from 1 June 2011.

Enhancements to container scheme – Under the MSI-ML (Container) scheme, all approved entities currently enjoy the same benefits as the former Maritime Finance Incentive scheme, including a concessionary tax rate of 5% or 10% on qualifying income derived from the leasing of qualifying sea containers and a case-by-case exemption from WHT on interest and related payments arising from foreign loans taken to finance qualifying containers. The following enhancements are proposed: the WHT exemption would be automatic for interest and related payments made on or after 17 February 2012 arising from foreign loans taken to finance qualifying containers and intermodal equipment (e.g. trailers); with effect from YA 2013, the 5% or 10% rate also would apply to income derived from the leasing of intermodal equipment that is incidental to the leasing of qualifying containers; with effect from YA 2013, "qualifying containers" would refer not only to containers that adhere to the standards defined by the International Organization for Standardization or the Institute of International Container Lessors, as currently is the case, but to any other equivalent organization.

Other proposals affecting businesses

CPF contribution rates – The CPF contribution rates for employees above 50 years of age currently range from 6.5% to 12% for the employer and 5% to 18% for the employee. The Minister would increase (effective 1 September 2012) the employer CPF contribution rates for employees aged 50 to 55 years by 2%, 1.5% for those aged above 55 to 60 years and 0.5% for those above 60 up to 65 years. The employee CPF contribution rates also would be increased.

Special Employment Credit (SEC) – The SEC scheme introduced in last year's Budget offered employers a one-time SEC of up to 50% of the employer CPF contributions for workers aged 55 to 59 and a higher credit of up to 80% of employer CPF contributions for workers aged 60 and above. For January 2012 to December 2016, the Minister proposed the following enhancements: employers will receive an SEC of 8% of the employee's income for each Singaporean worker over age 50 who earns up to SGD 3,000 per month; and a lower SEC will be given to employers for each Singaporean worker over 50 earning between SGD 3,000 and SGD 4,000. The enhanced SEC will be paid out twice a year, in March and September (with the first payment in September 2012).

— Ajit Prabhu (Singapore)
Partner
Deloitte Singapore
aprabhu@deloitte.com

Chan Huang Chay (Singapore)
Partner
Deloitte Singapore
hchan@deloitte.com

France issues guidance on new rules affecting "French-connected" trusts

The French tax authorities (FTA) issued guidance on 23 December 2011 (Ruling No. 2011/37 (ENR)) on the new trustee reporting obligations under article 1649 AB of the French tax code (FTC) established under Law No. 2011-900. The law, which entered into force on 31 July 2011, introduced major changes aimed at taxing assets held through foreign trusts where a connecting link with France exists (i.e. where the settlor or at least one beneficiary is a French tax resident or French assets are held in trust). The new rules deal with wealth tax, inheritance tax and income tax and introduce a 0.5% "specific trust levy" to ensure that assets in a trust that have not been taxed as an asset of the settlor for wealth tax purposes are subject to an equivalent tax.

The specific trust levy can be avoided by filing a return complying with the reporting obligations set forth for trusts in article 1649 AB if the settlor or beneficiary is not liable for wealth tax. Additionally, the trust levy is not due if the assets placed in the trust were declared for wealth tax purposes by the settlor. Failure to comply with the disclosure and reporting requirements may entail a 5% penalty on all assets held in trust (the trust levy and penalty are independent and may be imposed for the same failure). A decree detailing application of the provisions has not yet been adopted, leaving unanswered questions for many grey areas of the law under article 1649 AB.

Ruling 2011/37, however, does provide interesting details on the context and scope of a trustee's reporting obligations (which will apply once the decree is published) and provides some relief by excluding two types of trusts from the scope of the disclosure obligations.

Excluded trusts

Provided trustees are located in a jurisdiction that has concluded an administrative assistance agreement (or tax treaty containing a provision for such) with France, the disclosure obligations will not apply to trusts:

1. Established to manage the beneficiaries' pension rights deriving from professional activities within the framework of a retirement plan implemented by a company or group of companies; or
2. Established by a company (or group of companies) for its own account and the "settlor" of which is a company.

The criteria to qualify as an exempted trust must be carefully reviewed. For example, whether an employee benefit trust will qualify under the second exemption will require a case-by-case analysis, in particular as to whether the trust satisfies the "established for its own account" test.

Finally, charitable trusts are not listed among the entities exempted and, therefore, they still fall within the scope of the reporting obligations.

Disclosure obligation for existing, created, modified or terminated trusts

According to the ruling, trustees have an obligation to declare any trust in existence as of 31 July 2011, as well as the creation, modification or termination of a trust from that date, if the settlor or at least one of the beneficiaries is a French resident or if any trust asset is situated in France. The ruling further specifies that, if there are no French tax resident beneficiaries or settlors and the French situs assets qualify exclusively as financial assets exempted from French wealth tax (as defined by FTC article 885 L), this reporting requirement is applicable only if the assets were placed in the trust at creation or transferred during future modifications (i.e. any further modification after creation) or if the settlor or a beneficiary becomes a French tax resident. This carve-out to reporting, however, is not well-drafted and requires further clarification.

Disclosure obligation of asset value as of 1 January

The other obligation discussed in the ruling consists of an annual reporting requirement in respect of assets held in trust as of 1 January each year. The FTA confirmed that the scope of application corresponds to that of the trust levy. Once the decree is adopted, the annual reporting will apply to net assets held in trust as from 1 January 2012.

Scope of the annual reporting obligation – If the settlor or one of the beneficiaries of the trust is French tax resident, the reporting requirement includes worldwide assets in trust, even assets exempt from French wealth tax or otherwise reported for wealth tax purposes. Where there are no French resident settlors or beneficiaries, the scope of the reporting requirement is applicable only with respect to French situs assets.

Details on financial investments – For determining French situs assets for purposes of the reporting obligation, the ruling clarifies that the meaning of "financial investments" is the same as the definition used for French wealth tax purposes. The term "financial investments" includes deposits in Euros or other currencies, a shareholder's current accounts in a company or any other legal entity established in France, bonds or similar securities, shares, stocks or any rights issued by a company or legal entity established in France and life insurance or capitalization policies subscribed by insurance companies in France.

However, as for wealth tax, interests in real estate companies, shareholdings of more than 10%, and direct or indirect interests of more than 50% in entities owning real estate rights in France would qualify as French situs assets and as such should be reported by the trustee even when the settlor and all the beneficiaries are not French tax resident (as these kinds of investments do not qualify as financial investments and must always be reported).

Comments

While the ruling brings some clarity on the reporting obligations and excludes some trusts established by companies or groups of companies, it leaves numerous questions unanswered and must be analyzed on a case-by-case basis. Perhaps most notably, the ruling does not address how trustees can avoid the new 0.5% specific trust levy by complying with the reporting obligations. All affected parties and their advisors would welcome further clarification on these issues.

This material has been prepared by professionals in Taj, French tax and legal firm, member of Deloitte Touche Tohmatsu Limited

— Anne Vaucher (Paris)
Partner
Taj
avaucher@taj.fr

Argentina:
Treaty with Switzerland terminated

On 31 January 2012, Argentina's Official Gazette contained a summary of a note sent on 16 January by the Foreign Affairs Bureau to the Swiss Ambassador, informing Switzerland that Argentina no longer intends to provisionally apply the tax treaty signed in 1997 (as well as the 2000 and 2006 protocols) and intends to discontinue the formal approval process for the treaty. However, the note mentions that Argentina will continue negotiations with Switzerland for a tax information exchange agreement.

The note also states that Argentina is suspending the application of the transportation treaty between the two countries.

Clarification is awaited about the date on which the tax treaty will cease to apply on a provisional basis, but the unofficial position of the Argentine government is that the treaty ceases to apply as from the date the letter was sent to Switzerland (i.e. 16 January 2012). If the termination clause in the treaty is used, however, the official termination date would be 1 January 2013, but, since the treaty was never fully in force, the Argentine government has taken the position that the termination clause is not applicable and, therefore, the termination is immediate. Further details are expected to be provided on the status of the transportation treaty.

In 2011, Argentina established a bureau to review all of the country's treaties and analyze the costs and benefits of each treaty. The termination of the Switzerland treaty is the result of such a review.

— Christian Fucinos (Buenos Aires)
Partner
Deloitte Argentina
cfucinos@deloitte.com

Daniel Caracciolo (Buenos Aires)
Partner
Deloitte Argentina
dcaracciolo@deloitte.com

Belarus:
Transfer pricing rules introduced

New transfer pricing rules are included in the Belarus Tax Code as from 1 January 2012.

The rules apply to the following transactions:

- Sales of real estate where the transaction price is more than 20% lower than the market price on the date of the sale; and
- Foreign trade transactions, including transactions with related parties, where the price of the transaction (or transactions with the same party within a single calendar year) exceeds BYR 20 billion (approximately EUR 1.8 million) on the date of the acquisition or disposal of the goods and the price of the transaction deviates by more than 20% from the market price of the goods.

If the tax authorities determine that the transaction price deviates from the market price by more than 20%, they may adjust the tax base and profits of one of the parties to the transaction to an amount that would have been obtained had the transaction price been set at a market level. The tax authorities can use the comparable uncontrolled price, resale minus and cost-plus methods for determining the market price.

— Viktar Strachuk (Minsk)
Senior Manager
Deloitte Belarus
vstrachuk@deloitte.by

Croatia:
Changes to tax rules announced

On 9 February 2012, the Croatian government announced changes to the Corporate Income Tax Act, Personal Income Tax Act, VAT Act, the Social Security Contributions Act and tax administration rules. The Parliament is expected to ratify the proposed changes in the near future so that the new rules generally will apply as from 1 March 2012.

The most important changes are as follows:

- The withholding tax on dividends and profit distributions to nonresident entities will be 12% (no withholding tax is currently levied on such distributions). This rule will apply to distributions paid after 1 March 2012, except for dividends and shares paid out of profits made before 31 December 2000, regardless of when the payment is made.
- Once Croatia becomes an EU member state (on 1 July 2013), no tax will be withheld on dividends paid to a qualifying entity resident in another member state provided the recipient holds at least 10% of the capital of the Croatian payer entity for at least 24 months.
- The personal income tax rates will remain 12%, 25% and 40%, but the monthly amounts to which they apply will be revised (i.e. 12% on taxable income up to HRK 2,200, 25% on taxable income from HRK 2,200 to HRK 8,800 and 40% on taxable income over HRK 8,800).
- The basic personal allowance will increase from HRK 1,800 to HRK 2,200.

- Dividends received by resident individuals will be exempt up to HRK 12,000 per year. Amounts exceeding this threshold will constitute capital income subject to a 12% withholding tax (with no personal allowance). The nontaxable income up to HRK 12,000 will need to be reported in the annual tax return (i.e. it will not be automatically tax-exempt at the time of payment).
- Foreign pensions received by residents will constitute taxable employment income for the recipient.
- The general health insurance contribution will be reduced from 15% to 13%.
- The standard rate of VAT will increase from 23% to 25% and certain foods that were subject to the standard rate will be subject to the reduced rate of 10%.
- The input VAT deduction for vessels, airplanes, personal motor vehicles and other personal transport vehicles, including the procurement of goods or services related to such vehicles, will be abolished.
- The registration threshold for VAT will increase from annual sales of HRK 85,000 to HRK 230,000, as will the threshold for quarterly reporting, from annual deliveries of HRK 300,000 to HRK 800,000.
- Various changes will be made to the tax administration.

— Sonja Ifkovic (Zagreb)
Director
Deloitte Croatia
sifkovic@deloittece.com

European Union:
Luxembourg asked to amend VAT rules on independent groups

The European Commission has officially asked Luxembourg to amend its VAT rules relating to independent groups of persons because the rules are incompatible with EU law.

Under Luxembourg law, services provided by an independent group to its members are free from VAT provided the taxed activities of the members do not exceed 30% of their annual turnover (or 45% in certain cases). Group members also may deduct the VAT charged to the group on its purchases of goods and services. Lastly, operations by a member in its own name but on behalf of the group are regarded as nontaxable.

The European Commission has taken the position that these arrangements violate EU law for several reasons. Under EU law, to be exempt from VAT, services provided by an independent group to its members must be directly required for their nontaxable or exempt activities. The Luxembourg rule providing for a ceiling for taxed operations does not, therefore, satisfy this condition. The group's exempt activities must be linked exclusively to the exempt activities of group members. Moreover, group members should not be allowed to deduct VAT charged to the group, and the Luxembourg arrangements do not take account of VAT rules in EU law applicable to operations by intermediaries.

If Luxembourg fails to comply with the Commission's request within two months, the Commission may refer the case to the European Court of Justice.

— Raphael Glohr (Luxembourg)
Partner
Deloitte Luxembourg
rglohr@deloitte.lu

Indonesia:
Government clarifies exchange of information and assistance in tax collection

The Indonesian government recently issued guidance that clarifies the exchange of information and tax collection assistance under a tax treaty with a view to preventing tax avoidance and evasion and tax treaty abuse. The guidance applies as from 28 December 2011.

The Indonesian government can collaborate with the government of a tax treaty partner through an exchange of information, including conducting a joint audit, with regard to the following taxpayers:

- A taxpayer that receives income from Indonesia;
- A taxpayer that engages in transactions with an Indonesian taxpayer that is being audited as a result of tax avoidance or evasion or tax treaty abuse;
- An Indonesian taxpayer that receives income from a tax treaty partner country; or
- A taxpayer that engages in transactions related to a foreign taxpayer from a tax treaty partner country that is being audited by the treaty partner.

A special purpose tax audit may be conducted on a taxpayer in Indonesia when it is deemed necessary for the purpose of the exchange of information. The tax auditor from the government of the treaty partner country can participate in such an audit. This arrangement is reciprocal, i.e. the Indonesian tax auditor can join a tax audit conducted by the government of a treaty partner country for the same purpose.

Tax collection assistance between the Indonesian government and the government of a treaty partner country will be granted in the following cases:

- Tax due that is not under dispute, can still be collected under the tax law and the Indonesian tax authorities have tried their best to collect;
- The taxpayer or guarantor is not present in Indonesia; or
- The taxpayer or guarantor has no other assets that can be used for the payment of the tax.

— Firdaus Asikin (Jakarta)
Partner
Deloitte Indonesia
firdausasikin@deloitte.com

Connie Chu (Jakarta)
Senior Technical Advisor
Deloitte Indonesia
cchu@deloitte.com

New Zealand:
Considerations where interest paid to nonresidents

When considering the New Zealand withholding tax obligations on interest payments made to a nonresident, it is important to take into account the residence of the recipient(s) of the interest on a jurisdictional basis. It is not sufficient to merely confirm that New Zealand has concluded a tax treaty with the relevant country – further analysis is required to determine the applicable rate and whether the withholding is a final, minimum or maximum tax.

Interest paid to residents of most countries that have concluded a tax treaty with New Zealand will be subject to a 10% withholding tax, which is a final tax (or a maximum tax where the interest is between associated persons). Interest paid to recipients resident in non-treaty countries will be subject to a final 15% withholding tax. However, interest paid to an associated person resident in a non-treaty country will result in the withholding tax being a minimum tax (i.e. the associated party recipient will be required to file a tax return with the resulting New Zealand tax liability based on marginal rates, which may actually result in a tax liability exceeding the 15% withheld).

Not all of New Zealand's tax treaties provide for the same level of withholding at source, and some have non-standard provisions relating to interest or no provisions at all. For example, the New Zealand-Japan treaty does not contain an interest article, so interest paid to residents in Japan is treated the same as interest paid to recipients in non-treaty countries (i.e. a 15% final tax, unless the recipient is an associated person, in which case the 15% withholding is a minimum tax).

A 15% withholding tax, rather than the more common 10% rate applying in most treaty countries, applies to interest recipients resident in Canada and Malaysia and some interest payments to recipients resident in Chile, Thailand and Turkey.

It is also worth noting that interest paid to an associated person that is resident in Fiji, Japan or Malaysia will be subject to a 15% withholding tax. The Fiji and Malaysia treaties also contain a broader associated person test for purposes of capping the tax withheld. Where payments are between associated persons, the cap on tax withheld does not apply and the withholding tax becomes a minimum tax.

— Peter Truman (Dunedin)
Partner
Deloitte New Zealand
ptruman@deloitte.co.nz

Aran Bailey (Dunedin)
Manager
Deloitte New Zealand
arbailey@deloitte.co.nz

Russia:
Update on protocols with Cyprus, Luxembourg and Switzerland

On 15 February 2012, the Russian State Duma ratified the 2010 protocol to the 1998 tax treaty with Cyprus, which now awaits the signature of the president. Provided notification of ratification takes place in 2012, most of the provisions in the protocol will enter into effect on 1 January 2013 (except for changes relating to gains from the alienation of property, which will apply as from 1 January 2017, and the article on assistance in collection, which awaits changes to the domestic laws of Cyprus).

Russia has signed similar protocols with other countries, including Luxembourg (21 November 2011) and Switzerland (25 September 2011), through which major foreign investment flows pass into Russia's economy. The protocols to the treaties with Luxembourg and Switzerland have not yet been ratified.

One of the most important changes made by the Cyprus, Luxembourg and Switzerland protocols is to allocate priority taxing rights to capital gains (derived by individuals or entities) on the sale of shares (or other corporate rights) to the state where the immovable property is located, provided more than 50% of the value of the shares (or similar corporate rights) is represented by real property located in that state. Currently, the treaties generally grant the taxing right to the country where the seller is resident. However, the Cyprus and Luxembourg protocols do include circumstances under which the exclusive taxing right with regard to such income is allocated to the state where the alienator is resident.

The protocols also amend the section of their respective treaties that regulate the taxation of dividends, including the definition of "dividends" and the withholding tax rate on dividends (as well as the conditions for application of the withholding tax in the protocols with Luxembourg and Cyprus). These changes include a new minimum dividend withholding tax rate of 5% (instead of 10%) under the Luxembourg treaty where the dividends are paid to a company that holds at least 10% of the capital of the payer company and has invested at least EUR 80,000 or the equivalent in rubles in that company.

Application of the existing reduced rate of 5% under the treaty with Cyprus will require a minimum EUR 100,000 investment in the capital of the company paying the dividends rather than USD 100,000. Changes to the dividend rates under the Swiss treaty provide government-related exemptions and an exemption on dividends paid to qualifying pension funds and similar institutions.

All three protocols treat as dividends payments on shares in mutual investment funds and similar collective investment vehicles (other than investment funds mainly investing in immovable property), as well as depository receipts over shares. The protocols with Cyprus and Luxembourg treat payments from mutual funds investing in real property as income from immovable property; the protocol with Switzerland treats such payments as dividends, thus, providing more beneficial taxation terms.

The protocols pay special attention to the "thin capitalization" rules. The protocols with Cyprus (under the interest and dividend articles) and Luxembourg (under the dividend article) treat interest payments as dividends if they are subject to the same tax treatment as income from shares by the tax legislation of the source state. Russia and Switzerland (in the annex to the Swiss protocol, with reference to the dividend and interest articles) also have agreed on the possibility to apply the thin capitalization rules under domestic legislation.

A key change to the interest article under the Swiss treaty is a general exemption from withholding tax on interest, replacing the 10% rate (5% for bank loans) under the treaty.

All three protocols introduce limitations on benefits envisaged by the treaties. These restrictions will not apply automatically, but after mutual consultation between the tax authorities of the contracting states. The limitations on benefits under the treaties with Luxembourg and Switzerland will apply to a wider range of taxpayers as compared to the agreement with Cyprus.

The major amendments to all three treaties with regard to the exchange of information largely clarify existing obligations and powers of the contracting states. Additionally, the exchange of tax information will cover all types of taxes, including value added tax. The protocols do not provide for an automatic exchange of information.

Other provisions affected by the protocols include the following:

- For Cyprus and Luxembourg, the protocols amend the permanent establishment article, narrowing the meaning of this concept by introducing a "service PE."
- All three protocols amend the resident article with a new provision according to which, if the place of effective management of a person other than an individual cannot be determined, the competent authorities will determine the place of effective management by mutual agreement, having regard to all factors they consider relevant.
- The Luxembourg protocol introduces an "other income" provision that allows the taxation of other income in the recipient's state of residence (as provided by the current treaty), as well as in the other contracting state. At the same time, the protocol provides for the possibility to credit the tax paid in Russia against the amount of tax payable in Luxemburg. The protocol with Switzerland adds to the other income article so that Russian-source income of a Swiss resident derived from the alienation of certain types of movable property will be exempt from tax in Switzerland only if actual taxation of the gains in Russia is confirmed.
- Changes to the mutual agreement procedure under the Cyprus protocol mainly concern administrative issues. In particular, the protocol allows a resident to present his/her case regarding actions of one or both contracting states that are not in accordance with the treaty provisions to the competent authority of either contracting state (the current procedure provides only for the right of application to the competent authority of the state of which the person is a resident) within three (rather than two) years after the first notification on such non-compliance.

Some of the most notable positive consequences, including those discussed above, of the protocols include:

- A reduction of the minimum Russian withholding tax rate on dividends paid to companies in Luxembourg to 5% (subject to certain provisions), which can significantly improve the position of Luxembourg as a beneficial jurisdiction for holding companies;
- Removal of Cyprus from Russia's "black list," thereby allowing application of Russia's participation exemption to dividends received by Russian companies from Cypriot subsidiaries;
- An exemption from withholding tax on interest income received by residents of Switzerland, which may positively influence the use of Switzerland as a place to set up finance companies;
- Improvements to the exchange of information and transparency of tax relationships between the contracting states, as well as enhancement of efficiency of control over tax violations.

The changes demonstrate that the protocols largely are based on the principles and recommendations of the OECD. They are generally aimed at achieving maximum consistency of the treaties' provisions with international practice and fostering and encouraging economic relations between the contracting states.

— Elena Solovyova (Moscow)
Partner
Deloitte Russia
esolovyova @deloitte.ru

Ekaterina Kolomenskaya (Moscow)
Manager
Deloitte Russia
ekolomenskaya@deloitte.ru

Alexander Krylov (New York)
Senior Manager
Deloitte Tax LLP
alkrylov@deloitte.com

United States:
Framework for corporate tax reform released

The White House and the U.S. Treasury Department released a corporate tax reform "framework" on 22 February 2012 that calls for lowering the corporate tax rate to 28% while eliminating or revamping many current law business tax expenditures, creating new incentives to promote domestic manufacturing, overhauling the international tax rules and imposing a new "minimum tax" on multinationals, but the long-awaited plan offers few details on how those proposals would operate.

The framework follows the principles that President Obama outlined in the FY 2013 budget proposal he sent to Congress on 13 February. For example, it calls for the elimination of a variety of tax provisions such as last-in first-out (LIFO) accounting, certain deductions for large oil and gas companies, special depreciation rules for corporate purchases of aircraft and capital gain treatment of carried interest income.

In addition to specific revenue offsets, the framework lays out a menu of options for policymakers to consider in reforming the tax code, such as addressing depreciation schedules in the context of moving accelerated depreciation closer to economic depreciation; examining debt versus equity, including the possibility of reducing the deductibility of interest expense; and establishing greater parity between large corporate and noncorporate taxpayers.

It mostly ignores any discussion of individual tax reforms or any issues that would arise if individual and corporate tax reform are done at different times.

Rate reduction

The framework acknowledges that other countries, such as Canada and the U.K., have reduced their corporate tax rates far below that of the U.S. and sees the need to encourage U.S. economic competitiveness and to reduce tax-related economic distortions. Therefore, the president calls for a reduction in the top statutory corporate tax rate from 35% to 28%.To offset the rate reduction, the president calls for the elimination of many tax expenditures, especially those in certain industries.

The framework lists a handful of expenditures from past proposals – including the most recent budget – that the administration says "should be part of any reform," including:

- LIFO – The administration would disallow the use of the LIFO inventory accounting method. Although the framework provides no details, the most recent White House budget proposal would require taxpayers that currently use LIFO to write up their beginning LIFO inventory to its first-in, first-out (FIFO) value, and take this onetime increase in gross income into account ratably over 10 years, beginning with the first taxable year beginning after the effective date.
- Oil and gas preferences – The framework says it would repeal tax preferences for fossil fuels and lists two examples: expensing of intangible drilling costs and percentage depletion for oil and natural gas wells. The framework does not mention other budget proposals, such as repealing the (section 199) domestic activities manufacturing deduction for oil and gas companies.
- Insurers and their products – The framework specifically calls for tightening the rules for corporate-owned life insurance (COLI) as proposed in the budget, as well as other proposals that would affect insurers or their products. Presumably, these include proposals from the budget plan, such as information reporting on some insurance contracts and accounts, a fixed proration regime for the dividends received deduction on separate accounts and requiring any special loss discount accounts to be taken into gross income.
- Carried interest – The administration reiterates its belief that capital gains rates for managers on their carried interest income from investment services partnerships is an inappropriate loophole. As in previous administration proposals, the framework would subject income from carried interests to ordinary rates.
- Corporate-owned aircraft – In another repeat from the budget, the administration proposes to increase the depreciation recovery period for general aviation airplanes that carry passengers from five to seven years.

The framework also lays out a series of options that "should be under consideration" in reforming the tax code and notes that several of these options would be necessary to meet the 28% rate target:

- Depreciation – According to the framework, current depreciation schedules overstate the economic depreciation of assets. The administration says this mismatch may create an incentive to invest, but it believes that, in an increasingly global economy, this incentive may not be the best way to increase investment or create jobs in the U.S. The framework proposes "addressing" depreciation schedules by "moving towards economic depreciation" and using the savings to reduce rates.
- Debt financing – The framework discusses the way the current tax code creates incentives for using debt for financing rather than issuing equity. The administration believes that reducing the corporate rate will help address this problem, but also recommends that policymakers consider reducing the deductibility of interest.

- Entity choice – The framework discusses the way taxation affects choice-of-entity decisions and concludes that C corporations are at a disadvantage compared to pass-through entities. The framework says that ways to establish greater parity between large corporations and large noncorporate entities should be considered and points to proposals from President Bush's Advisory Panel on Tax Reform in 2005 and President Obama's Economic Recovery Advisory Board in 2010.

The framework also says that reform should increase corporate transparency and reduce the differences between what is reported for book and tax purposes.

Domestic manufacturing

As he called for in his State of the Union address in January and his budget release last week, President Obama wants the tax code to incentivize domestic manufacturing. The framework provides a few more details about this goal.

First, the president wants to effectively cut the top rate on manufacturing income to 25% and even lower for income from "advanced" manufacturing activities. According to the framework, this effective rate reduction would be accomplished by reforming the current domestic production activities deduction and increasing it from 9% to 10.7%. Advanced manufacturing activities would be allowed a larger deduction, although the rate is not specified.

Next, the framework says the research and experimentation credit should be made permanent and the simplified credit should be expanded to 17%. The president also wants to permanently extend the tax credit for the production of renewable electricity and to expand it by making it refundable.

International proposals

Draft legislation released in 2011 would move the U.S. from its current worldwide system of taxing offshore income to a territorial system. Many in the business community have called for this change to enhance U.S. competitiveness because most of the country's major trading partners have territorial systems. The administration has been reluctant to embrace territoriality, preferring to strengthen the current system to combat what it sees as incentives to shift income outside the U.S. The framework makes it clear that the administration believes a territorial system would "aggravate, rather than ameliorate, many of the problems in the current tax code." Instead it proposes tightening the current worldwide system, mostly by curtailing deferral.

The president's framework proposes setting a minimum rate of tax for income earned offshore by the subsidiaries of U.S. companies. The framework explains that "foreign income deferred in a low-tax jurisdiction would be subject to immediate U.S. taxation up to the minimum tax rate with a foreign tax credit allowed for income taxes on that income paid to the host country." However, the framework does not specify what the president thinks this minimum rate of tax should be.

The framework similarly repeats with little detail other proposals from the State of the Union address, such as disallowing deductions for expenses related to moving operations offshore and providing a 20% credit for returning operations to the U.S. The framework also recycles recent budget proposals that would tax excess profits associated with shifting intangibles to low-tax jurisdictions and deferring interest deductions for expenses attributable to foreign-source income until that income is subject to U.S. tax.

Small business

The framework notes that tax code complexity is unduly burdensome on small businesses. To reduce complexity and make up for any pain from the loss of expenditures, the framework offers two reform proposals. First, the president wants to make bonus depreciation permanent for small businesses by allowing them to expense 100% of qualified investments up to USD 1 million. Next, the framework proposes increasing the threshold for small businesses to use the cash method of accounting from USD 5 million in gross assets to USD 10 million. The president also calls on Congress to enact recent budget proposals, such as doubling the deduction for start-up costs and expanding the health insurance tax credit for small businesses, as part of reform.

Revenue neutrality

The framework discusses the unsustainable nature of the federal budget and repeats the administration's call for an approach balanced between constrained spending and increased revenue, while protecting middle-income families from tax increases. As part of this, the framework notes that "the business sector must also be asked to contribute to restoring fiscal sustainability." Further, the framework says business tax reform should be fully paid for and should not add to the national debt.

Outlook

The administration's tax reform blueprint was released after months of delays and is unlikely to see action in the near term. Congressional Republicans are developing tax reform plans of their own and are not expected to take up the president's plan in an election year. The administration for its part may see a benefit to keeping tax reform alive as a campaign issue, and it is telling that the Treasury Department chose to release the framework during a week when Congress is in recess. In that light, the framework may best be read as a roadmap for what the president would like to accomplish in his second term should he win re-election, rather than as a legislative agenda for the coming months.

Also telling is the fact that the framework does not provide legislative language or even a detailed description of how most of the proposals would operate. The president's tax reform plan raises all the major issues – rates, international tax, debt financing, depreciation and R&D – but does so with a lack of detail that has characterized many other reform discussions to date. In addition, the framework makes statements about what "should be considered" rather than providing specifics on proposals that Treasury believes should be done.

— Jeffrey Kummer (Washington, DC)
Director
Deloitte Tax LLP
jkummer@deloitte.com

Jon Almeras (Washington, DC)
Manager
Deloitte Tax LLP
jalmeras@deloitte.com

In brief

Belarus – As from 1 January 2012, companies employing over 50 persons must file an electronic tax return.

Greece – The Parliament has approved changes to the penalties imposed for the late filing of the list of intercompany transactions required under Greece's transfer pricing rules. Greek companies and branches of foreign multinational entities with annual revenue exceeding EUR 1 million must submit a list of their intercompany transactions disclosing the value, nature and counterparties within four months and 15 days following the end of the taxpayer's accounting year. With immediate effect for all pending cases of late filing for which a penalty has not yet been imposed, taxpayers will be subject to a one-time penalty of EUR 10,000, increased by EUR 1,000 for each day of delay, but the total amount of the late filing penalty cannot exceed EUR 100,000. The new penalty applies to late filed lists; the 10% penalty imposed on the value of a relevant transaction continues to apply to transactions omitted from the list.

Latvia – As from 1 January 2013, dividends paid by Latvian resident companies to nonresident companies will be exempt from withholding tax, except where payments are made to residents of tax havens. This rule will apply to interest and royalties as from 1 January 2014.

Madagascar – The corporate income tax rate and rate on income from movable capital is reduced from 22% to 21% as from 1 January 2012.

South Africa – The Finance Minister delivered his Budget 2012 speech on 22 February 2012, with several surprises. Highlights of the proposals include an increase in the withholding tax rate on royalties to 15% (currently 12%); an increase in the proposed 10% withholding tax on dividends to 15% effective from 1 January 2013 (South Africa currently imposes a 10% Secondary Tax on Companies levied on dividends declared by a company in lieu of a withholding tax on dividends); and an increase in the capital gains inclusion in taxable income from 50% to 66% for companies and from 25% to 33% for individuals. The Budget also indicates there will be a move to treat certain debt as equity (and therefore deny an interest deduction), as well as a later-in-time introduction of a cap on interest deductions.

Thailand – Recent guidance issued by the Director General of VAT allows for a credit or deduction of input VAT on the construction of buildings transferred within three years from the date construction is completed. Previously, input VAT incurred on the construction of a building that was transferred within three years after completion was disallowed and the VAT payer was required to repay any input VAT previously credited, in addition to a penalty and surcharge.

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.

Argentina-Switzerland – See article under Argentina in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120224_3.html

Belgium-Democratic Republic of the Congo – The 2007 treaty entered into force on 24 December 2011 and applies as from 1 January 2012.The 5% rate applies where dividends are paid to a company that holds directly at least 25% of the capital of the payer; otherwise the rate is 10%. The rate on interest and royalties is 10%.

Cyprus-Russia – See article under Russia in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120224_9.html

Czech Republic-Hong Kong – The 2011 treaty entered into force on 24 January 2012 and applies for the Czech Republic as from 1 January 2013 and for Hong Kong as from 1 April 2013. When in effect, the treaty provides for a 5% withholding tax on dividends. Interest and royalties will be taxable only in the state where the recipient is resident.

Estonia-Jersey – The 2010 treaty entered into force on 13 January 2012 and will apply as from 1 January 2013. When in effect, the treaty provides that dividends, interest and royalties will be taxable only in the state of residence of the recipient.

France-Panama – The 2011 treaty entered into force on 1 February 2012 and will apply as from 1 January 2013. When in effect, the treaty provides for a 5% withholding tax on dividends paid to a company 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%.

Germany-Liechtenstein – When in effect, the treaty signed on 11 November 2011 provides for a 0% rate on dividends paid to a company (other than a partnership) that holds directly at least 10% of the voting rights of the payer company for at least 12 months; the rate will be 5% where the dividends are paid to a company (other than a partnership) that holds at least 10% of the voting rights of the payer; the rate in all other cases will be 15%. Interest and royalties will be taxed in the state of residence of the recipient.

Indonesia – See article in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120224_7.html

Luxembourg-Russia – See article under Russia in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120224_9.html

Mexico- Bahrain – The 2010 treaty entered into force on 22 February 2012 and will apply from 1 January 2013. When in effect, a 4.5% withholding tax rate will apply for interest paid to a bank; otherwise the rate will be 10%. The rate on royalties will be 10%. The treaty does not provide a maximum withholding tax rate for dividends.

Norway-Georgia – When in effect, the treaty signed 10 November 2011 provides that the withholding tax rate on dividends will be 5% if paid to a company (other than a partnership) that directly holds at least 10% of the capital of the payer company; otherwise the rate will be 10%. Interest and royalties will be exempt.

New Zealand – See article in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120224_8.html

Russia-Switzerland – See article under Russia in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120224_9.html

Singapore-United Kingdom – When in effect, the protocol to the 1997 treaty signed on 15 February 2012 will exempt dividends unless paid by a real estate investment trust (which will be subject to withholding tax at a rate of 15%). The rate on interest will be 5%, with an exemption for interest paid to or by a bank or similar institution (in addition to government-related exemptions). The rate on royalties will be 8%. The protocol also removes from the definition of royalty those payments for the use of, or the right to use, industrial, commercial or scientific equipment.

Are You Getting Your Global Tax Alerts?

Throughout the week, Deloitte provides commentary and analysis on developments affecting cross-border transactions on a free subscription basis delivered straight to your email. Read the recent alerts below or visit the archive.
Subscribe: http://www.deloitte.com/view/en_GX/global/insights/browse-by-content-type/email-alerts/index.htm
Archives: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/article/c18d173f622d2210VgnVCM100000ba42f00aRCRD.htm

No new alerts were issued this week. Be sure to refer to the archives to ensure that you are up to date on the most recent releases.

Have a question?
If you have needs specifically related to this newsletter's content, send us an email at clientsandmarketsdeloittetax@deloitte.com to have a Deloitte Tax professional contact you.