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## Chile's President submits amended tax reform proposal

Chile's President submitted a tax reform proposal on 2 August 2012, withdrawing and replacing the proposal submitted 2 May 2012. The new proposal simplifies the original proposal by eliminating several items that were controversial and risked rejection by Congress, and by amending some of the original proposals. (For a discussion of the May proposals, see the 29 June 2012 edition of *World Tax Advisor*.)
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/120629_2.html

Proposals withdrawn in their entirety are those affecting the tax-free reorganization rules; taxation on withdrawals in excess of taxable profits; the thin capitalization rules; reductions in capital; the reinvestment of profits mechanism; the tax rate for the highest brackets under the global progressive income tax applicable to individuals resident in Chile; the rates for customs duties; and the introduction of a new green tax.

The August proposal would reduce the stamp tax rate on credit operations from 0.6% to 0.4%, instead of the original proposed reduction to 0.2%. Similarly, for loans payable on demand or without a maturity date, the August proposal would reduce the tax rate from 0.25% to 0.16%, instead of 0.1% as originally proposed.

Although the concept of Chile-source income would still be broadened to include an indirect sale of shares/quotas in a Chilean entity made by a seller resident abroad, regardless of whether the purchaser is domestic or foreign, the August proposal adds complexity and uncertainty by providing additional requirements and including not only the indirect disposal of shares of Chilean companies but also an indirect disposal of a permanent establishment and movable and immovable assets situated in Chile. However, the new rules also provide relief from the expansion to the sourcing rules for disposals resulting from a reorganization process.

Proposals reiterated without modification from those submitted in May include:



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- Increasing the corporate tax rate from 18.5% to 20% on earnings accrued as from 1 January 2012 (from 1 September 2012 for income subject to the single corporate tax).
- Extending the single corporate tax regime on capital gains that currently is available only on the transfer of shares in Chilean public corporations (SAs) and joint stock corporations (SpAs) to other legal entities, such as limited liability partnerships (provided the relevant requirements are fulfilled).
- To conform their tax treatment with that of SAs and SpAs, the tax basis for the disposal of shares or quotas in legal entities other than SAs or SpAs would be the acquisition cost indexed for inflation, unless a "Decree Law 600 foreign investment contract" is in place, in which case the basis would be the higher of the acquisition cost indexed for inflation and the foreign currency effectively invested in Chile converted into Chilean pesos at the exchange rate on the date of the disposal. (Decree Law 600 contracts are provided for under a special regime available to foreign investors bringing at least USD 5 million of funds into Chile.)
- Extending the scope of taxation of a Chilean permanent establishment of a nonresident company to include (in addition to Chilean-source income) any foreign-source income attributable to the PE. Further, the PE would be treated as a separate and independent entity from its head office, and all transactions between the PE and its head office would have to be on arm's length terms.
- Replacing the transfer pricing rules with rules that conform to the OECD transfer pricing guidelines and that enhance the Chilean tax authorities' ability to adjust prices in related party transactions.

Because the President submitted the new proposal to the Congress for its immediate discussion, it will receive priority.

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## China:
## Timetable for expanded VAT reform pilot announced

China's State Council announced on 25 July 2012 that the VAT reform pilot program in Shanghai will be expanded to eight provinces/cities. The Ministry of Finance and the State Administration of Taxation jointly issued a circular on 31 July 2012 (Circular 71) that formally sets out the timetable for, and scope of, the expanded program.

The VAT reform pilot commenced on 1 January 2012 in Shanghai and applies to the transportation and certain modern service industries, with the intention that the reform program eventually would be expanded nationwide. The pilot aims to resolve the double or multiple taxation issues that arise under China's current indirect tax system, which includes both a VAT levied on the supply of goods, the provision of repair, processing and replacement services, and on imports, and a Business Tax (BT), levied on the provision of other services and the transfer of intangibles and real property. Different rates are imposed under the VAT and BT regimes, and unlike VAT, an input tax credit is not available under the BT regime. The reform will gradually replace the dual tax system with a single system applying to the supply of both goods and services.

According to Circular 71, the expanded program will be phased in between September and December 2012, as follows:

- Beijing: 1 September;
- Jiangsu and Anhui: 1 October;
- Fujian (including Xiamen) and Guangdong (including Shenzhen): 1 November; and
- Tianjin, Zhejiang (including Ningbo) and Hubei: 1 December.

The applicable industry sectors and policies in the eight provinces/cities will be the same as those of the Shanghai pilot; the transportation and specified modern service industries are currently participating. However, the finance and construction sectors, which were expected to be included during the expansion of the pilot to other locations, are still not included within the scope of the pilot.

The circular also mandates that the local tax authorities immediately begin to prepare affected industries for the pilot program to ensure a smooth transition and, once the program starts, to monitor its progress. Some local authorities already


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have been proactive in this regard, by conducting taxpayer training sessions, initiating verification of taxpayer status and testing systems and equipment for tax filing/administration purposes and for the issuance of invoices.

## Comments

When the Shanghai pilot was first announced on 26 October 2011, it was envisaged that Shanghai was just the first step in a gradual transition from BT to VAT. The State Council's announcement on 25 July included a potential start date of 1 August for the new locations, but there were concerns that the one-week lead time was insufficient for taxpayers to be adequately prepared for the rollout. Circular 71 is welcome as it confirms the timetable for the eight provinces/cities and clarifies that 1 August is the start date to do the preparation work for the reform in those locations. Nevertheless, with less than four weeks before the first of the expanded pilots, businesses in the affected areas need to ensure that they understand the overall impact of the VAT reform pilot, as well as the technical and practical issues that have surfaced during the Shanghai pilot.

## Technical issues

Application for exemption for services provided overseas – Since development of the services sector is one of China's primary objectives, it is imperative for the pilot program to focus on improving China's competitiveness as regards the provision of services, especially services provided overseas. Previously issued guidance clearly laid out the possibility for services invoiced overseas to be exempt or zero rated (services eligible for zero rating and VAT exemption were initially provided in Circular No. 131 and Bulletin No. 13, along with the conditions needed to qualify for zero rating). However, given that most services provided overseas should be VAT exempt, it is important that the Chinese authorities issue guidance so that taxpayers clearly understand what is required to qualify for the exemption. According to a recent survey carried out by Deloitte, more than 50% of businesses stated that it has not been possible to apply the VAT exemption, with the result that many qualifying services are subject to VAT at 6%, which may actually increase the tax burden for the overseas recipient. Seven months have passed since the launch of the Shanghai pilot, and this remains one of the most critical issues where guidance is needed to clarify the conditions that must be satisfied to obtain the VAT exemption.

Supplies between the same legal entity – The tax treatment of supplies between the same legal entity (e.g. branch to branch, head office to branch, hereinafter referred to as "establishment") is another area where clarification is needed. Under the VAT rules, a branch and its head office are considered different VAT payers. Prevailing VAT rules contain a deemed supply rule for the supply of goods between establishments within the same legal entity; VAT charged by one establishment is generally creditable by another, so the net impact is nil from the legal entity's perspective. However, it is unclear whether there is a deemed supply rule for the supply of pilot services between different establishments within the same legal entity. Particularly during the period in which the VAT pilot is limited to specific locations, VAT charged by one establishment may not be recoverable by an establishment in a location outside the pilot which remains a BT payer and consequently, it becomes an absolute cost to the business. It is therefore important for affected businesses to know whether the SAT will issue clarifications on this issue.

Representative offices of foreign law firms – It also is unclear whether the pilot program applies to representative offices (ROs). Various approaches have been taken in Shanghai, especially in the case of foreign-invested law firms established in the form of an RO. Such firms are able – and required – to file taxes based on an "actual income" basis and their services should fall under the "consulting service" category according to the rules governing the pilot program. Some local tax authorities allow these law firms to participate in the VAT reform, while others do not due to the RO status. Thus, it is in the interest of law firms to know whether they will be covered by the pilot program.

VAT deduction – The expansion of the VAT pilot program should allow more companies to recover input VAT. Therefore, it is possible that the tax authorities will more closely scrutinize input VAT claimed by taxpayers. Taxpayers should carefully review existing internal control procedures to determine whether they have sufficient controls in place to ensure the full recovery of input VAT and make improvements if necessary.

Inclusion in the pilot – While the pilot rules attempt to define the covered services, some of the definitions are broad and not sufficiently detailed, making it difficult to match services provided by a company with the services covered by the VAT pilot rules in some cases. Taxpayers need to assess whether their services will fall within the scope of a specific covered category and the potential impact on their business. If it is beneficial to join the pilot, the business must present convincing arguments to the in-charge tax bureau.


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### Practical issues

Several practical issues also need to be addressed:

- The most formidable challenge remains communication, especially with customers, on the impact of the VAT charge to pricing; although this is a commercial issue, internal understanding and agreement are needed to manage the discussion. To ensure there is an ability to charge VAT, thus preserving a company's top line revenue, it is critical to understand how to address the discussion with customers and to have an internal execution strategy.
- Tax clauses in legal agreements also need to be examined to determine whether VAT can be charged (given that BT is a tax-inclusive charge, service contracts probably quote all sales fees as tax-inclusive). Contracts need to be examined now so they can be renegotiated as soon as possible; otherwise, there will be no legal basis to allow the charge to VAT, which means the company likely will have to bear any additional tax cost.
- VAT functions differently to BT. Thus, to ensure compliance requirements are met, it will be crucial for businesses to automate the issuance of the special VAT invoices, VAT ledgers and VAT returns. Many ERP systems have functionalities to automate compliance requirements, but this needs to be planned for and implemented.
- Finally, the VAT reform is a positive development for many businesses *provided* it can be applied in a methodical manner. However, the success of transitioning from a BT system to a VAT system also requires a comprehensive and analytical approach of the kind that Deloitte has worked to develop.

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## Czech Republic: New investment incentives available

Amendments to the Czech Investment Incentives Act that came into effect on 12 July 2012 create additional opportunities for investments in manufacturing and in technology centers and strategic service centers.

Investors satisfying the conditions set out below (among other criteria) are eligible for 10 years of corporate income tax relief of generally 40% of eligible investment costs (provided as a credit). Eligible investment costs are calculated as the fixed assets for production or as the payroll costs of the new jobs incurred with respect to the project during the 24-month period after filling the vacancy for technology centers and strategic service centers.

Work on an investment project (i.e. the acquisition of assets, including acquisition orders or commencing construction) may not begin before CzechInvest approves the project. Other basic investment requirements (which must be fulfilled within three years from the date the government provides confirmation on the investment project) are as follows:

- Manufacturing – The minimum investment must be EUR 2 or 4 million (depending on the region), at least 50% of which must be invested in new machinery.
- Technology centers – The minimum investment must be EUR 400,000 and at least 40 new jobs must be created. Activities qualifying as technology centers include applied research and the development and innovation of hi-tech products, technologies and production processes.
- Strategic service centers – There is no minimum investment requirement, but at least 100 new jobs (40 for software development) must be created. Activities qualifying as strategic service centers include software development or innovation and repairs of hi-tech equipment, as well as handling the management, operations and administration of the internal affairs of companies.
- In general, whether in manufacturing or in a technology center, at least 50% of the minimum investment must be financed from the company's own equity.


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Large-scale strategic investments in manufacturing and in technology centers also are eligible for direct capital support (i.e. cash grants) of 5% of eligible costs, up to a maximum of EUR 60 million or EUR 20 million, respectively. The conditions for qualifying as a large-scale strategic investor in the manufacturing industry require a minimum investment of EUR 20 million in fixed assets and the creation 500 new jobs, with strategic investments in technology centers requiring a minimum investment of EUR 8 million in fixed assets and the creation of no fewer than 120 new jobs. If the strategic investment involves introducing or extending production and concurrently building and extending a technology center, the direct capital support (cash grants) for the recipient may be increased to 7% of the total eligible costs.

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## India:
## AAR rules deemed fees for technical services can be taxed in India

India's Authority for Advance Rulings (AAR) ruled on 30 May 2012 that a U.S. company is liable to tax in India on a portion of the fees it received for the repair and overhauling of industrial gas turbines sold to an Indian public sector company (ICo) installed at an offshore location of ICo.

The AAR confirmed that the independent service contract for repair and overhauling was "inextricably linked" to the supply of the turbines installed at the offshore location. The payment for repairs and overhauling was split between: (1) consideration for the granting of a non-exclusive license to ICo allowing the Indian company to work on replaced parts/new technology that were introduced while the turbines were overhauled for the company's own use; and (2) consideration paid for mere inspection activities and borescoping. The former was treated as fees for technical services (FTS) taxable under India's Income Tax Act, 1961 (ITA), and also as fees for included services (FIS) under the royalties article (article 12(4) read in conjunction with article 12(3)) of the India-U.S. tax treaty. With regard to the latter, because the inspection activities and borescoping did not satisfy the requirement under treaty article 12(4) that they "make available technical knowledge, experience, skill, know-how, or processes," the consideration paid for them was not FIS and thus not taxable in India, subject to the U.S. company not being determined to have a permanent establishment in India.

### Facts of the case

The Applicant, a U.S.-incorporated company engaged in the manufacturing of industrial gas turbines, supplied turbines to ICo, which were installed at an offshore location. The contract for supply was supported by two other contracts: one for troubleshooting repairs and maintenance of the turbines and the other for repair and overhauling services with ICo through a tender process. Accordingly, it was agreed that periodic inspection activity would be conducted to examine the health of the installed parts of the turbine. On detection of a defect in the turbines, ICo would transport the turbines to the U.S. for the Applicant to correct the defect and subsequently return the overhauled turbines to India.

The dismantling, stripping and inspection of the turbines was carried out by the Applicant at its work site outside India. The Applicant provided a report of the result to ICo, along with details of the alterations via a drawing and data, granting the right to use the technical information furnished for a royalty-free non-exclusive license, but not allowing the information to be used for the benefit of anyone else apart from ICo.

The Applicant requested a ruling from the AAR as to whether the amount received from ICo under the contract for repair and overhaul services was taxable as FIS and subject to withholding tax in India.

### AAR ruling

Normally, under an overhaul contract, when the machinery is overhauled and returned to the owner so that the owner can resume its business, the arrangement cannot be said to involve making available any technical knowledge or information (as required for the consideration paid for the services to qualify as FIS under the treaty). The AAR acknowledged that all activities relating to the overhaul service, apart from the inspection activity, were carried out outside India, leading to the conclusion that the major part of the overhaul service was performed outside India.


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The part of the split consideration that was for the inspection activity carried out in India was not subject to tax in India, since the activity did not make available any technical knowledge or skill as required for the consideration paid to qualify as FIS under treaty article 12(4). On the other hand, as the tax authorities had argued, the Applicant had an intellectual property right over the data being granted under a royalty free, non-exclusive license. Hence, by granting the royalty-free license, the Applicant did make available to ICo technical knowledge or information that it could use for its own benefit.

In rejecting the Applicant's contention that the granting of the royalty-free license constituted an insignificant part of the transaction value, the AAR held that, "an assertion in the agreement that the non-exclusive license was being granted royalty free, cannot estop Revenue from contending that a part of the transaction value must be ascribed to the grant of that license." The AAR, therefore, concluded that part of the payment for the overhaul services could be attributed to the granting of the non-exclusive license to ICo (in relation to replaced parts or the upgrading of machinery) for its own use and that that part of the payment constituted FIS within the meaning of treaty article 12(4)(a).

Comments

While the importance of the ruling lies in its reinforcement of the crucial nature of the "make available" test for the treatment of services as FIS under a treaty, the proposition that a royalty-free non-exclusive license to use data relating to the equipment satisfies the "make available" criterion also is noteworthy. Interestingly, the AAR did not shed any light on its position as regards the Indian tax authorities' contention that, under treaty article 12(7), FIS is deemed to arise in India and is therefore taxable in India subject to the limitations imposed by article 12(2) where the payer is an Indian resident.

The "split-up" approach to composite contracts adopted by the AAR could have far-reaching consequences for payments made by Indian companies to nonresidents under such contracts. To the extent that approach concerns royalties, it broadly is in line with the technical explanation on treaty article 12(4)(a) under the "Memorandum of understanding concerning FIS in Article 12." The ruling will have significant implications for similar composite service contracts where the split-up approach is followed, with similar payments to nonresidents for the kinds of cross-border services that are commonly rendered to Indian companies being subject to closer scrutiny. However, it remains to be seen how the attribution rule will be applied in practice to composite contracts in general.

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## Indonesia:
## New settlement and reporting procedures for upstream oil and gas industry

The income tax calculation, payment and reporting procedures for taxpayers in the upstream oil and gas (O&G) industry have undergone changes as a result of an implementing regulation (MOF-79) issued by the Indonesian Ministry of Finance (MOF) and applicable 60 days from its promulgation date of 24 May 2012 (i.e. as from 23 July 2012). Notable changes are as follows:

- Under criteria to be defined and based on domestic supply needs, upstream O&G contractors may be required to settle their monthly corporate income tax liabilities using oil and/or gas as a cash payment substitute. For oil, payment will be calculated based on the Indonesian crude oil price prevailing in the month the income tax is payable, and for gas, the calculation will be based on the contractor's average price of sales made in the month the income tax is payable.
- Income tax must be remitted to the MOF U.S. dollar account at the Indonesian central bank. The monthly income tax is due by the 15th of the month following the month for which the tax is payable. Any year-end income tax underpayments are settled by the end of the fourth month following the end of the tax year. Failure to meet the payment deadline will result in penalties. Under MOF-79, tax overpayments at year-end must be settled in accordance with the prevailing tax laws and regulations. Thus, a contractor would claim a refund in its annual tax return submitted to the tax authorities, which would automatically trigger a tax audit. The industry's prior practice of offsetting any income tax overpayment against the subsequent period or year's income tax liability is unlikely to be allowed going forward. Further clarification on this issue is needed.


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- Contractors are required to have their tax payment slip validated by the MOF Directorate General of Budget and a delivery affidavit prepared and signed by the contractors and BP Migas in the case of O&G payments in kind. Given the short period between the tax payment deadline (15th of the subsequent month) and the tax reporting deadline (20th of the subsequent month), it remains to be seen how the validation procedure will be completed in a timely manner.
- Contractors must submit monthly and annual state revenue reports to the Directorate General of Taxation, the MOF Directorate of Non-Tax Revenue and BP Migas using a prescribed form. The monthly report will serve as a periodic income tax return and must be submitted at the latest by the 20th of the month following the month for which the tax is payable. The annual revenue report must be attached to the contractor's annual corporate income tax return. The validated tax payment slip and evidence of income tax remittance (or delivery affidavit in the case of in-kind income tax settlements) must be attached to the monthly and annual reports. Penalties can be imposed for failure to meet the reporting requirement and/or the MOF Director General of Budget can delay settlement of the government's obligations to the contractor.

Previously, monthly tax paid by O&G contractors was, in practice, only reported to the Directorate of Non-Tax Revenue and BP Migas. The regulation now provides the Directorate General of Taxation with clearer authority to monitor the timeliness of tax settlements and reporting by upstream O&G contractors. It is expected that the tax authorities will take immediate action when any irregularity is noticed in a contractor's payment or reporting.

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## Poland:
## Planned changes to VAT Act

The Polish government intends to amend the VAT Act, with new rules likely coming into effect on 1 January 2013. The scope of the planned changes is significant and would affect most businesses operating in Poland. Although the draft law has not yet been presented to Parliament (this is expected in September), the Ministry of Finance is confident the law will be approved without major changes.

According to the current wording of the draft bill, the main changes affecting cross-border businesses would be as follows:

Abolishing the reverse charge mechanism for certain supplies – Currently, if a foreign entity that does not have a registered seat or fixed establishment in Poland is registered for Polish VAT and supplies goods and services to Polish VAT payers, the foreign entity generally is required to issue a VAT invoice without VAT. The Polish customer must apply the reverse charge, i.e. it will self-charge VAT and generally will be allowed to recover the VAT in the same month.

The bill would abolish the reverse charge mechanism with respect to local supplies of *goods*. As a result, if a foreign entity registered for VAT purposes in Poland supplied goods in Poland, it would have to issue an invoice with the appropriate Polish VAT, and that VAT would have to be declared in the VAT return submitted to the tax authorities. This change could result in cash-flow disadvantages for both the supplier and the customer, since the foreign supplier would have to declare VAT in its Polish VAT return and the Polish customer would have to pay the VAT to the foreign company.

It should be noted that the VAT treatment of the supply of *services* would not change, i.e. the reverse charge would continue to apply (with some exceptions). This may result in difficulties and confusion in cases where a foreign entity registered for Polish VAT supplies both goods and services. Uncertainties could arise in all situations in which the provision of services and goods are closely linked because they could be treated as a composite supply. This would mean that if the main supply is the supply of goods, the accompanying services also would be charged with Polish VAT; and if the main supply is the supply of services, the accompanying supply of goods would not be charged with Polish VAT.

Appointment of tax representative for imports – Under existing VAT rules, foreign entities importing goods into Poland to further transport them to another EU member state are obliged to register for VAT in Poland. The new bill would allow such entities to appoint a tax representative in Poland instead of having to register for VAT purposes, thus easing the


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administrative burden on such companies. The representative would be responsible for VAT settlements of the foreign entity.

Abolishing time limits related to movement of own goods from another EU member state to Poland – According to Polish VAT law, the movement of a supplier's own goods from another EU member state to Poland generally is treated as an intra-community acquisition of goods (ICA) in Poland and, thus, triggers a VAT registration obligation in Poland. There are some exceptions to this rule that depend on the number of days the goods remain in Poland. For example, there is no ICA if goods are transported to Poland to be used for the purposes of rendering services (e.g. rental) for a period of less than 24 months; if the goods are used for a longer period, registration is required. Some of the time limits do not clearly result from the EU VAT directive and may cause discrepancies in the VAT treatment of the same movement of goods in the country of the dispatch and arrival. The new bill would abolish the time limits, which would be a positive change for taxpayers.

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## In brief

China – Chongqing Customs issued a circular on 10 April 2012 announcing the implementation of an advance ruling system on the origin of imported goods. The advance ruling on origin, along with Customs' pre-classification and pre-valuation mechanisms, aims to facilitate the importation of goods into China and improve the efficiency of customs clearance.

Costa Rica – As from 1 August 2012, all taxpayers must file their withholding tax returns electronically.

European Union – The European Commission has tabled a proposal for a "fast track" process that would enable EU member states to respond more quickly to serious and substantial VAT fraud. The proposed "Quick Reaction Mechanism" would allow member states to rapidly introduce extensions to the list of goods and services covered by the reverse charge mechanism that is already in use in many countries as a means of preventing "missing trader" fraud. The reverse charge currently can be applied only to a limited range of goods and services, and extending its application involves a time-consuming derogation process. If the Commission's proposal is adopted, it should allow the Commission to grant a temporary approval of a derogating measure that could stem losses due to fraud while the "normal" derogation process is followed. It is anticipated that such temporary approvals could be granted within one month of a request from a member state.

Israel – The standard VAT rate will increase from 16% to 17% on 1 September 2012.

Jersey – When Goods and Services Tax (GST) was introduced in Jersey in 2007, a grandfathering provision allowed long-term contracts entered into before 17 August 2007 to escape GST charges in certain circumstances. That transitional relief is due to expire on 16 August 2012. From that date, GST at 5% will be due on supplies under long-term contracts that previously were GST-free under the transitional rule. Affected businesses will need to consider their contract terms and will have to take account of the GST charges when invoicing on or after 17 August.

Netherlands – The standard VAT rate will increase from 19% to 21% on 1 October 2012.

Spain – The standard VAT rate will increase from 18% to 21% on 1 September 2012.



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Thailand – A personal income tax exemption is available for gains derived from the trading of securities listed on the ASEAN stock exchange via the trading system of the stock exchange of Thailand. The exemption does not apply to gains from the sale of treasury bills, bonds, bills or debentures.

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Taiwan
Capital gains tax introduced on sale of securities
The Taiwan Legislative Yuan passed an amendment to the Income Tax Act on 25 July 2012 that introduces a capital gains tax on the sale of securities. The new rules, which will affect both individuals and enterprises, come into effect on 1 January 2013. [Issued: 27 July 2012]
URL: https://www.deloitte.com/view/en_GX/global/services/tax/cross-border-tax/international-tax/255ea7247e8c8310VgnVCM2000001b56f00aRCRD.htm
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