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In this issue:

Dividend withholding tax and hybrid entities under amended Germany-U.S. tax treaty

The lower tax court of Cologne recently published its decision dated 24 April 2012, regarding the tax treatment of dividends paid by a German resident company to a U.S. S Corporation (S Corp) under the 1989 Germany-U.S. tax treaty, as amended by the 2006 protocol ("amended treaty"). The court held that such dividends qualify for the general 15% withholding tax rate under article 10(2)(b) of the treaty; it denied the further reduced rate of 5% under article 10(2)(a). The court based its decision on article 1(7) of the amended treaty (introduced by the 2006 protocol), which addresses the applicability of the amended treaty to hybrid entities.

This is the first decision by a German tax court on the treatment of an S Corp for dividend withholding tax purposes under the amended Germany-U.S. treaty, and it should be relevant for other U.S.-outbound/German inbound structures involving hybrid entities, i.e. entities that are treated as fiscally transparent in one country and as corporations in the other country.

Treaty provisions

According to article 1(7), income received by entities that are fiscally transparent under the laws of either contracting state will be treated as received by a resident of a (contracting) state to the extent the laws of that state treat such income as the income of a resident of that state.

Article 10 of the amended treaty provides for three withholding tax rates, depending on the extent of the recipient's participation in the distributing company, as follows:

- 0% where the recipient holds directly at least 80% of the voting stock of the distributing company for 12 months on the date on which entitlement to the dividends is determined and provided the taxpayer qualifies for treaty benefits under one of the tests in article 10(3) and the limitations on benefits article;

- 5% where the recipient holds directly at least 10%, but less than 80%, of the voting stock of the distributing company; and
- 15% in all other cases.

Facts of the case and decision of the court

The case involved a U.S.-resident corporation that elected to be treated as a transparent entity under subchapter S of the U.S. Internal Revenue Code (sections 1361-1378). As a result, the corporation was treated as a transparent entity for U.S. tax purposes and not subject to income tax (an S Corp calculates its income in the same manner as a regular corporation, but instead of the corporation being taxed on the profits, its owners are taxed on their shares of the profits of the corporation). In 2008, the U.S. corporation held 50% of the shares in a German limited liability company (GmbH) and received a dividend from the subsidiary. The German GmbH withheld a domestic dividend withholding tax of 21.1% (the applicable rate at the time) on this payment. The U.S. corporation applied for a reduction of the withholding tax to 5% based on article 10(2) of the amended treaty and requested a refund of the excess tax withheld. The German tax authorities denied the request and granted only a reduction to the 15% rate under article 10(2)(b).

To be entitled to the 5% withholding tax on dividends, article 10(2) of the amended treaty requires, inter alia, that the dividends be derived and beneficially owned by a company resident in the other contracting state. Article 4(1) defines the term "resident of a Contracting State" to mean "any person, who under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature." As a result, application of the treaty is directly linked to the tax treatment of the recipient in its state of residence. Because an S Corp is treated as a transparent entity for U.S. tax purposes and, therefore, is not subject to U.S. income tax, it cannot be treated as a "resident of a Contracting State," so is not entitled to benefit from a reduced dividend withholding tax under the 2006 treaty according to the lower tax court of Cologne.

The lower tax court clarified that the amended treaty does not include a residence fiction for transparent entities as contained in article 4(1)(b) of the original text of the 1989 treaty (based on the 1981 U.S. model tax treaty), which provided that, where income was derived or paid by a partnership, estate or trust, the term "resident of a Contracting State" applied only if the income derived by the partnership, etc., was subject to tax in that state as the income of a resident, either in its hands or in the hands of its partners or beneficiaries. According to the court, article 1(7) of the amended treaty, which deals with hybrid entities, cannot be interpreted in such a way that it deems an entity to have residence in a contracting state, and justified this interpretation by reference to the wording of article 1(7). The lower tax court also confirmed that the residence of an entity is a prerequisite for the application of article 1(7) (i.e. so that the source state is required to grant treaty benefits), rather than the consequence of the application of this provision.

Comments

The tax treatment of dividends paid by a German entity to an S Corp (or an LLC that is treated as transparent for U.S. tax purposes and nontransparent from German purposes) in light of the 2006 protocol and article 1(7) has been broadly debated in German tax literature. In 2008, the Federal Tax Court (BFH) ruled on this issue under the 1989 Germany-U.S. tax treaty, concluding that it was possible for an S Corp to benefit from the reduced 5% withholding tax based on articles 10(2)(a) and 4(1)(b). Since the amended treaty does not contain a provision comparable to article 4(1)(b) or a specific residence fiction for transparent entities, German tax practitioners have questioned whether otherwise qualifying payments would continue to benefit from the same treatment; in other words, whether the protocol's introduction of article 1(7) would provide the same relief.

The lower tax court of Cologne's April 2012 decision is a first step in resolving this question and should be relevant to the interpretation of article 1(7), not only for S Corps, but also for U.S. LLCs that are treated differently for German and U.S. tax purposes. Given that the right understanding and application of article 1(7) has such practical relevance, taxpayers should consider the following:

- Unlike article 4(1)(b) of the 1989 treaty, which applied only to partnerships, estates or trusts, article 1(7) of the 2006 protocol is broader, applying to any entity that is treated as a transparent entity by either contracting state. Even entities in third countries could fall under article 1(7) if treated differently for German and U.S. tax purposes.

- As a result of article 1(7), the source state is obliged to grant treaty benefits for profits derived by or through a hybrid entity only to the extent such income or profits are treated as income or profits of a person resident in the residence state based on the tax rules of the state of residence. The source state, therefore, is obliged to follow the rules of the residence state regarding the tax treatment of the hybrid entity. By virtue of this treatment, double taxation of such profits in the source and residence states should be prevented, but only if and to the extent the residence country taxes the profits.
- Shareholders of an S Corp must be U.S. citizens or residents (according to section 1361(b)(1)(C) of the U.S. Internal Revenue Code), and it is at the level of the shareholder that the income and the profits of the S Corp are subject to U.S. taxation. Thus, it is the shareholder's status under the Germany-U.S. treaty that is decisive for determining whether the reduced rate of withholding tax under the treaty applies.

Looking ahead

The lower tax court of Cologne left some questions on the application of article 1(7) unaddressed. The court noted but explicitly did not decide the issue of whether article 1(7) also constitutes an attribution rule, i.e. whether it provides the answer to the question of who is to be regarded as deriving the income for treaty purposes in the circumstances in which article 1(7) applies. However, it is possible that the decision could be interpreted as indicating that the article does constitute an attribution rule. Such an interpretation would have a significant impact on other structures involving hybrid entities under the Germany-U.S. treaty.

The court also did not discuss whether the shareholders of an S Corp are obliged to request a refund of withholding tax on an individual basis or whether the company itself can request such a refund (based on the reduced rate that applies to its shareholders) under article 29 of the treaty (refund of withholding tax) and section 50d of the German Income Tax Code. By not questioning the legality of the notice issued by the German tax authorities to the company allowing for the reduced 15% rate, the court appeared to grant the company the right to request a refund on a procedural basis. However, because the court did not specifically address this question, uncertainty remains. (It should be noted that the current draft of the Annual Tax Act 2013 contains a specific rule under which the qualification of an entity by the residence state also would be binding for the source state for procedural issues, i.e. only the person that qualifies as the taxpayer in the residence state would be allowed to request a refund/apply for a withholding tax exemption certificate.)

The lower tax court's decision is now pending before the BFH. Taxpayers should carefully review applications for reduced dividend withholding tax on payments to S Corps and LLCs and refund notices, and ask the tax authorities for a suspension of any appeal procedures until the BFH issues its decision.

The decision illustrates the uncertainties of using a U.S. hybrid entity for investments into Germany. Despite the widespread use of hybrid entities for U.S. tax planning purposes, U.S. investors should exercise prudence when using such vehicles for international investments. Withholding tax triggered on dividends from Germany to the U.S. generally should be creditable for U.S. tax purposes; however, in a situation in which the U.S. tax position does not grant a foreign tax credit, the withholding tax could become a final tax burden. Options to invest into Germany without triggering a risk of German dividend withholding tax could include operating in Germany through a branch of a U.S. company or through a German partnership (typically a limited partnership (KG)). However, the conversion of an existing German corporate entity into a branch or partnership structure is complex and needs to be planned carefully, because, upon conversion, historic retained earnings may be deemed to be distributed and thereby trigger withholding tax exposure.

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China: More steps taken to boost foreign trade

China's State Administration of Taxation (SAT) and the General Administration of Customs (GAC) released two sets of implementing regulations on 17 and 28 September 2012 that contain tax and Customs measures to promote the growth of foreign trade (Circular 432 and Bulletin 45). These regulations follow recent opinions issued by the State Council to stimulate trade, reduce administrative costs and facilitate a sustainable environment for the import/export sector, as well as guidance issued by the Ministry of Finance and SAT that clarifies and streamlines the export VAT refund rules.

Circular 432 – Circular 432 provides that all levels of the tax authorities should take the following steps to enhance administration of the export VAT refund:

- Accelerate the process for granting a refund;
- Assist exporters to better understand and utilize the relevant export VAT refund policies and administration rules;
- Strengthen communications with relevant departments, including the commerce administrative authorities, Customs, the People's Bank and the State Administration of Foreign Exchange, and establish and improve the information-sharing mechanism for export VAT refund-related data; and
- Provide regular updates to exporters on the status of their refund requests.

Bulletin 45 – Bulletin 45 introduces measures to improve Customs' supervision and services, expedite the reform of Customs administration, reduce clearance costs, simplify the supervision formalities relating to bonded materials/goods, preserve fair trade and further facilitate a sustainable environment for the export sector. The following measures are of particular relevance to import/export companies:

- As from 15 November 2012, the favorable Customs clearance model for Category AA or A companies will be extended to include manufacturing export companies in Category B that do not have any record of smuggling for the past year and that have a solid credit rating. (China Customs measures a company's overall performance by applying a Customs compliance rating of AA, A, B, C or D. Companies with an AA or A rating are subject to simplified Customs clearance measures, those with a B rating are subject to regular Customs administration measures and enterprises with ratings of C or D are subject to enhanced supervision.) Eligible companies will be permitted to make a customs declaration at the customs office where the company is registered, and obtain customs clearance at the office where the goods are physically imported or exported.
- During the period 1 October 2012 to 31 December 2013, AA and A companies will not be downgraded even if any of following requirements for AA/A category status cannot be met, provided the company has fewer than 20 instances of noncompliance:
    - The gross import/export value is USD 0.5 million or above in the previous year;
    - The company has issued at least 3,000 import or export declarations in the previous year (for Customs brokers); or
    - The error ratio of Customs declarations is within 3% (for AA companies) or 5% (for A companies).

  Companies that have been downgraded from Category AA/A status because of failure to meet these requirements can apply to have their AA/A status restored.
- The supervision formalities for bonded materials/goods will be simplified:
    - For bonded goods being manufactured in special supervision areas, but sold domestically, the formalities will be simplified for approving such goods to be shipped back to special supervision areas for repair or maintenance purposes;
    - The formalities for approving domestic sales of bonded materials/goods of AA/A or B companies and relevant import tax filings will be carried out on a consolidated, rather than a transaction-by-transaction, basis where effective guarantees can be provided; and
    - Supervision formalities for bonded materials/goods under the Processing Trade Relief will be further simplified; and
    - Special implementation guidelines to promote the integrated circuit industry will be studied and issued.
- Certain costs (e.g. costs for printing the "certification copy for foreign exchange settlement" of import and export declaration form, the "copy for an export VAT refund" of export declaration forms, etc.) will not be charged as from 1 October 2012.

Comments

The new regulations will make the export VAT refund process more efficient and, therefore, mitigate the cash flow burden on affected companies. Taken together with the State Council opinions and the guidance issued by the Ministry of Finance and SAT, the new regulations offer exporters an opportunity to review their operations and business models with a view to fully utilize these policies.

Since Customs has eased the requirements for granting AA/A category status, affected companies should review their category and operating status and take steps to obtain an upgraded status.

It should be noted, however, that despite the favorable measures, the tax and Customs authorities still are focused on the strict supervision of export VAT refunds and the import/export of goods. Circular 432 specifically directs the tax authorities at all levels to step up their evaluation mechanisms for export VAT refunds in order to prevent and crack down on tax fraud. Customs also emphasizes the monitoring of anti-smuggling activities in Bulletin 45. With the slow-down of the import/export sector, it is likely that the tax authorities and Customs will act aggressively to collect underpaid taxes to meet the fiscal revenue targets.

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European Union: Proposal on financial transaction tax to go forward

The European Commission has produced the formal proposal for enhanced cooperation on the financial transaction tax (FTT), which must be approved by the Council of Ministers. Ten EU countries (Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain) want to proceed with the FTT after failing to gain support on the controversial measure from all 27 EU member states.

Enhanced cooperation is a procedure that can be invoked when a group of at least nine member states decide that they will go forward with an initiative proposed by the Commission and it proves impossible to obtain unanimous agreement by all of the member states. The Council of Ministers will have to approve taking the FTT forward in this way, but some non-participating member states have already indicated they would not block those states that wished to go ahead.

The Commission says that the FTT will be based on the original directive, although there is no word at all on how revenue will be shared between the 10 member states. The FTT is a low rate broad-based tax that would be levied on all financial transactions (mainly buying/selling shares, bonds and derivatives) with any connection to the FTT area. Market-makers doing business with those in the FTT area may be required to register and collect the tax from counter-parties.

The European Parliament also will have to weigh in on the proposal as part of the enhanced cooperation process, i.e. once matters move outside the unanimity required at the Council level for EU-wide taxation.

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India: Expert committee issues draft report on taxation of indirect transfers

The expert committee appointed by the Indian prime minister to examine and make recommendations on the controversial measure to retroactively tax indirect transfers of shares or interests in a foreign company that derives its value from underlying assets in India issued its draft report on 9 October 2012. The report addresses the concerns of foreign investors and makes several important recommendations on the taxation of indirect transfers by nonresidents.

That measure, contained in the 2012 budget, seeks to tax offshore transfers dating back to 1 April 1961. According to the provision, the transfer of shares or interests in a foreign entity will be deemed to be sourced in India if the foreign entity derives its value, directly or indirectly, substantially from assets located in India.

The committee has suggested that the indirect transfer tax should not be applied retroactively, i.e. it should apply only to transactions entered after 31 March 2012. However, if the government does not withdraw the retroactive application, the committee suggests that the tax should not be recovered from the payer and no interest and penalties should be levied.

With respect to future transactions, the committee has made various suggestions, including providing an exemption for private equity investors, participatory notes issued by institutional investors, foreign-listed companies and intra-group transfers in certain situations. The committee also recommends that the indirect transfer rules should apply only if the value of the assets located in India is more than 50% of the total assets of the target and there should be an exemption for transferors that hold less than 26% of the voting power in the holding company that owns the Indian assets.

The government will now consider the recommendations in the draft report and make changes to the tax law to the extent it accepts those recommendations.

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India:
Rules issued on tax residence certificate requirement for treaty benefits

The Indian government issued a "notification" on 17 September 2012 that specifies the procedure for taxpayers to obtain benefits under India's tax treaties. A measure in the Finance Act 2012 makes it mandatory for a nonresident to obtain a tax residence certificate from the authorities in its country of residence. The tax residence certificate must contain the following information:

- Name of the taxpayer;
- Status (individual, company, firm, etc.);
- Nationality;
- Tax identification number in the country of residence;
- Residence status for tax purposes;
- Period for which the certificate is applicable; and
- Address of the taxpayer for the period in which the certificate is applicable.

The tax residence certificate requirement could pose practical challenges for taxpayers, particularly if the certificate is required at the time the relevant payment is made. In some situations, the tax residence of an individual can be determined only after the end of the relevant tax year, and it may not be possible to obtain the certificate in advance. Since most payments from India are subject to withholding tax, this will need further clarification.

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Peru:
New treaty with Switzerland signed

Peru and Switzerland signed a new income tax treaty, protocol and accompanying diplomatic notes on 21 September 2012. The treaty is the first between the two countries and it is drafted in accordance with international standards with a view to strengthening economic relations between the contracting states.

The treaty will reduce the withholding tax rates on certain passive income, capital gains on the transfer of shares, fees for technical assistance and digital services, and it includes a most favored nation clause that will be triggered if Peru enters into another treaty that provides for lower residual tax rates. The treaty also includes a services permanent establishment (PE) provision and an extensive exchange of information article.

Withholding tax rates on dividends, interest and royalties

Dividends – The treaty provides for a general maximum withholding rate of 15% on gross dividends, with a reduced rate of 10% applying when the beneficial owner of the dividends is a company (other than a partnership) that holds directly at least 10% of the capital and voting rights of the distributing company.

Interest – Interest generally will be subject to a maximum 15% withholding tax, although where interest is paid to a bank in connection with any type of loan or to other companies under an installment sale of industrial, commercial or scientific equipment, the maximum rate will be 10%.

Royalties – Royalties will be subject to a maximum 15% withholding rate if paid for the use of, or the right to use, a copyright, patent, trademark or other similar intangible property, or for information concerning industrial, commercial or scientific experience (i.e. know how). For these purposes, the term "royalties" includes payments received from the rendering of technical assistance services and digital services, which will be subject to a 10% withholding tax.

Capital gains

The treaty contains provisions addressing the taxation of capital gains. Gains derived by a resident of a state from the alienation of shares of a company resident in the other state may be taxed in the other state if more than 50% of their value derives, directly or indirectly, from immovable property located in that other state. Unless this rule applies, gains derived by a resident of Switzerland from a direct or indirect alienation of shares or other securities representing the equity capital of a company resident in Peru also may be taxed in Peru, but the tax cannot exceed:

- 2.5% of the net gain in the case of transactions on a Peruvian stock exchange involving securities recorded in the Securities Market Public Registry;
- 8% of the net gain on transactions carried out in Peru; and
- 15% of the net gain in all other cases.

Services PE

Article 5(3)(b) of the treaty contains a services PE provision, under which an enterprise will be deemed to have a PE if services (regarding the same or related project) are carried out by the enterprise through individuals physically located in the other country for more than nine months (in the aggregate) in any 12-month period. Peru does not have an analogous provision in its domestic law PE definition. The services PE provision in the Peru-Switzerland treaty is substantially similar to the provision in Peru's treaty with Canada, although the threshold required to create a PE under that treaty is lower ("more than 183 days").

Entry into force

The treaty will enter into force after both countries have notified each other that their ratification procedures have been completed. With respect to withholding taxes, the treaty will be effective for amounts paid or credited on or after 1 January of the calendar year immediately following the year the treaty enters into force. For all other taxes, the treaty will be effective for taxable periods beginning on or after 1 January of the calendar year immediately following entry into force.

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United Kingdom:
Taxpayer in FCE Bank case prevails at Court of Appeal

In a decision issued on 17 October 2012, the U.K. Court of Appeal unanimously upheld the decision of Upper Tribunal in favor of the taxpayer in the FCE Bank case, a case involving various U.K. Ford and Jaguar companies seeking to claim losses from Ford Motor Company Ltd (FMCL).

The claimant company, (FCE), was a U.K.-resident company, as was FMCL, the surrendering company. The case related to years before the introduction of worldwide grouping in 2000, and concerned FCE's group relief claim in respect of its accounting period for the year ending 31 December 1994. Before the changes in 2000, there had to be a common U.K. parent for there to be a group. The U.K. tax authorities (HMRC) denied FCE's claim for group relief on the basis that FCE and FMCL were not members of the same group during 1994. The reason was that the shareholding relied upon to establish those companies as group companies was held by Ford Motor Company (FCM), a U.S. resident company.

The Upper Tribunal held that the non-discrimination article of the U.K.-U.S. tax treaty provided for relief between the U.K. subsidiaries. The Court of Appeal has now agreed; the court said that it was common ground that the denial to FCE of relief was discriminatory compared to the treatment that it would have had if FMC had been a U.K.-resident company. The issue was identifying the reason for that discrimination. The reason was the fact that FMC was U.S. resident rather than U.K. resident, not that FMC as not a company liable to U.K. corporation tax (as HMRC had argued). The purpose of the nondiscrimination article of the U.K.-U.S. treaty was to 'outlaw' the treatment that FCE otherwise would have suffered.

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In brief

European Union   Advocate General (AG) Mengozzi of the European Court of Justice (ECJ) has issued his opinion on the compatibility of one aspect of the Belgian notional interest deduction (NID) regime with EU law. According to the AG, excluding investment in a PE located in another EU member state from the calculation basis of the NID, while such an investment in a Belgian PE is taken into account, violates the freedom of establishment. The restriction cannot be justified on the grounds of the preservation of the coherence of Belgium's tax system or the allocation of taxing powers between EU member states. The ECJ will now rule on the case.

European Union   The European Court of Justice (ECJ) has ruled on the deferral of VAT refunds claimed by a Latvian company on its monthly VAT returns. The Latvian tax authorities had deferred the refunds because they exceeded an arithmetical threshold in Latvian VAT law. The ECJ held that this was not permitted under EU law. The decision could have implications in other situations where VAT refunds are not repaid promptly.

Greece   The rules governing the methods the tax authorities can use to carry out "indirect audits" to determine taxable income have been amended to apply to both individuals and companies. An indirect tax audit can be used by the authorities to determine the taxable income of an individual, as well as the gross income, output and taxable profits of an entrepreneur. The results of an indirect audit will be taken into account in determining other tax obligations of a taxpayer (VAT, etc.).

Guatemala   The Constitutional Court issued a decision on 3 October 2012 that temporarily reinstates the exemption from interest withholding tax that applied to certain foreign banks and financial institutions. As a result, if specific requirements are met, loans contracted with foreign banks or other financial institutions will not be subject to the 10% withholding tax as from the date of the court decision.

Hong Kong-EFTA   The 2011 free trade agreement between Hong Kong and the EFTA (European Free Trade Association) countries (i.e. Iceland, Liechtenstein, Norway and Switzerland) entered into force on 1 October 2012 for Iceland, Liechtenstein and Switzerland and will enter into force on 1 November 2012 for Norway. The parties will abolish all customs duties on imports and exports of industrial and certain other products originating in an EFTA member state or in Hong Kong, and no new customs duties may be introduced.

OECD On 19 October 2012, the OECD released revised discussion drafts on proposed changes to the commentary on the model treaty regarding permanent establishments, beneficial ownership and cross-border trading of emissions permits.

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.
URL: http://www.dits.deloitte.com

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

Bulgaria-Switzerland – When in effect, the treaty signed on 19 September 2012 to replace the current treaty dating from 1991 provides that dividends paid to a company that holds at least 10% of the payer company for one year before the dividends are paid will be exempt from withholding tax; dividends paid to pension funds and the reserve bank of the other contracting state also will be exempt. Otherwise, the rate will be 10 Interest paid between associated companies where the recipient has held a stake of at least 10% for at least one year will be exempt from withholding tax; otherwise, the rate will be 5%. The rate on royalties will be 5%.

Cyprus-Estonia – When in effect, the treaty signed a tax treaty on 15 October 2012 provides for taxation of dividends, interest and royalties only by the state of residence of the recipient.

Czech Republic-Switzerland – When in effect, the protocol signed on 11 September 2012 to amend the 1995 treaty provides that dividends will be exempt from withholding tax if paid to the central bank or a qualifying pension fund or similar institution, or if paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company for an uninterrupted period of at least one year; otherwise, the rate will be 15%. The protocol does not amend rates under the interest or royalties articles.

Estonia-Bahrain – When in effect, the treaty signed a tax treaty on 12 October 2012 provides for taxation of dividends, interest and royalties only by the state of residence of the recipient.

Estonia-Thailand – When in effect, the treaty signed a tax treaty on 25 September 2012 provides for a 10% withholding tax on dividends and interest. Royalties paid for industrial, commercial or scientific equipment will be subject to an 8% rate; the rate will be 10% in all other cases.

Estonia-Uzbekistan – When in effect, the treaty signed on 28 September 2012 provides for a 5% withholding tax on dividends paid to a company that holds directly at least 25% of the capital of the payer company; the rate in all other cases will be 10%. The rate on interest will be 5% and that on royalties, 10%. Estonia does not levy withholding tax on dividends or interest.

Germany-Spain – The 2011 treaty to replace the 1996 treaty entered into force on 18 October 2012 and generally will apply as from 1 January 2013 (certain administrative articles apply from the date of entry into force). 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 distributing company; otherwise, the rate will be 15%. The 5% rate will not be granted where the dividend recipient is a REIT (or a partnership mentioned in the 1966 treaty). Interest and royalties will be taxable only in the residence state.

Hong Kong-Switzerland – The 2011 treaty entered into force on 15 October 2012 and will apply as from 1 January 2013 for Switzerland and as from 1 April 2013 for Hong Kong. (The 2011 agreement superseded an agreement signed in 2010, which never entered into force). When in effect, the treaty provides that dividends will be exempt from withholding tax if paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company, or if paid to a pension fund or scheme, the Hong Kong Monetary Authority or the Swiss National Bank; otherwise, the rate will be 10%. Interest will be exempt and the rate on royalties will be 3%.

Iceland-Slovenia – The 2011 treaty entered into force on 11 September 2012 and will apply as from 1 January 2013. When in effect, the withholding tax rate on dividends will be 5% if paid to a company that holds directly at least 25% of the payer company; otherwise, the rate will be 15%. The rate on interest and royalties will be 5%.

India-Malaysia – When in effect, the treaty signed on 9 May 2012 provides for a 5% withholding tax on dividends and a 10% rate on interest and royalties.

Latvia-Georgia – When in effect, the protocol to the 2004 treaty signed on 29 May 2012 provides a new exemption from withholding tax for dividends paid to a company (other than a partnership) that holds directly at least 50% of the capital of the payer company. The withholding tax rate will be 5% if paid to a company (other than a partnership) that holds directly at least 10% (currently 25%) of the capital of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 5% (both currently 10%). The protocol also adds an exemption for interest if paid on any loan or credit granted by a bank.

Latvia-Mexico – When in effect, the treaty signed on 20 April 2012 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 will be exempt if paid to a pension fund; otherwise, the rate will be 5% if paid to or by a bank and 10% in all other cases. The rate on royalties will be 10%.

Latvia-Turkmenistan – When in effect, the first-time treaty signed on 11 September 2012 provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 25% of the capital of the payer company; otherwise, the rate will be 10%. The rate on interest and royalties will be 10%.

Mexico-Ukraine – A tax treaty and protocol were signed on 23 January 2012, but the treaty is not yet in force. When in effect, the withholding tax on dividends will be 5% where the dividends are paid to a company that holds directly at least 25% of the shares of the payer company; the rate in all other cases will be 15%. Interest and royalties will be subject to a maximum withholding tax rate of 10%.

OECD – The OECD has announced that Burkina Faso, Cameroon and Pakistan have joined the Global Forum on Transparency and Exchange of Information for Tax Purposes, so the countries will participate in the peer review process that encourages all countries to adopt effective exchange of information in tax matters.

Peru-Switzerland – See article in this issue.
URL: http://newsletters.usdbriefs.com/2012/Tax/WTA/121026_6.html

Singapore-Jersey – When in effect, the treaty signed on 17 October 2012 provides that dividends will be taxable only in the state of residence of the recipient. The rate on interest will be 12% and that on royalties, 8%.

Slovenia-Azerbaijan – The 2011 treaty entered into force on 10 September 2012 and will apply as from 1 January 2013. When in effect, the withholding tax rate on dividends and interest will be 8%. The rate on royalties will be 5% where the royalties are paid for the use of, or the right use, computer software, a patent, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; otherwise, the rate will be 10%.

Slovenia-Switzerland – A protocol to the existing treaty was signed on 7 September 2012, but the protocol is not yet in force. When in effect, the protocol provides that dividends will be exempt from withholding tax if paid to a pension fund or to a company that holds at least 25% of the capital of the payer company for an uninterrupted period of at least one year; otherwise, the rate will be 15%. Interest and royalties paid between associated enterprises where there is a 25% participation that has been held for at least two years will be exempt from withholding tax; otherwise, the rate will be 5%.

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Canada

Budget proposals on foreign affiliate "dumping" again revised

The Canadian government has made some taxpayer-favorable technical changes to the proposals in the March 2012 federal budget that would negatively affect investments made in shares or debt of foreign affiliates by Canadian subsidiaries of foreign companies. [Issued: 18 October 2012]

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