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In this issue:

US FATCA effective date is just around the corner

The Foreign Account Tax Compliance Act (FATCA), enacted by the US government in 2010, will officially become effective 1 July 2014.

The purpose of FATCA is to identify US persons located outside of the US who are subject to US tax, but who may not be paying US tax on income earned outside the US. FATCA accomplishes this goal by requiring non-US entities to submit information regarding non-US bank accounts and shareholders of non-US corporate entities. The rules aim to encourage non-US entities to report US persons' financial account information and US shareholder ownership by imposing a 30% withholding tax on certain payments from US persons to non-US entities that do not comply with the rules and provide the required information. FATCA withholding potentially will apply to US-source payments of certain fixed or determinable annual or periodical (FDAP) income, such as dividends, interest, rents, salaries, wages, premiums, annuities, compensation, remunerations and emoluments; these payments are called "FATCA withholdable payments."

FATCA is a targeted withholding regime – its ultimate goal is not to collect FATCA withholding, but to encourage non-US entities to disclose US depositors or substantial US ownership. Through that disclosure, the US expects to collect taxes owed by US persons who have non-US income that currently escapes US taxation.

Generally, FATCA withholding will be collected when a non-US entity fails to comply with FATCA rules requiring it to disclose US depositors and investors. The law primarily will affect entities that are traditionally thought of as financial institutions, such as banks, brokerage firms, asset management companies, etc. However, the law was written broadly and creates compliance obligations for certain non-US entities in nonfinancial services industries. There are various ways in which nonfinancial MNCs may prepare for the implementation of FATCA.

Non-US entities

MNCs may have foreign entities in their organizational structures, such as holding companies, treasury centers or captive finance companies, which may meet the definition of a foreign financial institution (FFI) under the FATCA rules. MNCs should analyze the business activities of their non-US entities and determine whether the entities are FFIs or nonfinancial foreign entities (NFFEs). Once the entities are classified, the MNC potentially will have to register the FFIs with the US Internal Revenue Service (IRS) and submit required information under the FATCA rules.

Certain non-US pensions may be classified as FFIs under the FATCA regulations. However, Intergovernmental Agreements (IGAs), discussed below, and the FATCA regulations provide broad exceptions to this standard rule. MNCs should analyze their non-US pensions to determine if they are FFIs that are required to register with the US government.

IGAs, which are agreements that are separate and distinct from tax treaties and allow for the implementation of FATCA under local law, must be analyzed as well and may result in different classifications or reporting requirements for a specific entity or plan. In general, IGAs follow one of two model formats released by the US. However, each country that signs an IGA has the opportunity to negotiate the terms of the agreement. The non-US jurisdiction will enact legislation implementing the IGA to assist foreign entities with implementing FATCA. IGAs likely will add complexity for FFIs because the various IGAs are not uniform, and FFIs will have to interpret the IGA in each of their respective jurisdictions to determine their proper reporting and withholding obligations.

All non-US entities will have to complete the documentation necessary to inform US withholding agents (USWAs), as well as FFIs, of their FATCA status.

US withholding agents of MNCs

USWAs that are part of an MNC's organizational structure should update their information reporting and withholding procedures to comply with the reporting and withholding requirements imposed under FATCA. USWAs that make FATCA-withholdable payments should ensure that they properly withhold against these payments and report the payments to the IRS on Forms 1042/1042-S.

To accomplish this, USWAs must collect the appropriate documentation from any foreign recipient of income that may be subject to the FATCA rules. The IRS has issued several new forms in the Form W-8 series (Form W-8BEN (for individuals), Form W-8BEN-E (for entities), Form W-8ECI, Form W-8EXP and Form W-8IMY), as well as a new Form W-9, in preparation for FATCA. Under the FATCA regime, it is imperative that these documents are collected prior to making payment. If the documentation is not collected and the payment is subject to 30% FATCA withholding, USWAs will be liable for the 30% withholding.

With the 1 July 2014 FATCA effective date right around the corner, MNCs should confirm that they are ready for this new withholding regime. The first steps are to classify all non-US legal entities and pension plans as FFIs or NFFEs, and for USWAs and FFIs to implement proper policies and procedures to withhold on FATCA-withholdable payments to entities that are not FATCA-compliant and report these payments to the US government.

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Brazil:
Switzerland moved from black list to gray list status

The Brazilian tax authorities published guidance on 20 June 2014 (Normative Ruling (NR) (No. 1,474/2014)) that removes Switzerland from the list of tax haven jurisdictions (black list), but includes certain Swiss corporate regimes on the list of privileged tax regimes (gray list). NR No. 1,474/2014 also removes Hungarian limited liability companies (Kft companies) from the gray list.

As depicted on the chart below, the consequences of a remittance or transaction with a black list country are that the transfer pricing rules apply regardless of whether the parties are related, the applicable debt-to-equity ratio is reduced to 0.3:1 (rather than the standard 2:1) and the withholding tax rate on outbound payments is increased to 25% (rather than the standard rate of 15%). Gray list status has transfer pricing and thin capitalization consequences.

Subject	Transaction with unrelated party: non-black list/non- gray list	Transaction with a related party: non-black list/non- gray list	Transaction with any party: black list	Transaction with any party: gray list
Transfer pricing rules	No	Yes	Yes, even with unrelated parties	Yes, even with unrelated parties
Thin capitalization rules	No	2:1 debt-to-net equity ratio	0.3:1 debt-to-net equity ratio	0.3:1 debt-to-net equity ratio
Withholding tax on outbound payments (general rate)	15%	15%	25%	15%
Nonresident capital gains taxation rate	15%	15%	25%	15%

A jurisdiction will be deemed to have a privileged tax regime if it:

- Does not tax income (domestic or foreign source) or earnings or imposes tax at a rate lower than 20%;
- Grants tax benefits to nonresident legal entities or individuals without requiring that substantial economic activities be carried out in the country, or benefits that are conditioned on no economic activities in the country; or
- Does not permit access to information regarding the corporate structure, ownership of assets or rights or economic transactions.

Switzerland was included on the tax haven list in 2010 when the Brazilian tax authorities expanded the list and introduced the privileged tax regime list. Subsequently issued guidance established a procedure that allowed countries on either list to submit a request to the Brazilian tax authorities for removal from the list; Switzerland's status as a tax haven was "suspended" after the Swiss authorities invoked this procedure (the Netherlands and Spain also submitted removal requests to the Brazilian authorities, but these requests still are under review). The new NR revokes the suspension status, removes Switzerland as a tax haven and characterizes certain Swiss structures that result in a lower taxation threshold of 20% as privileged tax regimes.

NR No. 1,474/2014, which applies retroactively as from 1 January 2014, provides that Swiss legal entities that are incorporated as holding companies, domiciliary companies, auxiliary companies, mixed companies, administrative companies or in any "other corporate form via a ruling issued by the local authorities" and that are subject to a corporate income tax rate lower than 20% (combined federal, cantonal and municipal rate) are considered to be subject to a privileged tax regime. NR No. 1,474/2014 also removes Hungarian Kfts from the list of privileged tax regimes.

Comments

As described above, the tax consequences of inclusion on the gray list are less severe than those of inclusion on the black list. Due to Switzerland's suspension status, transactions between Brazilian and Swiss entities have not been deemed to fall within the scope of the black or gray lists until now. In practice, the retroactive effect of NR 1,474 may result in a restricted thin capitalization limit and a mandatory transfer pricing analysis, even for transactions with unrelated parties, which could result in unexpected issues for taxpayers. Additionally, since Brazil has not concluded a tax treaty with Switzerland, lower withholding tax rates would not be available.

The removal of Hungarian Kfts from the gray list should reduce the transfer pricing and thin capitalization requirements that apply to transactions with these entities.

Affected companies may want to review transactions already undertaken in 2014, as well as those planned for the remainder of 2014.

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Germany:
BFH opinion provides no guidance on treatment of remaining liabilities in liquidation

In a decision dated 5 May 2014, Germany's federal tax court (BFH) failed to provide expected guidance on the tax treatment of the remaining liabilities of a company at the end of a liquidation process. The BFH ruled on the appeal of the lower tax court of Cologne's 2012 decision without addressing the controversial issue.

The liquidation of an over-indebted company can be a difficult process for the company and its advisors. In addition to the business implications and procedural obstacles of the liquidation procedures, the tax authorities have added an additional layer of complexity and uncertainty to this process: in their opinion, liabilities that remain with the company after all assets have been sold should lead to a taxable gain when the company is liquidated. Even if sufficient net operating loss (NOL) carryforwards are available to theoretically cover this gain, Germany's minimum taxation rules would, in most cases, result in a cash tax liability for the company that is being liquidated. (Under the minimum taxation rules, the first EUR 1 million of current year profits may be offset against NOL carryforwards with no limitations, but only 60% of any excess current year profits may be offset against NOL carryforwards; the remaining 40% is subject to tax at the general rates.)

The case decided by the BFH concerned the liquidation of a limited liability company (GmbH). Nearly all assets had been sold; however, the company still had shareholder liabilities of approximately EUR 18 million. The company filed an application for a binding ruling with the responsible tax authorities, requesting confirmation that the final liquidation of the company would not lead to a taxable gain in the amount of the outstanding shareholder liabilities. The tax authorities did not agree with this position, and did not grant the binding ruling. The company challenged the tax authorities' decision in the lower tax court, which decided in favor of the company and ordered the tax authorities to provide the requested (taxpayer favorable) binding ruling. The tax authorities then appealed the case to the BFH.

In its opinion, the BFH analyzed whether a tax court can review a decision of the tax authorities on whether to provide a requested binding ruling in an appeals procedure. In the view of the BFH (and contrary to the opinion of the lower tax court), the scope of a tax court's review is limited to questions on whether the tax authorities fully understood the facts and whether the legal analysis provided by the tax authorities was conclusive and not obviously incorrect. Instead of providing a full legal analysis of the tax authorities' decision on the application for a binding ruling, the BFH ruled that only a limited, high-level review could be carried out through a court proceeding and that the tax authorities' decision not to issue a binding ruling in the case was in line with the relevant principles. Based on these grounds, the BFH overruled the lower tax court's decision. The BFH, however, did not provide a full and final analysis of the question the taxpayer asked the tax authorities, which was part of the application for the binding ruling.

The BFH's decision will not help resolve the controversial topic of the treatment of the remaining liabilities of a company in a liquidation. Even though the lower tax court decision included a clear and explicit statement against the opinion of the tax authorities, the tax authorities are not expected to change their position. Based on the tax authorities' approach, there is a risk that the lifetime tax result of a company would not be able to be less than zero because, at the latest, the remaining liabilities of the company would be balanced by a deemed taxable gain during its liquidation. This result, however, is questionable from an economic perspective and seems to ignore reality. The risk of taxation of these deemed profits could lead to the result that companies that have stopped being active and are left with no attributes other than liabilities would be kept in existence in perpetuity instead of being liquidated. Alternative solutions such as the migration/merger of the company out of Germany or release through a transfer of the liability to a foreign related party may not provide the necessary legal certainty.

Hopefully, the tax authorities will adopt a more business-oriented approach in the future and will refrain from assessing a final tax on a company that already is over-indebted in these situations. Apart from the legal debate, it could be difficult to enforce a tax assessment notice against a company that has nothing left besides liabilities.

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India:
AAR rules on tax treatment of sales promotion services

India's Authority for Advance Rulings (AAR) has held that payments for services rendered by a marketing executive for promotion of sales and a brand name in Sri Lanka were not taxable as fees for technical services (FTS) under India's Income-tax Act, 1961 (ITA) or under the India-Sri Lanka tax treaty. At the time the services were provided, the treaty did not contain an article covering the taxation of FTS, and although the treaty did have an independent personal services article, that provision did not apply because the services were not provided in India.

The nature of services provided by a nonresident has often given rise to controversies between taxpayers and the Indian tax authorities because service fees can be taxed in India under the ITA only if the services are managerial, technical or consultancy in nature. The scope of taxation of service fees is even narrower under some of India's tax treaties (e.g. the India-US treaty).

Facts of the case

Oxford University Press (OUP) is an Indian branch of Oxford University Press, UK that publishes, prints and reprints educational and scholarly books.

OUP appointed a Sri Lankan tax resident to serve as an exclusive marketing executive for OUP for a period of 12 months. As per the letter of appointment, the executive was responsible for achieving sales and collection targets in Sri Lanka. She also was responsible, *inter alia*, for brand enhancement, providing value-added services in workshops and other educational activities, etc. All of the executive's activities were undertaken entirely in Sri Lanka; no activities were undertaken in India.

OUP paid the executive monthly remuneration and reimbursed her for certain expenses (for storage space, telephone, internet, conveyance, etc.), which were remitted from OUP's bank account in India to the executive's bank account in Sri Lanka.

The issue before the AAR was whether OUP's payments of monthly remuneration and/or reimbursements to the executive should be subject to withholding tax in India.

AAR ruling

After examining the nature of the executive's duties and accountabilities, the AAR characterized her services as being primarily for the promotion of sales and OUP's brand name, and determined that her job description was more consistent with that of a "marketing executive" than any other position. As a result, the AAR concluded that the services provided did not fall within the scope of managerial, technical or consultancy services and, therefore, payments for the services were not FTS as defined in the ITA.

The AAR further ruled that taxability under the India-Sri Lanka tax treaty had to be examined under the independent personal services article and, since the services were provided entirely in Sri Lanka, the remuneration was not taxable in India under that article.

The AAR considered the reimbursements of expenses to be linked directly to the executive's services provided in Sri Lanka and, therefore, the reimbursements were not taxable in India under the ITA or the treaty.

Comments

In reaching its conclusions, the AAR observed that the 1982 India-Sri Lanka tax treaty (which was replaced by a new treaty in 2013 that specifically addresses FTS and provides for a 10% withholding tax on such fees) did not define FTS and, therefore, the definition of FTS under the ITA had to be used to determine whether the payments could be characterized as FTS.

However, based on the principle that tax treaties are to be read independently, except where they refer to domestic law provisions, and given that the India-Sri Lanka treaty did not contain specific FTS provisions, it would seem that a direct reference to the independent personal services article of the treaty would have sufficed: i.e. the AAR's recourse to the definition of the FTS under the ITA appears to be redundant. Where a treaty does not contain a specific article on FTS and the independent personal services article does not apply, the business profits or other income article should apply. The concern, however, is that the tax authorities could use the AAR's ruling to argue that in other cases where a treaty does not contain a specific article on FTS, the provisions of India's domestic law should apply.

Nevertheless, the AAR's ruling confirming that fees for sales promotion activities cannot be regarded as FTS under the ITA is welcome, especially considering that the domestic law definition of FTS is very broad. Although the ITA provides that rulings from the AAR apply only with respect to the taxpayer that is the subject of the ruling, the rulings have persuasive value in other cases.

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India:
Retroactive amendments to tax law do not affect tax treaty definition of royalties

In a decision issued in the case of *Antwerp Diamond Bank NV* on 18 March 2014, the Mumbai bench of the Income-tax Appellate Tribunal (ITAT) examined the scope of the definition of a royalty under the India-Belgium tax treaty, in light of retroactive amendments to India's Income-tax Act (ITA). The tribunal concluded that the amendments did not affect the definition of a royalty provided under the treaty and that the expanded definition under the ITA cannot be incorporated into the treaty definition. Specifically, the tribunal held that the reimbursement by an Indian branch of data processing costs for a nonresident head office's computer software did not constitute a royalty.

The classification of software payments as royalties under the ITA has been controversial, and a number of courts have ruled on the issue. The classification took on greater importance when the source rule for the taxation of royalties under the ITA was amended in the 2012 Finance Act on a retroactive basis, effective from 1976, and questions have arisen as to whether these amendments affect the definition of royalties under India's tax treaties.

The amendments to the source rule expanded the scope of the definition of a royalty. Under India's domestic law, a royalty now is deemed to arise in India (i.e. to be India-source income subject to tax in the country) if the underlying rights, property, information or services are utilized in India, regardless of where the services are rendered or where the property is situated. The amendments clarified the following:

- That a transfer of any or all rights for the use of, or the right to use, computer software (including a grant of a license) fall within the scope of the definition of a royalty, regardless of the medium through which the transfer takes place; and
- That the definition of a royalty includes consideration for any right, property or information, regardless of its location or whether the payer has used it directly or has possession or control of it.

Facts of the case

The taxpayer (Antwerp Diamond Bank (ADB)), a Belgian bank, operates in India through a branch office. ADB acquired application software from an unrelated third party, and subsequently allowed the Indian branch to use the software by making it accessible through a server located overseas. ADB had a nonexclusive and nontransferable right to use the software; it had no right to assign or sublicense the right to use the software without the prior written consent of the software provider.

ADB charged and recovered data processing costs from its Indian branch, which represented a pro rata allocation of the actual expenses (without any mark-up) incurred by the head office for the use of the software license. ADB took the position that the payment from the branch was made for the use of computer software, and not for the use of, or the right to use, the copyright for the software (the latter would have constituted a royalty under article 12(3) of the India-Belgium tax treaty). Accordingly, the Indian branch did not withhold tax from its payment of data processing charges to the head office.

During the audit of ADB's India tax return, the tax officer determined that the payment by the India branch for the use of the software constituted a royalty under the amended ITA, and disallowed the India branch's deduction for the payment due to the branch's failure to withhold tax on the payment.

Mumbai tribunal decision

With respect to whether the Indian branch's use of the software constituted the payment of a royalty, the tribunal noted that the head office had only a nonexclusive and nontransferable right to use the software; it did not have any right to assign, sublicense or otherwise transfer its rights. Thus, the tribunal concluded that the payment from the India branch was made for the use of the software, and not for any right to the copyright.

The tribunal also examined the definition of royalties under article 12(3) of the India-Belgium tax treaty and determined that, to fall within its scope, the India branch should have exclusive and independent use of, or the right to use, the software. However, no such right was vested in the branch; it simply sent data to the head office to be processed with the help of the software. Therefore, the tribunal held that the data processing charges paid by the India branch to its head office did not qualify as a royalty under the comprehensive definition provided in article 12 of the treaty.

Relying on recent court decisions, the Indian tax authorities contended that, due to the retroactive amendments to the definition of a royalty under the ITA, the payment in question should constitute a royalty. However, the tribunal rejected this argument and held that, because the treaty provided a comprehensive definition of a royalty, the scope of the definition under the ITA was irrelevant and need not be incorporated into the treaty definition.

The tribunal also held that the data processing costs incurred by the Indian branch did not fall within the scope of the provisions in the ITA relating to the deductibility of executive and general administrative expenses incurred by a head office on behalf of its branch (which could have limited the deductibility of the expenses). In this case, the data processing costs incurred by the Indian branch represented an allocation of expenses incurred by the head office for the banking application software, and did not fall within the scope of executive and general administrative expenses. Therefore, the tribunal held that the data processing expenses incurred by the Indian branch were fully deductible.

Comments

The issue of the interpretation of terms defined in tax treaties, compared with the definitions provided in the retroactively amended ITA, has been considered in several recent court decisions with varying results.

The Mumbai Tribunal and the Madras High Court recently examined the retroactive amendments to the ITA, and concluded that the payments at issue qualified as a royalty under both the ITA and the relevant tax treaty. These decisions have upheld the "ambulatory interpretation" of tax treaties, according to which treaties may be affected by changes to domestic law and, accordingly, the amended definition of a royalty under the ITA and the definition under a tax treaty must be read together.

The recent decision of the Karnataka High Court in the case of *Vodafone South Ltd.* also touched on a similar issue. The *Vodafone* decision was rendered in the context of a stay petition and, therefore, the issue of the interpretation of terms under a tax treaty was not the primary issue addressed by the court. However, the High Court stated that parliament has the sovereign power, not only to make (i.e. conclude) a tax treaty, but also to "break" a treaty through an amendment to domestic law subsequent to the conclusion of the treaty. Although these remarks were not germane to the primary issue before the High Court, and therefore should be considered nonbinding *dicta* rather than a binding rationale for the decision, they have generated further controversy on the already debatable issue of whether a domestic law amendment can override beneficial provisions of a tax treaty.

On the other hand, in the case of *Sanofi Pasteur Holding SA*, the Andhra Pradesh High Court stated that the retroactive amendments to the ITA in the 2012 Finance Act have no impact on the interpretation of terms in an applicable tax treaty, since these amendments are not supported by a *non-obstante* clause, which could have specifically expressed an intent for the amendments to override the provisions of applicable tax treaties. Similar observations have been made in few other decisions.

Although the *Antwerp Diamond Bank* case could be interpreted as bolstering the argument that a unilateral amendment to domestic legislation does not affect the taxability of an item under an applicable tax treaty, the fact remains that there are a number of conflicting rulings. With litigation involving this issue continuing to increase, a decision from the Indian Supreme Court likely would go a long way toward putting the issue to rest.

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Italy:
Changes to IRAP and withholding tax rates enacted

The Italian government passed Law Decree No. 66 on 24 April 2014, which includes some important changes in tax rates that could affect multinational companies with activities in Italy. The decree was published in the official gazette on the same date, and converted into law on 18 June 2014 (the law was published in the official gazette on 23 June 2014). The most relevant new provisions are as follows:

Decrease of IRAP rates

IRAP – the regional tax on productive activities – is levied on the net added value of the production derived in each Italian region by resident companies, as defined by the relevant tax rules (but basically derived from the statutory accounts). Net added value of production comprises the value of production minus certain costs of production. Banks or other financial institutions/companies (including holding companies) and insurance companies determine net added value by using specific criteria.

The new law reduces the standard IRAP rate of 3.9% to 3.5%. The standard rates for financial institutions and insurance companies are reduced from 4.65% and 5.9% to 4.2% and 5.3%, respectively. The new rates are effective for fiscal years starting after 31 December 2013. Due to the rate reduction, special rules will apply to advance payments of IRAP under the forecast method for the 2014 fiscal year.

Each region may increase or decrease the standard IRAP rate by up to 0.92%.

Increase of withholding tax rate on financial income derived by nonresidents

As from 1 July 2014, the 20% domestic withholding tax currently applicable to certain dividends, interest and capital gains will increase to 26%. Interest and capital gains on bonds issued by the Italian government will remain taxable at a reduced 12.5% rate.

A refund of up to 11/26 (currently 1/4) of the Italian tax levied on dividends paid to a foreign recipient may be available, to the extent tax is paid in the recipient's country of residence. Specific exemptions or reduced withholding tax rates may be applicable under the relevant EU directives or under tax treaties.

Capital gains derived by foreign corporations upon disposals of substantial participations in Italian companies remain subject to a 13.673% effective tax rate (i.e. 27.5% corporate income tax on 49.72% of the gain), unless a relevant tax treaty applies. Substantial participations are those representing (i) more than 2% of the voting rights or 5% of the equity in companies listed in regulated markets, or (ii) more than 20% of the voting rights or 25% of the equity in other companies.

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Korea:
Tribunal rules on beneficial ownership and application of reduced treaty rates on dividends

Korea's Tax Tribunal issued a decision on 3 April 2014 that provides guidance on the beneficial owner of dividend income and on the application of reduced withholding tax rates under the Korea-France tax treaty.

The case involved a Korean company (KOR1) that was established under a joint venture between another Korean company (KOR2) and a UK holding company that was owned by a French company. The joint venturers each owned 50% of KOR1. When KOR1 paid dividends to its UK shareholder, it withheld tax at a rate of 5% under the Korea-UK treaty, on the grounds that the UK holding company was the beneficial owner of the dividends. However, Korea's tax authorities asserted that the Korea-France tax treaty, rather than the Korea-UK treaty, should be applied because the French company was the beneficial owner of the dividend income, and the UK holding company was a mere conduit that should be disregarded.

The tribunal upheld the tax authorities' position because the French company made all major decisions on KOR1's business and KOR1 was, in substance, operated and managed by the French company. The tribunal also concluded that the French company was not entitled to the 10% reduced withholding tax rate that applies under the Korea-France tax treaty when the dividend recipient is a company that holds *directly* at least 10% of the company paying the dividends. Because the French company indirectly held its interest in KOR1 through the UK holding company, it was subject to the default treaty rate of 15%.

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Madeira:
International Business Centre licensing period extended

The European Commission has approved an extension of the period for licensing new companies to operate under Madeira's International Business Centre (IBC) preferential regime to 31 December 2014.

Provided certain conditions are satisfied, companies licensed to operate under the IBC benefit from a reduced income tax rate of 5% on income arising from transactions with nonresidents, exemptions from withholding tax on interest, royalties and service fees and exemptions from capital tax and registration fees until 31 December 2020.

The European Commission declared the current Madeira IBC regime compatible with the EU internal market in 2007 and, in November 2013, authorized an extension for granting licenses for companies to operate under the regime to 30 June 2014. The new extension authorized by the Commission will allow the licensing of entities until the end of 2014, thus permitting new companies to be able to enjoy IBC tax benefits until 2020.

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Netherlands:
BES islands to be included in new tax treaties

The Dutch government has announced that new tax treaties concluded by the Netherlands also may apply to the "BES islands" (Bonaire, St. Eustatius and Saba), depending on the outcome of the negotiations on the scope of the specific treaty.

The "Caribbean Netherlands" refers to the Caribbean islands of Bonaire, St. Eustatius and Saba, as from October 2010 (when Curacao and St. Martin became autonomous countries within the Kingdom of the Netherlands, like Aruba). These islands also are known as the BES islands, and are special municipalities of the Netherlands. Although the BES islands are part of the Netherlands, they have their own tax system.

The Dutch government has announced in its official tax treaty policy that it intends to include the BES islands in new tax treaties concluded by the Netherlands; however, the negotiations for each specific treaty will determine whether the BES islands actually are included within the scope of the treaty. Thus far, of all the new tax treaties concluded by the Netherlands since 2010, only those with China and Ethiopia apply to the BES islands. (There also is a tax treaty between the former Netherlands Antilles and Norway, concluded before 2010, that remains applicable to the BES islands.)

With respect to the application of EU law, the BES islands remain overseas territories of the EU, at least until 2015. This means that the EU treaty (apart from Chapter IV, which enables local exported goods to enter the EU without excise duties) and directives (such as the parent-subsidiary directive, but excluding the savings directive), do not apply to BES island residents and resident companies. In 2015, the EU members will negotiate whether the BES islands will become "outermost regions" of the EU; if this is the case, they would fall within the scope of the EU treaty and directives as from 2016.

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In brief

Bahamas – The 2014-2015 budget would postpone the introduction of a value added tax from 1 July 2014 to 1 January 2015. It also would reduce the 15% standard rate that previously was proposed to 7.5%, and would reduce the number of proposed exemptions. (For prior coverage, see the *World Tax Advisor* article dated 14 March 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/140314_2.html

Belgium – The Constitutional Court has issued a decision holding a provision of the income tax code unconstitutional to the extent it would be interpreted as preventing a tax judge from examining a secret commissions tax assessment to determine whether the assessment is factually and legally justified and whether all legal provisions and general principles – including the proportionality principle – have been respected. In other words, a tax judge is allowed to reduce the 309% secret commissions tax.

China – The Ministry of Finance and the State Administration of Taxation announced on 13 June 2014 that the VAT rates of 6% and 4% both will be reduced to 3% as from 1 July 2014. The rate reduction may benefit certain smaller companies.

European Union – At its 20 June 2014 meeting, the Council of Finance Ministers (ECOFIN) agreed to amendments to the EU parent-subsidiary directive to clarify that it would be possible to tax receipts from hybrid loans and from other tax-deductible dividends (and agreed to continue working on potential amendments related to the addition of a general anti-avoidance rule). Once the text of the amended directive is finalized, EU member states will have until 31 December 2015 to

amend their domestic law to implement the revised directive. (For prior coverage, see the *World Tax Advisor* article dated 9 May 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/140509_5.html

European Union – The European Commission has opened three in-depth investigations to examine whether decisions by tax authorities in Ireland, Luxembourg and the Netherlands with regard to corporate income tax comply with the EU state aid rules. The Commission has been investigating tax practices in several EU member states following media reports alleging that some companies have received significant tax reductions by way of tax rulings issued by national tax authorities. The Commission clarified that tax rulings are not inherently objectionable, but they may involve unlawful state aid if they are used to provide selective advantages to a specific company or group of companies. The Commission explained that, unlike Ireland and the Netherlands, Luxembourg has supplied it with only a limited sample of the information requested, so it has initiated infringement proceedings against Luxembourg. In parallel to the investigations, the Commission will continue its wider inquiry into tax rulings.

Netherlands – The State Secretary for Finance published several decrees on 12 June 2014 that provide updated guidance on aspects of the advance pricing agreement (APA) and advance tax ruling (ATR) regimes. While the new decrees do not significantly change the approach under previous decrees, the new guidance should be of interest to companies investing in the Netherlands. The decrees address access to the specialized foreign investors' desk and to the APA/ATR team of the tax authorities; conditions and procedures for obtaining APAs and ATRs; substance requirements for holding companies; and substance requirements for certain group financing, licensing and leasing companies that apply for an APA/ATR, as well as a policy regarding the exchange of information for these companies.

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?id=us:em:na:wta:eng:tax

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

Belgium-India – See article in this issue.
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/140627_5.html

China-Switzerland – The free trade agreement signed in July 2013 enters into force on 1 July 2014.

Croatia – The multilateral Convention on Mutual Administrative Assistance in Tax Matters, as amended, entered into force in respect of Croatia on 1 June 2014 and will apply generally as from 1 January 2015.

Croatia-India – When in effect, the treaty signed on 12 February 2014 provides for a 5% withholding tax on dividends paid to a company (other than a partnership) that holds directly at least 10% of the capital of the distributing company; otherwise, the rate will be 15%. A 10% rate will apply to interest, royalties and fees for technical services.

Cyprus-Spain – The 2013 treaty entered into force on 28 May 2014 and applies as from 1 January 2015 for income and capital taxes, and as from 28 May 2014 for other taxes. When in effect, the treaty provides that a 0% withholding tax will apply to dividends paid to a company whose capital is wholly or partly divided into shares and that holds directly at least 10% of the capital of the distributing company; otherwise, the rate will be 5%. Interest and royalties will be taxable only in the state of residence of the recipient.

Greece-San Marino – The 2013 treaty entered into force on 7 April 2014 and will apply as from 1 January 2015. When in effect, the treaty 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 distributing company; otherwise, the rate will be 10%. The rate on interest will be 10% and the rate on royalties will be 5%.

Hungary-Saudi Arabia – When in effect, the treaty signed on 23 March 2014 provides for a 5% withholding tax rate on dividends. Interest will be taxable only in the state of residence of the recipient. A 5% rate will apply to royalties paid for the use of, or the right to use, industrial, commercial or scientific equipment; otherwise, the rate will be 8%.

India-Sri Lanka – See article in this issue.
URL: http://newsletters.usdbriefs.com/2014/Tax/WTA/140627_4.html

Ireland-Botswana – When in effect, the treaty signed on 10 June 2014 provides for a 5% withholding tax rate on dividends, a 7.5% rate on interest, a 5% rate on royalties paid for industrial, commercial or scientific equipment, and 7.5% in all other cases.

Israel-Panama – The 2002 treaty entered into force on 26 May 2014 and will apply as from 1 January 2015. When in effect, the treaty provides for a 5% withholding tax on dividends paid to a pension fund; a 20% rate will apply on dividends distributed by a REIT where the recipient holds directly no more than 10% of the capital of the REIT payer; otherwise, the rate will be 15%. A 0% rate will apply to interest paid to a pension fund; otherwise, the rate will be 15%. Royalties will be subject to a 15% rate.

Lithuania – The multilateral Convention on Mutual Administrative Assistance in Tax Matters, as amended, entered into force in respect of Lithuania on 1 June 2014 and will apply generally as from 1 January 2015.

Mexico-Turkey – When in effect, the treaty signed on 17 December 2013 provides for a 5% withholding tax where dividends are paid to a company (other than a partnership) that holds directly at least 25% of the capital of the distributing company; otherwise, the rate will be 15%. A 10% rate will apply to interest paid to a bank; otherwise, the rate will be 15%. The rate on royalties will be 10%.

Poland-Bosnia and Herzegovina – When in effect, the treaty signed on 4 June 2014 to replace the 1985 treaty between Poland and the former Yugoslavia provides for a 5% withholding tax rate where dividends are paid to a company (other than a partnership) that holds directly at least 25% of the capital of the distributing company; otherwise, the rate will be 15%. The rate on interest and royalties will be 10%.

Switzerland – The intergovernmental agreement (IGA) with the US to improve international tax compliance and to implement the Foreign Account Tax Compliance Act (FATCA) entered into force on 2 June 2014. An act to simplify the implementation of FATCA for Swiss financial institutions and an ordinance on disclosure obligations will enter into force on 30 June 2014. The current IGA is a Model 2 IGA, which requires Swiss financial institutions to report information directly to the US Internal Revenue Service (IRS) and does not include reciprocal reporting responsibilities for the US; however, the Swiss Federal Council has approved a draft mandate to renegotiate the IGA to change to a Model 1 IGA. A Model 1 IGA would require financial institutions to report information to the Swiss tax authorities, which would then report information to the IRS; it also would provide for the automatic exchange of information.

United States – IGAs to improve international tax compliance and to implement FATCA have been signed between the US and Slovenia (on 2 June 2014), South Africa (on 9 June 2014) and New Zealand (on 12 June 2014). The list of jurisdictions that have agreed in substance on the terms of an IGA with the US and will be treated as having signed an IGA until 31 December 2014 (the date by which the IGA must be signed in order for this status to continue without interruption) also has continued to grow, to more than 35 jurisdictions as of 3 June 2014. Additionally, the IRS published the first list of FATCA-compliant Foreign Financial Institutions (FFIs) on 2 June 2014. The list, which should be updated on the first day of each month, currently contains information related to more than 77,000 FFIs that had registered with the IRS as of 23 May 2014.

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European Union

CJEU rules Netherlands fiscal unity regime incompatible with EU law

The Court of Justice of the European Union issued a decision on 12 June 2014, concluding that the fiscal unity regime in the Netherlands Corporate Income Tax Act is incompatible with the freedom of establishment principle in the Treaty on the Functioning of the European Union and that there is no valid justification for the regime. The Dutch Ministry of Finance has not yet announced how it will respond to the decision.

Issue date: 12 June 2014

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-eu-120614.pdf?id=us:em:na:wta:eng:tax:062714

Luxembourg

Tax authorities issue guidance on use of foreign currency for tax purposes

Luxembourg's tax authorities issued a circular on 16 June 2014 that contains the rules and conditions under which a taxpayer may use a currency other than the euro in calculating its taxable results. According to the new circular, Luxembourg entities, including partnerships, can opt to determine taxable income in a foreign currency, but the company's commercial accounts must be in the same foreign currency as its share capital.

Issue date: 16 June 2014

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-luxembourg-160614.pdf?id=us:em:na:wta:eng:tax:062714

OECD

OECD BEPS Transfer Pricing Deliverables on Track for September G20 Review and Approval

The Organization for Economic Cooperation and Development has made considerable progress on the OECD/G20 base erosion and profit shifting (BEPS) project toward the goal of approval by the G20 in September 2014 of the 2014 BEPS Action Plan deliverables of the two transfer pricing action items.

Issue date: 11 June 2014

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tp-alert-oecd-2014-11-120614.pdf?id=us:em:na:wta:eng:tax:062714

Sweden

Committee on corporate taxation proposes changes to corporate tax rules

Sweden's committee on corporate taxation released a report on 12 June 2014 that includes recommendations for a new corporate taxation system. The committee was charged with the task of proposing a system that would result in greater neutrality between the taxation of equity and debt, and that would prevent tax planning by using the interest deduction rules. The committee's report includes two alternative proposals that address the deduction of interest expense and other financial costs: a main proposal that the committee favors, and an alternative. The report also includes a number of other proposals for changes to the tax legislation.

Issue date: 17 June 2014

URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-sweden-170614.pdf?id=us:em:na:wta:eng:tax:062714

Have a question?

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