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SECTOR

## International **TAX INSIGHT** July 2009

### EDITORIAL

Welcome to the first edition of International **TAX INSIGHT**, a quarterly publication highlighting important cross border tax developments that may affect those doing business in global locations.

In this quarter's issue we feature news of tax developments in China, the European Union (EU), France, India, Italy, the Netherlands, Singapore, the United Kingdom (UK) and the United States of America (USA).

In each case the information given is intended as a brief overview and may not cover all circumstances. Readers should seek professional advice on their own particular situation before taking any action. Baker Tilly International member firms worldwide will be pleased to advise further. To locate your nearest firm, please see the Worldwide Directory at [www.bakertillyinternational.com](http://www.bakertillyinternational.com).

#### **Bill Hogan**

*Director of taxation, Baker Tilly International*  
E. [bill.hogan@bakertillyinternational.com](mailto:bill.hogan@bakertillyinternational.com)

### CHINA

#### **Tax Incentives for Some Technically Advanced Service Companies**

Technically advanced service (TAS) companies which provide offshore outsourcing services, defined as services to foreign companies, regardless of where the work is carried out, can now qualify for tax benefits if they are registered in one of 20 designated cities in China and if they satisfy further conditions.

The tax benefits, available for a period of five years from January 2009 to December 2013, include a reduction in corporate income tax from 25% to 15% and an exemption from business tax on offshore outsourcing income. Business tax is a sales tax, normally levied at 5% on income received.

The 20 designated cities include Beijing, Dalian, Shanghai and Shenzhen.

Further conditions imposed are extensive and merit detailed consideration by potential applicants. They include that TAS income must form at least 70% of the company's total annual income and that income from offshore outsourcing services must form at least 50% of annual income.

For groups engaged in information technology these developments are an incentive to set up TAS operations in China with the emphasis on offshore outsourcing services. Groups already established in these activities in China but outside of the 20 designated cities might wish to consider relocating.

### EU

#### **Major VAT Change from January 2010**

EU businesses providing services for foreign companies, and those which buy services from foreign suppliers, should consider preparing now for new place of supply rules which come into effect on 1 January 2010.

Currently the supply of a service is generally deemed for VAT purposes to take place in the country where the supplier is located. As a result, the supplier charges VAT on its invoices at the rate of VAT applicable in its own country and it pays over to its own government the VAT which it collects. This applies regardless of whether the customer is domestic or foreign, and if foreign whether

it is inside or outside the EU, and regardless of whether or not the customer is itself carrying on a business.

There are a number of exceptions to this general rule. For example, accountancy, legal, advertising and telecommunications services are all taxable in the country where the recipient is located if the recipient is in business. Services relating to land are taxable in the country where the land is situated.

The change to the general rule from 1 January 2010 is that supplies of services to business customers will be deemed for VAT purposes to take place in the country where the recipient is located. In consequence, the supplier must no longer charge VAT on invoices for such services if the recipient is located in a foreign country. If the recipient is registered for VAT in its own country it must self-assess the VAT due at the rates applicable in its own country and pay it over to its own government. The mechanism will be the reverse charge procedure, already familiar to those traders which buy in services from outside the EU.

Supplies of services to customers not carrying on a business will continue to be treated as being made in the country in which the supplier is located. The supplier should continue to charge VAT in these circumstances, unless one of the exceptions applies.

Suppliers of services to businesses registered for VAT in other EU countries will be required to file quarterly EC Sales Lists. This document is already familiar to traders who supply goods to VAT registered customers in other EU countries. From 1 January 2010 it must also be used to report supplies of services.

Businesses affected by these developments should begin preparing now for the new rules. Service suppliers will have to distinguish supplies to business customers from those to customers not carrying on a business, and for the EC Sales Lists they will need the VAT registration numbers of their business customers located elsewhere in the EU. Purchasers of services from elsewhere in the EU will have to amend their VAT return preparation procedures to incorporate the reverse charge obligation.

## FRANCE

### **New Transfer Pricing Documentation Requirements**

International groups with operations in France should note that a legal requirement to set up and maintain transfer pricing documentation is being introduced. The new law will apply to both French companies and to French permanent establishments of foreign companies. The date of introduction has still to be announced but it is thought that it could be as early as the beginning of next year.

A size criterion will be applied and enterprises with balance sheet assets and annual sales figures below prescribed levels will be exempt from the requirements. The threshold currently proposed is

€400m, both for balance sheet assets and annual sales figures, although it has still to be clarified as to whether this applies to the group as a whole or to the French company or permanent establishment.

Groups coming within the scope of the new law will be required to maintain documentation relating both to the group and to the French entity. Documentation on the group must include information on its intellectual property, such as patents and trade marks, to the extent that this is utilised in France. Documentation on the French company or permanent establishment must include a description of the pricing methods used for transactions with related parties and evidence that they result in the equivalent of arm's-length prices.

Failure to respond to a directive from the French tax authorities to produce transfer pricing documentation, or producing documentation which is perceived to be inadequate, will result in penalties being imposed.

## INDIA

### **Relief from Withholding Taxes**

Companies based outside India and with no premises or staff in the country but which have nevertheless suffered withholding taxes on the receipt of fees for services supplied to clients and customers there can take comfort that the decision in March 2009 in the legal case of Deputy Commissioner of Income Tax v. Venkat Shoes Pvt. Ltd now points the way to their receiving their fees gross in future.

The case concerned an Indian shoe manufacturing company which paid commissions to an unrelated company abroad and which did not deduct from the fees any withholding taxes. Tax law in India requires that resident companies must deduct withholding tax at the full rate from fees paid abroad unless prior permission has been obtained from the authorities under the terms of a bilateral double tax treaty for withholding tax to be applied at a reduced rate or to be waived altogether. Withholding taxes deducted must be paid over to the authorities.

Venkat's case was that the company to which it paid commissions was not located in India, had no physical presence there and had performed the services for which it was being remunerated outside of India. They contended that in these circumstances the foreign company had no liability to tax in India and that withholding taxes should not, therefore, apply.

Venkat's contentions were disputed by the tax authorities but upheld by the Appellate Tribunal. As a result, foreign companies which supply services in India and which suffer withholding taxes on their fees should approach their customers and clients there with a view to their now being paid gross.

## ITALY

### Claims Invited for Reduced Withholding Taxes on Dividends

Following a clarification issued by the tax authorities on 21 May 2009, companies based in the EU or the European Economic Area (EEA) which have investments in Italian companies and which do not already qualify for exemption from withholding taxes on dividends under the EU Parent - Subsidiary Directive can now apply for the standard rate of withholding tax on dividends of 27.5% to be reduced to 1.375%. The revised rate is calculated as the standard rate of 27.5% on a tax base equivalent to 5% of the dividend.

The reduced rate applies to dividends paid out of profits of 2008 and later.

It is a condition for the reduced rate to apply that the company receiving the dividends is subject to corporate income tax in its own jurisdiction.

Claims for the reduced rate should be made to the Italian tax authorities. Companies will need to show that they are resident in the EU or EEA and that they are subject to corporate income tax in their own country. They must also show that the country in which they are resident meets the standards set by the Organisation for Economic Co-operation and Development for transparency and exchange of information.

## THE NETHERLANDS

### Refunds of Dutch Dividend Withholding Tax for Some Non-resident Entities

Pension funds and charities established in the EU but outside of the Netherlands which suffered withholding tax on Dutch source investment income in the years 2004 to 2006 can obtain refunds of the tax. The rate of the withholding tax during this period was 25%. Dutch resident pension funds and charities were exempt from the tax and the Dutch revenue authorities now accept that this constituted discrimination which is not permissible in EU law.

A condition of the right to refunds is that the non-resident pension fund or charity is exempt from tax in its own country and would have been exempt from Dutch corporate income tax if it had been resident in the Netherlands. Claims for refunds must be made within five years of the year in which the relevant dividend was received.

From 2007 Dutch law has been changed, giving exemption to pension funds and charities throughout the EU.

Collective investment funds established in the EU but outside of the Netherlands may also wish to claim for refunds of withholding tax suffered in the years 2004 to 2007 since Dutch resident collective investment funds were exempt from tax in this period. However, the Dutch revenue has not yet conceded that this constituted discrimination and may contest such claims.

From 2008 Dutch resident collective investment funds are no longer entitled to exemption, so the previous discrimination no longer applies.

## SINGAPORE

### Conditions Expected to be Eased for Fund Management Tax Exemptions

Following an initial announcement in the Singapore Budget in January 2009, the Monetary Authority of Singapore has provided further details of the Enhanced-Tier Fund Tax Incentive Scheme planned for the period from April 2009 to March 2014. The scheme is designed to further enhance the attractiveness of Singapore as a regional base for the fund management industry.

It is proposed under the scheme to abolish the so-called 30/50 rule. Exemption from tax for "specified income" from "designated investments" is currently dependent on compliance with the rule which states that Singapore based corporate investors must not own more than 30% of the fund if it has fewer than ten investors and not more than 50% of the fund if it has ten or more investors. Abolishing the rule will enable Singapore-based funds to compete on equal terms with other funds for investment from Singapore-based corporations.

In order to qualify for tax exemption a fund must have assets of at least S\$50m and incur expenses of at least S\$200,000 in Singapore each year. The fund must be managed in Singapore by a fund management company which employs a minimum of three investment professionals in Singapore.

The definition of "designated investments" is expected to remain largely unchanged, although it is likely in the future to exclude shares in private companies which have Singapore property interests.

Under the proposal, fund management companies which derive income from providing management services and investment advice to qualifying Enhanced-Tier Funds will enjoy a concessionary tax rate of 10%.

The Monetary Authority's announcement does not have the force of law. Legislation to give effect to the proposed changes has still to be enacted.

## UK

### Tax Exemption for Dividends from Foreign Companies

UK companies will generally be exempt from UK tax on dividends they receive from foreign companies after 30 June 2009. There are a few targeted exceptions to the new general exemption.

UK companies were already exempt from UK tax on dividends they receive from other UK companies. They were previously taxable however on dividends they receive from foreign companies, with a credit given for foreign withholding taxes suffered, and, where the

shareholding was 10% or more, for the taxes paid by the foreign company on its profits. The move to a general exemption brings the UK into line with some other European countries and is expected to boost its competitiveness as a base for international groups.

There are some consequential changes to the UK's "controlled foreign companies" rules, which are designed broadly to deter UK companies from diverting profits to low tax areas abroad. The CFC rules are now under review and are expected to be replaced by a new system in 2011.

### **Worldwide Debt Cap Threatens Tax Relief for Interest Payments**

For accounting periods beginning after 31 December 2009 UK companies will be subject to a "worldwide debt cap" rule and will be denied tax relief for interest payments to the extent, if any, that their net finance expense, from intra-group and external borrowings, exceeds the consolidated group's external finance expense.

Small or medium-sized groups, as defined under EU rules, will be exempt. These are groups with less than 250 employees and either turnover of less than €50m or balance sheet assets of less than €43m. Groups which do not come within this exemption and which have a UK member should review its financing before the end of this year and make such adjustments as are necessary to ensure that it qualifies for full tax relief on its interest payments.

### **USA**

#### **Bank Account Filing Requirement Temporarily Lifted for Non-residents**

Corporations registered outside of the US but doing business there through a permanent establishment have faced months of uncertainty as to whether they are required to file with the Internal Revenue Service (IRS) for the calendar year 2008 a form TD F 90 - 22.1, a Report of Foreign Bank and Financial accounts (FBAR).

US corporations, partnerships, trusts and estates, citizens and residents must report annually on the FBAR the financial interests that they have in foreign bank accounts, (where the aggregate balances on such accounts exceed US\$10,000), and any signing authority or other authority that they have over foreign bank accounts.

In October 2008 the IRS issued a revised version of the form in which for the first time it was stated that entities "in and doing business in" the US must complete and submit the FBAR. In the absence of a precise definition of this phrase, corporations registered outside of the US but carrying on part of their business in the US were unsure of whether they had a filing obligation.

Clarification has now come in the form of IRS Announcement 2009-51 that for 2008 FBARs, due on 30 June 2009, only US citizens, residents and domestic entities must file the forms. Foreign corporations doing business in the US are exempted.

Meanwhile, the IRS is working on further guidance to clarify for the future who is a "US person" and thus who has FBAR filing obligations.

#### **Tax Amnesty**

The IRS announced on 23 March 2009 the IRS Offshore Income Reporting Initiative. Under the initiative US taxpayers who make voluntary disclosures by 22 September 2009 of previously undeclared foreign accounts may avoid criminal penalties and civil fraud charges. Not all disclosures will be considered voluntary under the initiative and accuracy-related and other penalties may still apply.

This is a window of opportunity for US citizens and green card holders, whether resident in the US or abroad, to make amends for past filing omissions.



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#### **WorldHeadquarters**

2 Bloomsbury Street  
London WC1B 3ST  
United Kingdom

**T.** +44 (0)20 7314 6875

**F.** +44 (0)20 7314 6876

**E.** [info@bakertillyinternational.com](mailto:info@bakertillyinternational.com)

[www.bakertillyinternational.com](http://www.bakertillyinternational.com)