International review: key developments in 2012

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Europe

Ireland

Ireland recently introduced two provisions concerning the mobility of workers:

- special assignee relief program (SARP); and
- foreign earnings deduction (FED).

The SARP is available where the assignment commences in 2012, 2013 or 2014 and replaces the limited remittance basis available to non-Irish domiciled individuals on employment income. The SARP operates by granting an exemption from income tax on 30% of employment income between €75,000 and €500,000, equating to a maximum annual deduction of €127,500. For a marginal rate (41%) taxpayer, the net value of the relief would be €52,275. The relief can be claimed for the duration of the assignment up to a maximum of five years. The SARP does not reduce liability for the universal social charge or PRSI (social insurance contributions).

The FED is an incentive for companies assigning Irish based employees into emerging markets in Brazil, Russia, India, China, and South Africa (the BRICS countries). The relief operates by way of a deduction against employment income for employees who spend at least 60 qualifying days in a year in a BRICS country and will operate for three tax years commencing 1 January 2012 and ending on 31 December 2014.

France

As the austerity package begins to bite there are multiple tax changes on the table. A new income tax rate of 45% will be applied broadly on household income exceeding €150,000 and an exceptional rate of 75% in 2013 (with respect to 2012 income) on income exceeding €1m per person. Increased rates are also being applied to non-residents with French property, e.g. a holiday home.

France has just introduced a new rule that disallows the deduction of interest and other financing expenses incurred for acquisitions if the decisions relating to the shareholdings are not made in France or the control or influence over the acquired company is not exercised in France. This new rule therefore affects the tax treatment of French and non-French acquisitions by French companies held by international corporate groups or private equity funds that do not have an autonomous decision-making centre in France.

The rule concerns participation shareholdings, eligible for the French participation exemption regime, which provides for a 90% exemption of capital gains realised on the sale of shares. The rule does not apply to shareholdings in companies with assets that consist primarily of real estate assets or shares in real estate companies.

Spain

Spain has introduced several changes to its corporate income tax regime to deal with the financial crisis. These include:

- a further restriction on the carry forward of losses;
- replacing the thin capitalisation rules with a limitation on net financial expenses;
- reducing the deprecation rate of intangible assets with an indeterminate useful life from 10% to 2%; and
- introducing an optional 10% tax rate for dividends and gains derived from abroad.

Belgium

Until 2011, Belgium only applied its thin capitalisation rule to the payment of interest to a beneficial owner established in a tax haven. In 2012, Belgium strengthened its rule (5:1 debt:equity ratio) and extended it to interest paid to group companies. Companies are deemed to belong to the same group if one company has decisive influence over another company or if both companies belong to a consortium. If a loan is guaranteed or financed by a third party, that party will be deemed to be the beneficial owner if the main purpose of that guarantee or financing is tax avoidance. The deduction of interest paid on debt will be disallowed if, and to the extent of the excess, the total amount of the debt exceeds five times the company's equity.

Denmark

A law has been enacted that allows new machinery and equipment to be depreciated in an amount equal to 115% of the purchase price. The 'super-depreciation' will apply only to newly manufactured (unused) machinery and equipment acquired on or after 30 May 2012, and up to 31 December 2013. It will not apply to cars, ships, and certain leasing equipment or to machinery and equipment with a very long useful life, such as aircraft, oil rigs, power stations, and railway facilities. Qualifying equipment is added to the depreciation base with an increased value (i.e. 115% of the purchase price) and depreciated by an annual rate of 25%.

Italy

The Italian government approved a surcharge to be applied on income earned by all Italian residents for the period 2011–2013. This is intended to ease the European Central Bank and market concerns about Italy's economy. The surcharge will amount to:

- 5% on any income exceeding €90,000, up to €150,000;
- 10% over €150,000,

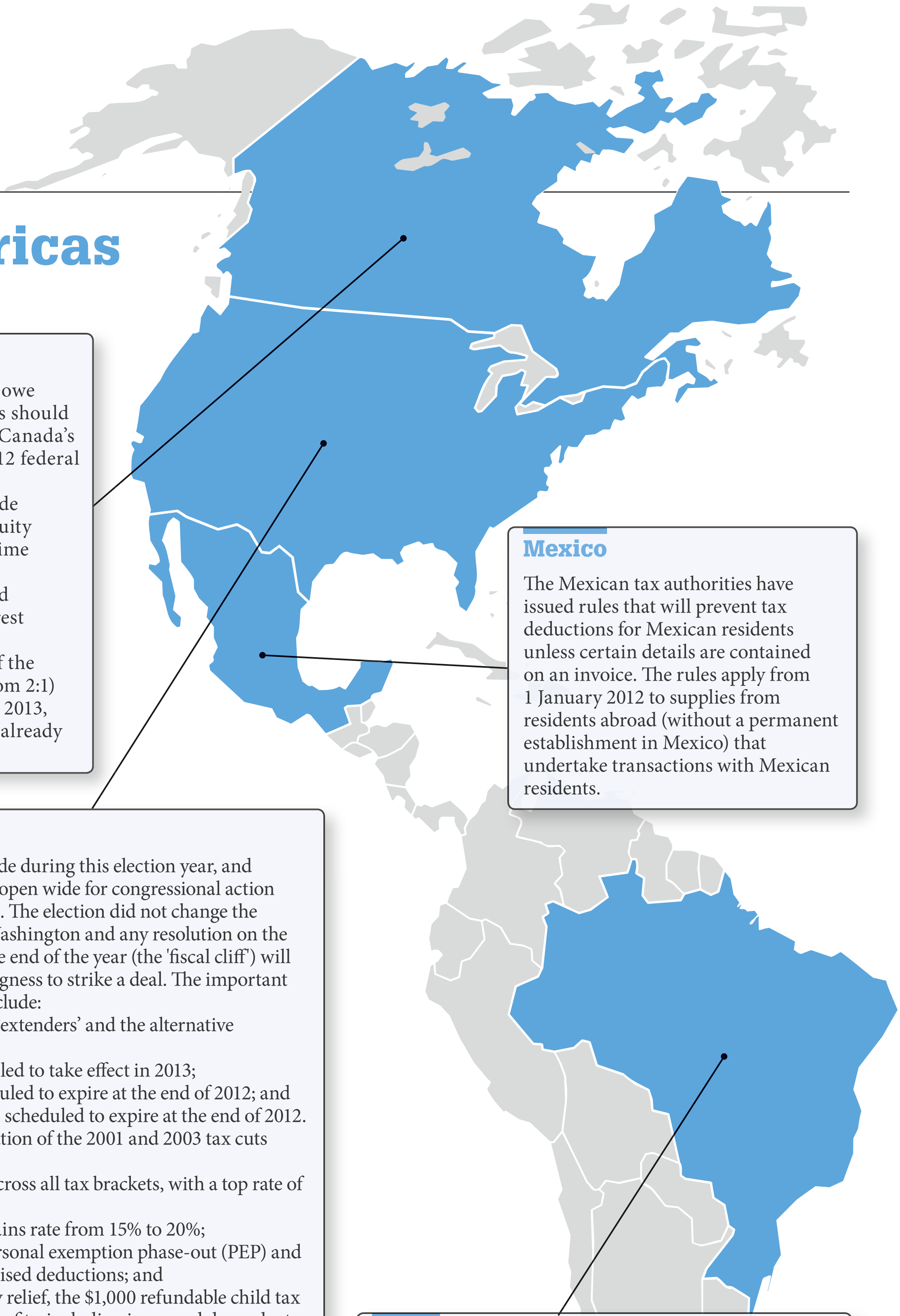
and would be deductible from the gross income as of 2012. In addition, if its application results in a marginal tax rate of more than 48%, taxpayers could opt to apply the 48% tax rate instead of the solidarity tax.

This charge will impact executives working in Italy who are subject to Italian personal income tax. Foreign companies with executives on an Italian assignment should factor this additional cost into their executives' compensation package.

Malta

Prior to recent amendments, Malta exempted royalties and similar income including any amounts paid for the grant of a license to exercise rights derived from registered patents for qualifying inventions, whether registered in Malta or elsewhere. The Maltese Parliament has approved amendments to the income tax law that extend the scope of the royalty exemption to cover income from some copyrights, thereby enhancing Malta's position as a European domicile of choice for intellectual property planning. The amendments apply retroactively from 1 January 2012.

The Americas



Canada

Canadian corporations that owe debt to certain non-residents should review the modifications to Canada's thin capitalisation in the 2012 federal budget.

These modifications include a reduction in the debt-to-equity ratio, an extension of the regime to partnership debt, and the introduction of a new deemed dividend rule for excess interest expense.

Although the reduction of the debt-to equity level to 1:5 (from 2:1) will generally not apply until 2013, other important changes are already in effect.

Mexico

The Mexican tax authorities have issued rules that will prevent tax deductions for Mexican residents unless certain details are contained on an invoice. The rules apply from 1 January 2012 to supplies from residents abroad (without a permanent establishment in Mexico) that undertake transactions with Mexican residents.

US

Very few tax changes were made during this election year, and the floodgates are expected to open wide for congressional action on changes scheduled for 2013. The election did not change the current balance of power in Washington and any resolution on the unfinished tax items before the end of the year (the 'fiscal cliff') will depend on both parties' willingness to strike a deal. The important tax issues for consideration include:

- expired provisions like tax 'extenders' and the alternative minimum tax (AMT);
- new Medicare taxes scheduled to take effect in 2013;
- the Bush-era tax cuts scheduled to expire at the end of 2012; and
- current estate and gift rules scheduled to expire at the end of 2012.

Without legislation, the expiration of the 2001 and 2003 tax cuts would result in:

- income tax rate increases across all tax brackets, with a top rate of 39.6%;
- an increase in the capital gains rate from 15% to 20%;
- the reinstatement of the personal exemption phase-out (PEP) and the phase-out of some itemised deductions; and
- the end of marriage penalty relief, the $1,000 refundable child tax credit and several other benefits, including increased dependent care and adoption credits, and enhanced education incentives.

New Medicare taxes enacted in the health care legislation are also scheduled to take effect in 2013. First, the rate of the individual share of Medicare tax will increase from 1.45% to 2.35% on earned income above $200,000 for single filers and $250,000 for joint filers. The 1.45% employer share will not change, creating a top rate of 3.8% on self-employment income. Second, investment income such as capital gains, dividends and interest will be subject for the first time to a 3.8% Medicare tax to the extent adjusted gross income exceeds $200,000 (single) or $250,000 (joint). This tax will not apply to active trade or business income that is not otherwise considered to be self-employment income, or to distributions from qualified retirement plans.

Brazil

A recent ruling created a new filing obligation for information concerning transactions involving non-resident persons regarding services, intangibles and any other operation with an impact on the equity of resident persons. The parties responsible for providing this information are those individuals and/or legal entities resident in Brazil who:

- render or contract services;
- dispose or acquire intangibles, including intellectual property rights, by any legal means;
- represent unincorporated bodies that carry out transactions which may change their equity value.

Africa

South Africa

On the 5 July 2012, the South African treasury published the Taxation Laws Amendment Bill to further help the government's goal of making South Africa the gateway to Africa for international investment. The bill seeks to address double taxation and offset aspects of the country's strong anti-avoidance legislation. A key provision of the bill offers relief from South Africa's effective management regime, which has served as a disincentive for firms wanting to use South Africa as their launching board.

Because much of Africa lacks economic infrastructure, overseas firms are forced to set up a significant portion of their overall African operation in the relatively more developed South Africa. In some cases, political instability and the lack of qualified personnel add to the difficulty, requiring companies to carry out most of their management in South Africa.

However, under South African tax laws, extensive guidance issued from South Africa to a related party in another African country crosses the effective management threshold. The company is deemed to be South African and is then treated as a resident for tax purposes. With taxes also due in the target African country, double taxation arises.

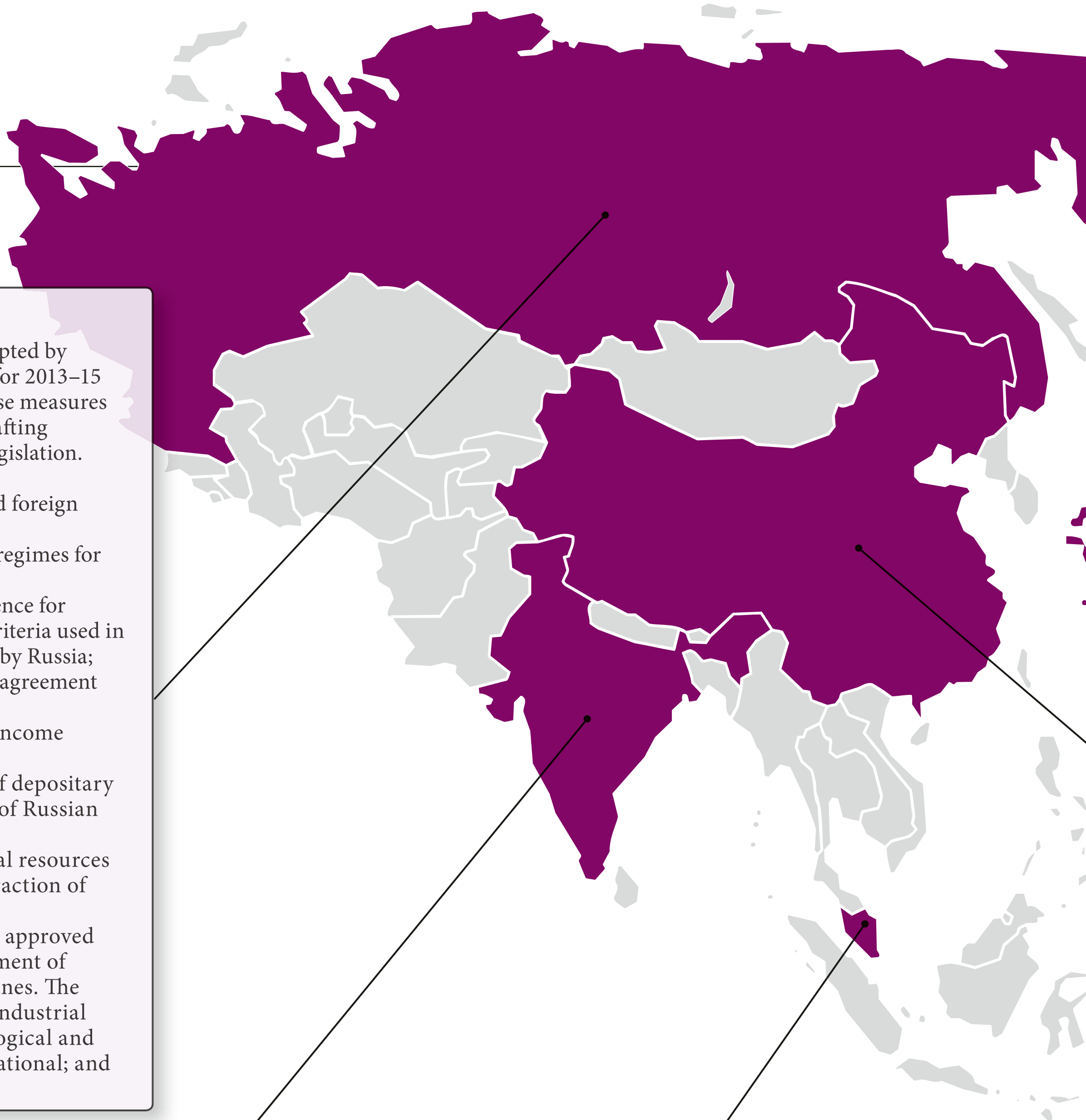
In order to promote South Africa as an ideal destination for international capital dedicated to African regional investment, an exception from the effective management test for foreign investment funds has been created. The purpose of the exception is to remove the potential to subject the fund to South African worldwide taxation if the fund is managed by a South African manager.

Mauritius

The Mauritian government has recently enacted the Limited Partnership Act which came into force on 5 December 2011. The Limited Partnership (LP) structure was introduced in Mauritius to add to the country's wide range of offshore products that already comprises companies, trusts and sociétés. The LP structure is of particular interest to managers in the private equity/ venture capital business who may use it to create an investment fund under the control of a general partner, who alone has unlimited liability for the partnership's obligations. The limited partner is only liable to the extent of his contributions, provided he does not take part in the management of the partnership business. The LP vehicle provides investors with benefits of a separate legal personality and limited liability protection while preserving the fiscal transparency and 'look-through' component associated with partnerships generally.In terms of taxation, only the share of profit allocated to the partners is subject to tax at the rate of 15%. An LP holding a category 1 global business license can choose not to have the partners taxed and opt for the LP to be treated as a company which in turn will be taxed at an effective tax rate of 3%.

Another key element introduced by the legislation is the registration of foreign limited partnerships in Mauritius – which might increase the tax planning options for those foreign limited partnerships subject to a tax rate higher than 15%. Those foreign limited partnerships that are eligible for a category 1 global business license would only be subject to tax at an effective rate of 3%.

Asia



Russia

Key tax policy trends adopted by the Russian government for 2013–15 have been published. These measures represent the basis for drafting amendments to the tax legislation. Significant proposals are:

- to introduce controlled foreign companies rules;
- to develop special tax regimes for small enterprises;
- to define the tax residence for companies based on criteria used in tax treaties concluded by Russia;
- to develop the mutual agreement procedures;
- to amend individual income taxation;
- to improve taxation of depositary notes and eurobonds of Russian issuers; and
- to increase the mineral resources extraction tax on extraction of natural gas.

The Russian government approved criteria for the establishment of four special economic zones. The four types of zones are: industrial and production; technological and innovative; tourist-recreational; and port operations.

India

The Finance Bill 2012 in India included a number of measures with international significance. These included:

- taxing indirect transfers of capital assets in India (with retrospective effect from 1 April 1962);
- the proposed introduction of a general anti-avoidance rule (GAAR), although this is now being deferred for further consideration;
- limiting benefits that can be claimed under a tax treaty by requiring a certificate of tax residence to prevent residents of third party countries claiming treaty benefits;
- denying treaty provisions where the GAAR applies;
- changes to the transfer pricing rules to: enable an advance pricing agreement to be obtained, valid for five years; expand the remit of the rules to include specified domestic transactions and intangibles; reduce the permitted variation from the arm's length price from 5% to 3%; change the appeals process; and change the powers and penalties.

India also had the controversial *Vodafone* decision around retrospective legislation. A high-level expert panel set up by the government has said retrospective amendments in tax laws targeting overseas mergers and acquisitions of companies with assets in India, should be scrapped. Retrospection should only apply in the 'rarest of rare cases'.

Malaysia

The Inland Revenue Board of Malaysia has recently issued a Public Ruling (PR) dealing with foreign nationals working in Malaysia to provide clarification as to the claiming of tax treaty relief for foreign nationals working seconded to Malaysia for a short period of time by non-resident employers. To be eligible for tax exemption in the country of source the following three conditions must be met:

- The foreign national is present in Malaysia for a period or periods not exceeding 183 days in aggregate in the fiscal/calendar year concerned; or the foreign national is present in Malaysia for a period or periods not exceeding 183 days in aggregate in any 12 month period commencing or ending in the fiscal year concerned
- The employer paying the remuneration must not be a resident of the country where the employment is exercised
- Remuneration is not borne by a resident or permanent establishment in Malaysia

The PR looks at the three conditions and how they are applied in Malaysia.

Japan

The Japanese government released tax reform proposals, which include a restriction on the deductibility of interest paid to some foreign affiliates (earnings stripping). Interest would be limited to 50% of adjusted taxable income, and the deductibility restriction would be in addition to the existing thin capitalisation rules. If enacted, the measure could have a detrimental impact on the Japanese operations of foreign companies that receive financing from offshore group companies. The regime would apply for fiscal years beginning on or after 1 April 2013.

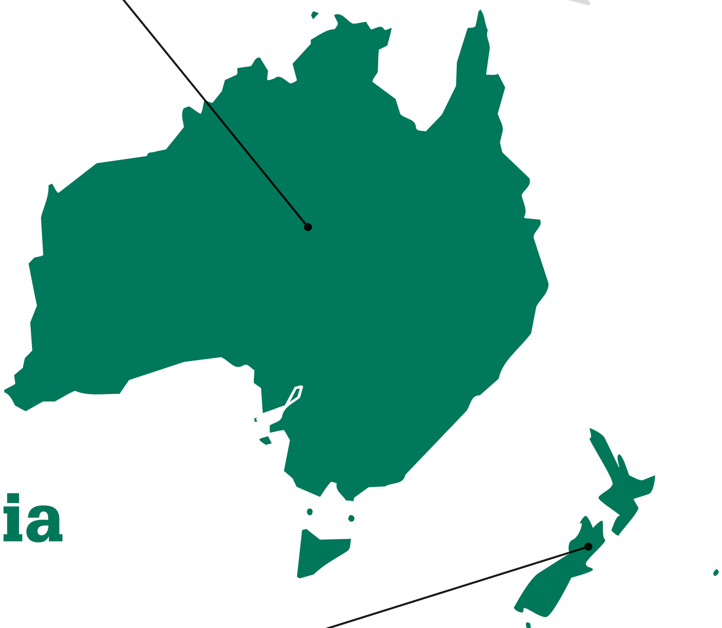
China

The State Administration of Taxation (SAT) issued an announcement providing rules on determination of beneficial owner under tax treaties.

Whether or not a resident of a contracting state is the 'beneficial owner' may not be decided merely on certain adverse factors or the absence of the intention of tax evasion or reduction and shifting or accumulation of profits. It must be determined on the basis of an analysis of the following: the article of association; financial statements; statement of cash-flow; minutes of the board of directors; allocation of human resources and assets; related expenditures; function and risk analysis; loan contracts; agreements on use or transfer of intellectual properties; certificate of the patent registration; certificate of the ownership of author's right; and contract on agency or designated nominee.

If the requesting taxpayer of the tax treaty benefit for the dividends derived from China is a listed company of the contracting state, the applicant automatically meets the definition of the beneficial owner. The same applies to 100% subsidiaries directly or indirectly owned by the listed company of the contracting state (the intermediate indirect shareholding in a third country is excluded) provided that the dividends stemmed from the shareholding of the listed company.

Oceania



Australia

On 22 November 2012, the Australian Treasury released the Exposure Draft of the Tax Laws Amendment (Cross-Border Transfer Pricing) Bill 2013: Modernisation of transfer pricing rules (Stage 2) which proposes to update Australia's domestic transfer pricing regime. The key impacts of Stage 2 are expected to be the following: the application of significant penalties to transfer pricing adjustments where the company does not maintain specific transfer pricing documentation; the intention of the Australian Taxation Office (ATO) to apply the new transfer pricing rules to all cross-border transactions, including transactions between third parties; shifting transfer pricing to a self-assessment basis, placing on the company's public officer the responsibility of determining the company's overall tax position arising from all cross-border dealings; the introduction of time limits of eight years on when the ATO can make transfer pricing amendments; and the introduction of specific rules allowing the ATO to reconstruct transactions and arrangements. Stage 1 of this process received Royal Assent on 8 September 2012 and focused on the retrospective application of transfer pricing rules for companies dealing with foreign associated entities located in countries that have a double tax treaty with Australia. Stage 2 focuses on how Australia's transfer pricing regime will operate prospectively for all taxpayers, including the application of significant penalties to transfer pricing adjustments where the company does not maintain specific transfer pricing documentation. The proposed changes align the existing transfer pricing regime to the self-assessment taxation system operative in Australia, placing on the company's public officer the responsibility of determining the company's overall tax position arising from all cross-border dealings.

Australia is also considering whether to update its own GAAR, which has now been in place for many years.

New Zealand

An issues paper for public comment *Taxation of foreign superannuation*, deals with the rules for taxing foreign retirement savings of New Zealand residents. Foreign retirement savings may have been accumulated by people migrating to New Zealand, or by New Zealanders who have previously worked overseas. The current law for taxing foreign retirement savings is complex and can produce inconsistent outcomes. The issues paper proposes a single set of rules, which are designed to achieve fairness and simplicity from a compliance perspective. The issues paper proposes the following: pensions would be taxed at an individual's marginal tax rate when received; lump-sum payments would be partially taxed depending on the length of time between when the individual arrives in New Zealand and the date that they transfer or withdraw their superannuation funds. At the time the funds are withdrawn or transferred from the foreign superannuation scheme, the individual would apply an 'inclusion rate'. The individual's marginal tax rate would be applied to the result calculated by multiplying the amount of superannuation funds withdrawn by the inclusion rate; and transitional residents would continue to be temporarily exempt from most New Zealand tax, including tax on foreign superannuation. Lump sums arising from a retirement benefit scheme in Australia are not taxable in New Zealand under the Australia/New Zealand income tax treaty (2009). Also, superannuation falling under the new arrangement with Australia regarding the portability of retirement savings would not be affected.