



businessbrief

The newsletter with regional tax and economic information

This newsletter is devoted to providing information on tax related and general business issues.

Contributions for inclusion in this newsletter are provided by member firms and are published in a regional format.

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Worldwide

AGN Consolidates its International Tax Expertise:

In November 2007 international tax experts from AGN member firms from Europe, The USA and Argentina met in London for the first International Tax Meeting. The group has formed itself into the International Tax Task Force and plans to meet once a year in November. The group has also elected Karl Horsburgh (Horsburgh & Co, Luxembourg) as Chairman, Dan Byrne (Rothstein Kass, USA) as Vice Chairman and Nancy Cruickshanks (Shipleys, UK) as Secretary.

The ITTF is looking for members from Asia and the Pacific to come and join them so that they have worldwide cover. The ITTF also hopes to organize an international tax meeting at the World Congress and looks forward to welcoming all international tax experts of AGN to come and discuss international tax experiences.

Below you will find a brief summary of what we discussed at the meeting. All the presentations are on the AGN International web site and each member can access and download them for their own use through the members area.

(Route: [www.agn.org/Members/Private_Home/Login/MembersOnly/International/International Tax Meeting](http://www.agn.org/Members/Private_Home/Login/MembersOnly/International/International_Tax_Meeting))

Tax Transparent Entities in the International Context:

(William Harwood, Meaden & Moore, USA)

We discussed elective transparency under U.S. tax law. A lively discussion centered around two "inbound" cases, i.e. involving investment by a non-U.S. company in a U.S. based operation,

In the first case, a Dutch BV, wholly owned by two Dutch residents, acquired a U.S. LLC. The U.S. LLC was allowed to keep its standard, transparent classification, and this resulted in the BV being treated as the U.S. taxpayer through a branch operation (permanent establishment). However, by filing an election with IRS, the Dutch investors were able to treat the BV as tax transparent for US tax purposes and thus the two individuals became the direct U.S. taxpayers. This allowed for lower annual tax on profits due to a splitting of the LLC income combined with the graduated rate bands applicable to individuals. Further, on sale of the LLC, a large portion of the recognized gain could be taxed at the preferred 15% capital gains rate which is not available to corporate entities.

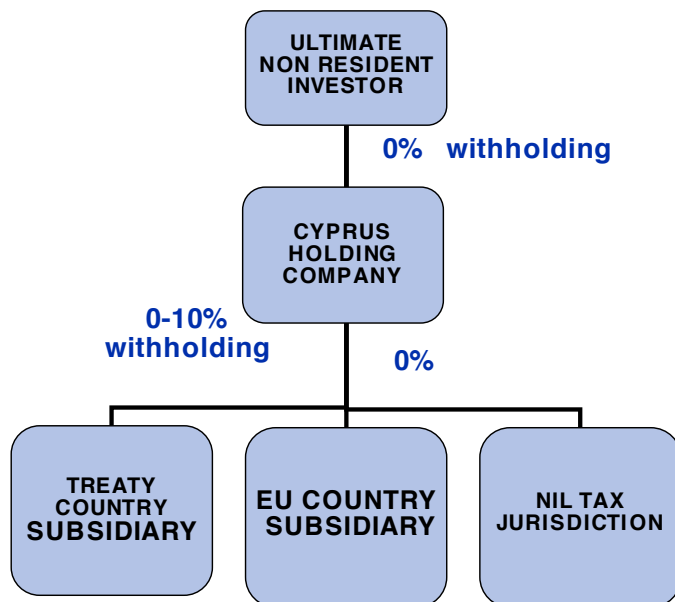
The second case involved a Swedish corporate investor, X, AB, who acquired US real estate through a newly created U.S. LLC. As the Swedish group had very little debt and a strong cash position, it funded the acquisition largely through a loan from the Swedish parent AB to the wholly owned U.S. LLC. Unfortunately, the group did not realize that the U.S. LLC will be treated as tax-transparent. U.S. tax law does not permit a PE to deduct interest on debt to the mother company, and the tax treaties are of very little help. The solution could be found in the filing of an election to treat the U.S. LLC as a taxable company. As in the first case, Meaden & Moore applied for special retroactive relief from the IRS. The relief in the first case has been granted, and relief in the second is now pending.

Why is a Cyprus Holding Company attractive?

(Kypros Protopapas, Joannides & Co, Cyprus)

- No tax on dividend income received from a company in which the Cyprus Company holds at least 1% provided the company which paid the dividend is not subject to tax at a rate which is less than 5%. If this is the case the exemption will still be available if the company which paid the dividend is not involved in investment activities contributing to its income by more than 50%. If this company's income is made up of dividends the exemption will still be available if such dividends did not arise from investment income.
- No withholding tax on payment of dividends and interest to non resident individuals or any corporate entities
- No tax on profits from disposal of shares
- No tax on the liquidation of the holding in another company.
- No thin capitalisation rules or debt-equity restrictions.
- No annual or Wealth taxes in Cyprus of either the holding or subsidiary companies.
- No minimum holding period of investments.
- Use of a wide tax treaty network with more than 40 countries as well as the EU parent subsidiary directive for international tax planning.

A typical Holding Structure is as follows:



-In most cases there shall be no taxes in Cyprus on dividends received from overseas subsidiaries, benefiting from the use of EU parent subsidiary directive and the use of favourable withholding tax provisions of the Cyprus double tax treaties

-The Cyprus holding company shall pay no taxes in Cyprus on the profit from the disposal of subsidiary shares or the disposal or liquidation of the Holding company

International Corporate Structures (Karl Horsburgh, Horsburgh & Co, Luxembourg)

Karl presented two corporate structure that he had recently set up for clients.

The first was a structure to buy real estate in France. Until January 1, 2008 it was extremely advantageous to purchase French property through a Luxembourg company. Due to the conflict between the French national law and the double tax treaty between France and Luxembourg if a Luxembourg company was the owner of an apartment block, an office building or a villa in France all rents earned and the final capital gain made on the sale of the building was completely tax free. No tax in France and no tax in Luxembourg. If the Luxembourg company was owned by a Cyprus holding company which in turn was owned by say a Maltese trust the beneficial owner could pay dividends from Luxembourg to Malta without any withholding or other taxes. However the treaty has been renegotiated and this no longer works with a Luxembourg company. However, replace Luxembourg with Denmark and you have the same benefit. The Cyprus holding is also necessary to avoid the French 3% annual tax based on the market value of the property. If you have the double EU company structure the French tax authorities do not impose the tax.

The second structure was to buy real estate in Germany. This is done by using Luxembourg companies as the unlimited and limited partners of a German limited partnership (GmbH and Co. KG). Combining this with Convertible Preferred Equity Certificates one is able to deduct all the interest paid on a bank loan from the rents earned which normally would be limited to a 1.5 to 1 debt equity ratio. Also the interest would move up the structure to the beneficial owner almost tax free.

VAT in the European Union (Magnus Loven, Frejs Revisionsbyrå, Sweden)

When doing business in the European Union it is very important to be aware of the VAT-rules. If you do not plan for the VAT or if you fail to report the VAT in the correct way, it may cause you a lot of problems and cost you a lot of money.

VAT in the EU is charged in each country according to national legislation. That legislation is based on and is interpreted in accordance with the VAT-directive. There are however still some differences between the countries as there may be different exceptions to the directive or some differences in interpretation.

When deciding if a company need to register, charge and report VAT in a country within the EU you first look at if the supply itself is exempted from VAT. Supplies of hospitals and medical care are for instance exempted from VAT. You then need to find the country of supply. It is the rules and VAT-rate of that country that will be used. After locating the country of supply you need to find who is responsible for reporting the VAT. The reporting could be done by either the seller or the buyer. If the buyer is responsible for the reporting the seller does not have to register for VAT in the specific country and do not have to charge VAT in the invoice. This is called the reverse charge system.

It is also important to keep track of the rules regarding recovery of VAT. A taxable person not established in a country will as a general rule be able to recover VAT paid on most goods and services within an EU country. The taxable person

will have to apply for a special refund in each member state. This is however only done if you are not registered for VAT within that specific country.

VAT Pitfalls and Opportunities Presentation (Nancy Cruickshanks, Shipleys LLP, UK)

Here are some examples of problems faced by her clients in relation to cross border transactions.

Hosting a conference – there is a mismatch between UK VAT and German VAT in that the UK requires organisers to register for and charge VAT in respect of conference income whereas German VAT law does not.

Provision of catering at a live event in Greece – Greek VAT law requires foreign businesses to appoint a fiscal representative and for supplier invoices to be addressed to the representative rather than the business. Reissue of invoices is not permitted by Greek VAT law so if incorrectly addressed the VAT cannot be recovered.

Pre-registration expenses – Spanish VAT law does not appear to allow recovery of VAT incurred on pre-registration expenses.

Argentine and Regional Tax Opportunities (Alberto Adaminas, Elizalde, Casares & Asociados, Argentina)

The taxation in Argentina is based on the following taxes: Income Tax (Corporate and Individuals), Tax on Minimum Presumed Income, VAT, Personal Assets Tax, Excise Tax and Turnover Tax. There are several special benefits and systems for the software industry, non natural forests (plantations) and mining industry, among others.

Argentina, to avoid double taxation, has in force treaties with the followings countries: United Kingdom, Spain, Italy, France, The Netherlands, Germany, Austria, Finland, Sweden, Belgium, Denmark, Switzerland, Norway, Brazil, Canada, Chile, Bolivia and Australia.

Besides that, there are special structures to improve the tax planning in cross border transactions with Argentina, like the utilization of Spain ETVE as Holding Company, Chilean Platform System for doing business in the region, financing in Brazilian investments by Argentine companies, and a Trading Company in Uruguay.

Investing in U.S. Real Estate and Other U.S. International Tax Planning Ideas (Daniel M. Byrne, Rothstein Kass, USA)

In order to avoid U.S. estate tax on real estate owned in the U.S., which may be as high as 45 to 55 percent depending on the year of death, non-U.S. investors generally should not purchase U.S. real estate directly and should not directly own U.S. corporations that own such U.S. real estate. Rather, it is generally advisable to set up a non-U.S. holding corporation, which can be located in a tax haven jurisdiction, that in turn will own a U.S. corporation that owns the U.S. real estate. If desirable from a non-U.S. perspective, the non-U.S. holding company and the U.S. subsidiary can be organized as partnerships that make a “check-the-box” election to be treated as corporations solely for U.S. tax purposes.

A healthy amount of related-party debt, with commercially acceptable terms, should be used to finance the U.S. real estate subsidiary in order to reduce the U.S. tax base by the interest charged on the loan and allow for a “cash out” repayment of loan principal without U.S. withholding tax in the case of refinancing. This can be advantageous even if the lender is located in a tax haven jurisdiction because the interest expense normally results in a combined U.S. federal and state tax benefit of 40 percent or more, while the U.S. withholding tax rate on that interest is only 30 percent. The 30 percent U.S. withholding tax can be avoided altogether if the related party lender is located in a U.S. treaty jurisdiction that exempts the interest from withholding and preferably a country that provides for a low effective tax rate on the related interest income.

There are only a few remaining jurisdictions that provide a low effective tax rate on interest income and, at the same time, have a tax treaty with the U.S. that does not currently contain comprehensive “limitation on benefits” (“LOB”) provisions: Hungary, Poland, and Iceland. A new treaty with Iceland containing a comprehensive LOB provision was signed on October 23, 2007 but is not yet in force. In addition, the Treasury Department recently announced that the treaties with Hungary and Poland are being renegotiated to add comprehensive LOB provisions. However, given the amount of time it may take to finalize the negotiations and have these changes enter into force, Hungary and Poland may still provide significant tax benefits for another year or two. After the new treaties take effect, some refinancing would be required.

Asia / Pacific

Malaysian Budget 2008

On the 7th September 2007, the Finance Minister unveiled the 2008 Budget, themed *Together Building The Nation and Sharing Prosperity*.

Tax-related highlights of the 2008 Budget include:

- ◆ Reduction of corporate income tax rate:
The corporate tax rate has been reduced to 26% for Year of assessment (YA) 2008. For YA 2009 and subsequent YAs, the corporate tax rate will be further reduced to 25%. The new rates will apply to the following entities:
a company, a trust body, an executor of an estate of a deceased individual who was domiciled outside Malaysia at the time of his death; and a receiver appointed by the court pursuant to Section 68(4) of the Act. However, for small and medium companies the tax rate for chargeable income up to RM500,000 remains at 20%. The proposal is effective from YA 2009.
- ◆ Single tier tax system:
To simplify and enhance the efficiency of the tax administrative system, the single-tier company income tax system has been proposed to replace the current imputation system. The tax payable by a resident company will now constitute a final tax. Dividend paid under the single-tier system will be tax exempt in the hands of shareholders.
- ◆ Exempting small and medium enterprises from submitting tax estimates for the first two YAs:
To mitigate the financial limitation of newly established SMEs with paid up ordinary share capital not exceeding RM2.5m, it is proposed that the newly set up SMEs be relieved from furnishing tax estimates or making tax installments for a period of two years of assessment beginning from the YA the company commences operation. Full income tax payment is to be made only upon submission of tax returns. The proposal is effective from YA 2008.
- ◆ Removal of service tax thresholds for professional, consultancy and management services:
To promote healthy competition among the same service providers, it is proposed that the service tax licensing threshold for professional, consultancy and management services be abolished. This means that the service providers have to be licensed once there is an intention to trade as service tax needs to be collected from the first invoice.
- ◆ Streamlining of tax treatment for expatriates working for International Procurement Centres and Regional Distribution Centres.
- ◆ Allowing Labuan offshore companies to elect to be taxed under the Income Tax Act 1967.
- ◆ Extending stamp duty exemption for mergers and acquisitions of listed companies.
- ◆ Increase of tax benefits for Islamic fund management activities and Takaful businesses.
- ◆ Review of incidence of double taxation in life insurance business.
- ◆ Deductibility of discounts or premiums on bonds.
- ◆ Non-application of balancing charges on the disposal of industrial buildings to Real Estate Investment Trusts (REITs).
- ◆ Rationalisation of Information and Communication Technology incentives by centralizing such activities in Cybercities and Cybercentres.
- ◆ Enhancing the tax incentives for companies involved in renewable energy and conservation of energy.

Europe

EU: Eurostat Tax Burden Report

In June of 2007, Eurostat published a report indicating that the overall tax burden in the EU increased to 39.6% of GDP in 2005. The EU tax ratio exceeds the ratio of the United States by approximately 13 percent. The tax burden varies in the EU from 28% in Romania to 51.3% in Sweden.

The average tax rate on labour, including social security, amounted to 35.2%, and ranged from 22.1% in Malta to 46.4% in Sweden. Tax on labour is generally much higher in the EU than in the US and generates 50% of EU tax revenue.

The average rate of consumption taxes within the EU increased to 22.1% in 2005, highest in Denmark at 33.7%, and lowest in Spain at 16.3%. Consumption taxes accounted for approximately 28% of all tax revenues.

The average rate on capital increased to 27.3% in 2005 with the highest rates, again, in Denmark (46.5%), and the lowest in Estonia (8.1%).

The top personal income tax rate is also in Denmark at 59.0%. Germany had the highest corporate income rate at 38.7%. Low corporate rate countries included Bulgaria and Cyprus (both 10.0%), Ireland (12.5%) and Latvia (15.0%).

(Provided by William Harwood, Meaden & Moore, USA)

Czech Republic: New Tax Regulations

The recent Act on Stabilisation of Public Finances will significantly affect the tax regulations from 1 January 2008 and key changes include the following:

Personal Income tax

- ◆ The tax exemption for transfer of securities by natural persons will in future only apply if a maximum of 5% of the registered capital has been held for two years before the sale, otherwise it is "reclassified" to the category of sales of shares in other trading companies where there is a five year holding period to qualify for the exemption.
- ◆ The exemption from income tax on interest from mortgage bonds has been cancelled.
- ◆ The minimum tax for natural persons – entrepreneurs has been cancelled.
- ◆ The income tax rate will be 15% (12.5% from 2009) instead of progressive rates from 12% to 32%. As the tax base will be the "super-gross" income the effective rate for employees for 2008 will be 23.1% and approximately 19.3% for 2009.
- ◆ Social security and health insurance costs will no longer be tax deductible for employees and the self-employed, and insurances paid by employers will increase the employees' tax base.
- ◆ Spouses will no longer be taxed jointly because the unified rate has been introduced.
- ◆ There are substantial increases in the sums reducing the annual tax liability; the amount available to each taxpayer amount increase from CZK 7,200 to CZK 24,840, and the per child allowance increases from CZK 6,000 to CZK 10,680.

Corporate income Tax

- ◆ The sale by a parent company of shares in a subsidiary in accordance with the EU parent subsidiary directive will be exempt from corporate income tax. If the subsidiary is not tax resident in the EU then the exemption may still apply if other conditions, such as the country of residence having concluded a double tax treaty with the Czech Republic, and the corporation tax rate being at least 12%, so the final obstacle to the Czech Republic being a location for international holding companies has now been removed.
- ◆ The corporate income tax rate will be reduced from 24% to 21% in 2008, 20% in 2009 and 19% in 2010.
- ◆ Liabilities unpaid or lapsed for 36 months must be added to the tax base. This basically applies to liabilities whose origin was linked to the origin of costs for the taxpayer.
- ◆ Costs arising from the demonstrable liquidation of inventories of stock, goods, unfinished production, semi finished and finished products will be tax deductible.
- ◆ For finance lease costs to be tax deductible the lease term must correspond at least to the minimum depreciation period, in the case of real estate, 30 years.
- ◆ There is increased scope for a binding agreement from the tax administrator (e.g. in the case of both business and non-business use of an asset), for the appraisal of whether expenditure is on technical improvements or regular costs etc.
- ◆ The tax deductibility of interest. There are additional conditions to be fulfilled, even for unrelated entities, and the term "financial costs" is expanded to include related costs such loan processing or guarantee fees. Implementation of the new rules to existing arrangements will be deferred until 2010.
- ◆ The maximum acquisition price for cars of CZK 1,500,000 is cancelled.
- ◆ The 4 year deprecation "group 1a" is cancelled, cars will be reclassified to "group 2" and depreciated over 5 years.
- ◆ Provisions against receivables or debts over CZK 200,000 will in future only be tax deductible if "recovered in court".

Value Added Tax

- ◆ The lower VAT rate will increase from 5% to 9%.
- ◆ Groups of related entities will be able to jointly register and make one overall VAT payment.
- ◆ Apartments up to 120 m² and houses up to 350 m² which are for social living will be subject to a lower VAT rate in relation to their construction and transfer.

Other

- ◆ There will be no obligation to use cash registers from 1 January 2008.
- ◆ The minimum tax on tobacco products will be increased from CZK 1.64 to 1.92 per cigarette and from CZK 905 to CZK1,280 per Kg of tobacco.
- ◆ A maximum base for social and health insurance will be introduced for employees and the self-employed equal to 4 times the average wage.
- ◆ Other taxes will be implemented, notably on natural gas, solid fuels and electricity.

(Provided by Martin Felenda, Schaffer & Partner, Czech Republic)

France: The Sarkozy reforms (LE PAQUET FISCAL): A Summary

During his presidential campaign, Nicolas Sarkozy promised to introduce certain wide ranging tax reforms in order to increase hours worked and to enhance the spending power of the French people. This also benefits non-French people who have an exposure to French tax.

The reforms include measures dealing with the following:

- ◆ tax and social security contribution exemptions for overtime worked above the 35 hour week currently in place
- ◆ tax exemptions for certain students in employment
- ◆ income tax relief for mortgage interest paid on the acquisition of a main residence
- ◆ important reductions/exemptions from gift/succession duties
- ◆ enhancement of the “*bouclier fiscal*” (tax shield) system
- ◆ wealth tax changes.

This article will concentrate on the last four of these measures which will have an impact on private clients.

Mortgage interest relief

This measure gives relief for interest paid on mortgages taken out from 6 May 2007 to buy a main residence.

Limits to the relief are as follows:

- ◆ It applies only to the first five years of the mortgage
- ◆ 20% of the interest paid each year, with the amount of interest capped at €3,750 for a single person or €7,500 for a married couple or couple under PACS. The caps are increased by €500 for each dependant child.

It should be pointed out that this cannot apply to non - French residents. Also, the concept of a “*foyer*” applies, so relief is given to the household as a unit.

Succession and gift duty changes

The new law introduces material changes:

- ◆ As in the UK, transfers **on death** between spouses are now fully exempt, whereas previously transfers over €76,000 could be taxed up to 40%
- ◆ The rights of partners under PACS are now equivalent to those of married couples.
- ◆ Gifts during lifetime between spouses and partners under PACS remain taxable over €76,000

Remember that inheritance law in France often prevents the testator from leaving everything to a widow(er), or a surviving partner of a PACS.

- ◆ The exemption for transfers on death or lifetime gift is increased to €150,000 for transfers from parents to children, and children to parents (previously €50,000).

Other changes include:

- ◆ increase in exemptions for siblings, from €5,000 on death only to €15,000 on both gifts and death
- ◆ increase in exemptions for nieces and nephews, from €5,000 on gifts only to €7,500 in both gifts and death
- ◆ abolition of the €50,000 exemption on death which was shared by various family members.
- ◆ There is a new exemption for cash gifts to your children, grandchildren, and great grandchildren, of €30,000 provided that the donor is over 65 years of age and the recipient is over 18 years of age. Note that this exemption is in addition to the general gifts exemptions.

As previously, these limits apply cumulatively every 6 years. Also, it is worth noting that all of the exemptions, as well as the tax bands applicable will be increased in line with inflation on 1st January each year.

Enhancement of the “*Bouclier Fiscal*” (tax shield)

The “*bouclier fiscal*” is essentially a measure under which certain taxes paid by a French-resident household are limited to a certain percentage of the household’s worldwide income and additionally gains.

Previously, this was set at 60%, but in future this will be reduced to 50%.

Taxes previously included were:

- ◆ Income tax
- ◆ Capital gains tax
- ◆ Wealth tax
- ◆ Property taxes (*Taxe d’Habitation* and *Taxes Foncières*) on the main residence.

The new measure also includes the 11% social surcharge on unearned income and gains.

These two changes represent a significant improvement to the regime introduced last year.

Note that the tax shield applies only to French residents. It is likely to benefit wealthy individuals moving to France who are able to live off capital, and with relatively little income.

Wealth tax changes

- ◆ The existing 20% allowance against the value of the main residence for the calculation of wealth tax is increased to 30% from 1st January 2008. Clearly this can only be of benefit to a French resident.
- ◆ A reduction of wealth tax payable will be given to those who invest in certain small or medium trading companies based in the EU, Iceland and Norway. The reduction in wealth tax is calculated at 75% of the amount paid for share capital in the year, subject to a cap on relief of €50,000. Anti-avoidance rules will apply.

(Provided by Sophie Lemaitre, Dixon Wilson, France)

Portugal: Stamp Duty Tax on increases in Share Capital

According to article 1 of the Portuguese Stamp Tax Duty Code and section 26 of the Portuguese Stamp Tax General Table, increases in a company's share capital are taxable at a rate of 4%.

However, on 21st June 2007 the European Community Court of Justice (ECCJ) announced that it considered this is incompatible with the European Community Directive 69/335/EU that regulates the indirect taxes on capital increases. This would appear to be on the basis that at the time Portugal joined the EU it had not established the right to charge stamp duty on share capital increases.

In fact, the European Commission itself has already defended the proposal given that the existence of the charge may negatively influence the competitiveness of Portuguese companies (in general) and, consequently, of the Portuguese Economy, by discouraging investment.

The charge makes *private equity* and *public equity* less appealing. The removal of this cost will, at the same time, contribute to the reduction of the use of mechanisms that intend to avoid this taxation, namely, capital increase operations from financial centres located in more favourable tax jurisdictions.

In the short term, the sentence pronounced by the ECCJ should have two consequences:

- ◆ the revocation of the Stamp Duty taxation over capital increasing operations;
- ◆ Repayment of amounts improperly collected under this practice (including penalties etc) to taxpayers who make the appropriate claim.

The ECCJ decision has a retroactive effect to 2003. This is the period defined by the Portuguese Law (a period of 4 years from the payment act), as the deadline for a tax act revision (considering that the Tax Authorities are responsible for the mistake).

This will result in a short term cost to the Portuguese Treasury

but macroeconomic theory is that this will be exceeded by an increase in future revenues. Even so, taking into account only the companies which paid this tax which are listed on the Euronext Lisbon (Portuguese stock market), the amount to be repaid is expected to reach a sum of approximately 14 million euros.

Considering the amounts involved in every single capital increase since 2003 and, additionally, if we also add the associated interest etc, the total refunds will be a considerably higher amount.

(Provided by João Luís, Auditum & Associados, Portugal)

Spain: New Accounting Principles:

The Spanish Ministry of The Economy has published a new legal decree which specifies a new set of accounting principles ("Plan General de Contabilidad"), the aim of which is to adapt Spanish accounting rules to IFRS on the basis of the recommendations issued by the European Union.

The new accounting principles and policies, which include updated charts of accounts, have been created by a commission of experts and regulatory bodies for application to all kinds of companies, and include some modifications for smaller companies.

The new "Plan General de Contabilidad" will be effective and compulsory from January 2008 and will apply to all types of regulated companies in Spain.

(Provided by Manuel Satorra, Satorra, Planas & Asociados, SL, Spain)

UK – VAT Update

Side Effects of Carousel VAT Fraud

HM Revenue & Customs (HMRC) have attempted to combat Carousel VAT fraud by targeting the industry sectors most likely to be affected.

However, in order to perpetrate such fraud it is essential to be registered for VAT. So VAT Registration Units are instituting more thorough checking procedures to detect and reject fraudulent applications.

This may be a laudable aim but it is causing problems for legitimate taxpayers who are required to send large quantities of documentary evidence confirming the existence of the business and the bona fides of its activities even though the form itself makes no mention of this. As a consequence, the turnaround time for applications has increased from three weeks to up to nine months. This is a serious concern as it can cause major cashflow headaches, difficulties with customers, and in some case loss of business.

HMRC have, belatedly, recognised the need to improve performance and are taking steps to do so. For example, we understand that all applications should, for the time being, be sent to Wolverhampton office from where they are distributed for processing. This does appear to be having a positive effect, but at this stage it is advisable to assume the worst and build the delay into cashflow projections and business plans.

Film Fraud

The fraud investigators of HMRC have also been busy in other areas.

A recent example involved a film producer and serves as a timely warning as the individual concerned has been jailed for five years after fraudulently obtaining VAT repayments in excess of £4 million.

In our experience many VAT Officers find the film industry difficult to understand, and may become more suspicious than is warranted. This can lead to delays in receiving repayments, lengthy and expensive investigations, fines and interest charges.

It pays, therefore, to take advice and ensure that VAT is dealt with properly and expeditiously.

Company Credentials

Since the creation of HM Revenue & Customs many of the work practices of the former Inland Revenue have migrated across into VAT.

One example is that callers to the VAT helpline are routinely asked security questions relating to recently submitted VAT returns or correspondence.

Written correspondence received from persons other than directors, partners or proprietors of businesses is often rejected unless the author of the letter can produce written authority to engage in correspondence.

This can cause problems for many businesses that routinely delegate VAT functions to accountants and external advisers.

Employees' Computers

In 1999 the Government introduced a tax exemption to enable employers to lend computers to employees for use at home without incurring a tax charge, and recovery of the related input VAT was allowed even though some private use of the computer was anticipated.

The tax relief was withdrawn from 6 April 2006, so Customs have now followed suit by withdrawing the right to full input VAT recovery. With effect from 13 August 2007 it will be necessary to apportion the input VAT to reflect the private use.

(Provided by Stuart Dey, Shipleys LLP, United Kingdom)

North America

Pending Changes to the Canada-U.S. Tax Treaty

This article highlights several important changes contained in the Fifth Protocol (the "Protocol") to the Canada-U.S. Tax Treaty (the "Treaty") signed on September 21, 2007. The Protocol enters into force on the later of January 1, 2008 or the date by which both the Canadian and U.S. governments ratify it into the laws of each country. Generally, and unless otherwise noted below, the provisions of the Protocol will apply to taxation years that begin after the calendar year the Protocol is ratified by both governments.

Extension of Treaty benefits to U.S. members of LLC's

U.S. limited liability companies ("LLC's") are not currently eligible for Treaty benefits because Canada's position has long been that LLC's do not meet the Treaty definition of a U.S. resident since an LLC, unless it elects to be treated as a corporation for U.S. purposes, is not subject to tax in the U.S. Canada has historically refused to look through LLC's and grant Treaty benefits to LLC members who are U.S. residents.

The Protocol will extend Treaty benefits to income, profits or gains derived by U.S. residents through LLC's. This welcome and long awaited change will provide U.S. residents who earn Canadian source income through LLC's with the same Treaty benefits that would be available if they earned Canadian source income directly.

Denial of Treaty benefits to Canadian unlimited liability companies

The Protocol contains a new rule that may adversely affect U.S. residents carrying on business in Canada through Nova Scotia or Alberta unlimited liability companies ("ULC's").

ULC's are treated as taxable corporations by Canada. However, because ULC's are generally disregarded entities for U.S. purposes, ULC's have become popular entities through which U.S. residents earn Canadian source income in part because Canadian corporate taxes paid by ULC's may be claimed as a foreign tax credit by the U.S. residents.

Generally, this new rule provides that certain income received by U.S. residents from a ULC is not entitled to Treaty benefits where (i) under Canadian tax law, a U.S. resident is considered to have received income from an entity resident in Canada, and (ii) because the entity is disregarded for U.S. purposes, the treatment of the amount received under U.S. tax law differs from what it would be if the source of income was not a disregarded entity. This means dividends and interest paid by ULC's would not be entitled to Treaty reduced rates of withholding tax and instead be subject to Canada's domestic withholding tax rate of 25%.

These rules are not effective until at least 2010.

Treaty definition of Permanent Establishment

The Treaty definition of permanent establishment will be amended to deem a permanent establishment to exist in the other country where (i) services are performed by an individual who is present in the other country for more than 182 days in any 12 month period and during that period more than 50% of the gross business revenue of the enterprise is derived from services performed in the other country by the individual, or (ii) services are provided in the other country for more than 182 days in any 12 month period with respect to the same project or a connected project for customers who are resident in the other country. Projects will be considered

to be connected if they constitute a coherent whole, commercially and geographically.

These rules are not effective until at least 2010.

Canadians moving to the U.S.

Under Canadian tax law, when a Canadian resident emigrates from Canada, the individual is deemed to dispose of most types of property for proceeds equal to fair market value. However, the U.S. does not recognize this fair market value deemed disposition on emigration from Canada to the U.S. This can result in double taxation if the individual later disposes of the appreciated property after becoming a U.S. resident. The Protocol will provide that where an individual is subject to a fair market value deemed disposition upon moving to the U.S., the individual can elect for U.S. tax purposes to increase the cost base of property owned on the date of emigration from its historical cost to its fair market value.

It should be noted that Article XIII(7) of the current Treaty already provides for such an election but this election has only been available in the past to U.S. citizens moving from

Canada to the U.S. The Protocol will therefore extend the availability of this election to all Canadians residents moving to the U.S.

This rule applies to deemed dispositions on emigrations that took place after September 17, 2000. U.S. tax advisors may want to review prior year capital gains reported by non-U.S. citizen clients who moved to the U.S. from Canada after this date.

Withholding tax on cross border interest payments

The rate of withholding tax on cross border interest payments is currently 10%. Withholding tax on cross border interest payments to an unrelated person will be eliminated two months after the Protocol enters into force.

Withholding tax on cross border interest payments to a related person will be gradually phased out. The rate will decline to 7% for the calendar year the Protocol enters into force, 4% in the following year and be eliminated thereafter.

(Provided by Glen MacMillan, Adams & Miles, Canada)

West Asia and Africa

Related Party Transactions – recent IFAC Exposure Draft:

Auditors and businessmen alike are required to be aware of the proposed new definition of related party “a party that either: controls or significantly influences the entity whether directly or indirectly; is controlled or significantly influenced by the entity; or is under common control with the entity”.

The International Auditing and Assurance Standards Board (IAASB) have recently issued an exposure draft of a revised and redrafted version of ISA 550, Related Parties. This is the second exposure draft of ISA 550 to be issued, the first having attracted significant comment. As a consequence of the extent of the changes made following the initial consultation, the IAASB has decided to re-expose the standard.

The standard identifies the objectives of auditors, when considering related parties to be: obtaining sufficient evidence about the required accounting and disclosure of related-party information and transactions; understanding how related parties might affect the view given in the financial statements; and identifying the risk of fraud arising as a consequence of related-party relationships.

The exposure draft includes a new definition of related-party to help set a minimum level for audit purposes. This will be relevant to those jurisdictions whose accounting framework does not include requirements with respect to the disclosure of related-party transactions. The suggested definition is a party that either: controls or significantly influences the entity whether directly or indirectly; is controlled or significantly influenced by the entity; or is under common control with the

entity. In line with this change to the definition the proposed requirements, with respect to the enquiries required of management to enable the auditor to identify related parties, have also been amended from the original exposure draft, in order to restrict them either to the requirements of the relevant reporting framework under which the entity has to report or the definition within the ISA.

The original exposure draft contained provision that auditors would have to search for ‘significant’ and ‘non-routine’ transactions, a requirement that many commentators thought might not be cost-effective and which also ignored the potential risks associated with routine related-party transactions that were either unidentified or undisclosed. Instead of the active search envisaged in the original exposure draft, auditors will instead be required to make enquiries of management about the existence of related parties when, during the audit, significant transactions outside the normal course of business are identified.

Finally, the inclusion in the first exposure draft of a list of certain documents that were required to be reviewed by auditors caused concern to many commentators. However, the IAASB has retained a revised list of documents that the auditor must review, albeit now restricted to bank and legal confirmations and minutes of meetings of shareholders and those charged with governance.

(Provided by Saad Maniar, Mak & Associates, Dubai, UAE)

European Regional VAT Survey 2007

Introduction: It is recognised that the attitude of business towards taxation has always been to regard it as simply another cost. So like any other item of expenditure business will try to control and minimise taxation. This was not always the case for VAT which was, in its earlier years, almost completely ignored because it was not considered to be a cost and therefore did not require minimisation or control.

This was partly because business accounting records are compiled on a VAT exclusive basis and irrecoverable VAT was generally hidden from view. In addition costs of compliance were relatively small as VAT was simply a small additional burden placed on existing accounts staff. So for a long time it was not obvious that VAT was a potentially large cost to business.

However the continuing trend towards complexity and ever increasing rates of VAT have led to a recognition by all businesses that VAT can become an enormous drain on resources for two main reasons:

1. The cost of complying with VAT regulations can be extremely high and the cost of getting things wrong is potentially extremely damaging; and
2. More and more businesses are faced with the prospect that not all VAT incurred on business expenses is recoverable.

The objective of the annual VAT survey attempts to identify and compare key aspects of the VAT rates and systems in place across Europe including the recovery of VAT by a company established in one European country from all other European countries. By so doing it is hoped to provide a useful tool to help business control the ever spiralling cost of VAT.

Countries Covered: The 2007 survey covers 31 countries (27 members of the EU as well as Croatia, Isle of Man, Russia and Switzerland).

Results of the 2007 Survey

VAT Rates: From this it can be seen that there is a wide variation in rates of VAT across Europe which can be a hidden source of VAT cost to business. Firstly, a high standard rate will result in a heavy cost for any business unable to fully recover VAT or which incurs high expenditure on items for which VAT recovery is specifically blocked. Secondly, the existence of so many rates adds to complexity and pushes up compliance costs. This will be a particular problem for any business looking to expand into other countries.

Registration Thresholds: The wide variation in VAT registration thresholds is another indicator of potential complexity and a trap for the unwary business involved only periodically in cross border transactions.

Reporting Requirements: Any business that is looking to establish in another jurisdiction the confusing array of VAT reporting requirements can cause a major compliance headache and add to costs. This is particularly highlighted by the many and varied reporting periods and timescales. In theory compliance costs within the EU should be lower due to the existence of the Single Market. However, although the introduction of the Single Market regulations happened 15 years ago the VAT rules in the EU are a long way from being harmonised. As a result international business is just as costly in the EU as elsewhere.

Conclusion:

The main conclusions from the 2007 VAT Survey are therefore:

1. Never assume that the VAT system in another country is in any way similar to your own; and
2. Always beware of VAT.

So it is advisable to check out the VAT implications of a transaction before rather than after the event.

Before taking or refraining from action in relation to the above, specific professional advice should be taken.

Full details of the AGN surveys, including a chart comparing the countries surveyed, can be downloaded from the internet at www.agn-europe.org Our Organisation Latest-Tax Surveys

VAT - 2007
A European Comparison

