



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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Asia / Pacific

Australia – now a more competitive tax location

Australia has one of the most complicated tax systems in the world – little wonder it has not been a very attractive international investment location – but the latest reforms change the way Australia taxes, both Australians investing offshore and foreign investment in Australia. Being introduced in stages, what is important is not the number of tax reforms, but their effectiveness, particularly in the Asia/Pacific region.

Recommendations & Reforms

The Board of Taxation in Australia had four main objectives:

- attract equity capital for offshore expansion
- maintain Australia's competitiveness in a global economy
- promote Australia as a location for internationally focused companies
- promote Australia as a global financial services centre

The Board introduced two main reforms as the RITA package. As part of this package, the following were enacted, becoming effective in 2004 :

- exemption from Australian tax on all branch profits and non-portfolio dividends of an Australian resident company derived from foreign branches and foreign companies respectively;
- exemption from Australian tax on capital gains derived by an Australian resident company or its controlled foreign companies (CFC) on the disposal of non-portfolio interests in a foreign company, provided the foreign company carries on an active business and that the interest has been held for at least 12 months in the 2 years prior to the disposal.

Besides the RITA recommendations, other reforms were introduced, including narrowing CGT rules for non-residents, removing foreign loss and foreign tax credit quarantining rules, tax relief for conduit foreign income and foreign income exemption for temporary residents. Besides the conduit foreign income rules, which received royal assent on December 14, 2005, none of the other recommendations have been enacted.

(Provided by David Kenney, Hall Chadwick, Sydney, Australia)

Central & South America

Income Tax Exemption for Foreign Investments in Brazil

The Brazilian government has just issued a new regulation

Existence of a Permanent Establishment

In a recent Interpretative Decision (ID), the Australian Tax Office (ATO) has indicated its view that a home office maintained by an Australian employee of an New Zealand company would amount to an Australian permanent establishment. This would mean that the NZ company would be subject to Australian tax.

In the case under review, the taxpayer was a New Zealand resident company that was not also a resident of Australia for tax purposes. The company sold goods in Australia through two employees who operated from a room in their respective residences. The New Zealand company did not rent or own any business premises in Australia of its own.

Under the Australian tax law, the assessable income of a non-resident taxpayer includes all income directly or indirectly from Australian sources.

In addition, reference must also be made to the Australia-New Zealand Double Tax Agreement (DTA). Under the DTA, the business profits of a New Zealand enterprise shall only be taxable in New Zealand unless the enterprise carries on a business in Australia through a permanent establishment.

Based on a US court decision, the ATO held that a home office was a fixed place of business through which an enterprise is carried on and as such constituted a permanent establishment.

Consequently, the income was held to be assessable in Australia.

Taxpayers with even a very minor presence offshore should carefully consider any potential foreign tax liabilities.

Tax Office Audit Program – Service Entities

The ATO has recently announced plans to slightly modify its audit program of service trust arrangements for 2006. A service trust arrangement exists where a trust provides services at mark up to related entities including, for example, staff, premises, other services and facilities.

For the first six months of 2006, the ATO will concentrate its audit efforts on service trust arrangements that meet the following criteria:

- service fees in excess of \$1 million;
- service fees representing in excess of 50% of the gross fees derived by the firm; and
- situations where 50% of combined profits have been directed into the service entity

In addition, the ATO announced that it is reviewing the safe harbours published in the draft ruling and service entity booklet.

(Provided by Paul Hockridge, William Buck, Melbourne, Australia)

exempting foreign investments in treasury bonds from federal income tax. Moreover, the government will no longer be charging the 0.38% check transactions tax (CPMF) on purchase of shares under public offerings. The

main characteristics of the recent government measures can be summarized as follows:

- Exemption from CPMF for purchase of shares under public off-stock-market public offerings.
- Income Tax exemption for foreign investments in federal public debt funds;
 - Investor has to be a resident of a country where the Income Tax rate is higher than 20%
 - Operations eligible for exemption are definitive transactions, without resale commitment
 - Operations carried out prior to publication of the new regulations continue to be taxed normally
 - After payment of the IT for bonds already purchased, yields will be tax exempt
- Income Tax exemption for foreigners who invest in venture capital funds (high-risk funds generally made up of shares of start-up companies)
 - The funds should feature portfolios with at least 67% shares in joint stock corporations, debentures convertible into shares and subscription bonus
 - Here too the investor has to reside in a country where the IT rates is higher than 20%

(Provided by Erico Canarim, AGN Canarim, Rio de Janeiro, Brazil)

Tax Benefits For New Investments Act In Ecuador

Objectives:

Temporary tax benefits for specific new investments by domestic or foreign companies incorporated in Ecuador.

Types Of New Investments:

- Hydroelectric and non conventional electric power.
- Oil manufacturing with high technology
- Manufacture of electronic devices with high technology and of optical fiber as well as other devices such as electronic and digital communications.
- Assembly of electric and digital circuits, microprocessors, hardware such as ram memory, electronic cards, mobile computers, scientific sensors, software and related hardware.
- Development, implementation, installation and operation of regional distribution centers of air traffic and interconnection cargo for international flights.
- Construction and operation of deep water maritime ports and international transfer of cargo and containers. It is also included the construction of wet maritime ports and ports for rivers.
- Manufacture of new machinery and equipments for farming and industrial farming and new goods produced with this machinery and equipments.
- New investments for the environment protection addressed to the preservation and improvement of the actual installed hydraulic power for the hydroelectric power system.
- New investments for the production of oxygenated additive coming from renewable raw material such as the anhydride ethane.

Tax Benefits:

- Income tax exemption
- Custom duties exemption of the imported machinery and equipment, parts and raw materials not made in Ecuador required for the manufacture of goods and services related to these tax exempted new investments.
- Total exemption of taxes in the company incorporation.
- Tax benefits will be in effect for a period of 10 or 12 years, depending of the country location.

Obligations For Investors:

- These benefits will be granted only for domestic or foreign companies incorporated in Ecuador engaged to develop new projects in the sectors stated above.
- Common stocks must be equivalent to the 10% of the investment amount.
- Investment amount will not be less than 7,5 million and 2 million in fixed assets, depending of the type of investment.
- Investment amount must be invested in fixed assets during two years beginning from effective date of this act.
- Fixed assets must not be transferred to other party, otherwise, the respective taxes must be paid.

Effective Date:

Beginning on November 2005.

(Provided by Carlos Aurea, AGN Aurea & Co, Ecuador)

Additional Advantages For Companies Established In Uruguayan Customs Free Zones

The companies established in Uruguay Customs Free Zones, are exempted of all Uruguayan taxes. It was not clear if the exemption included the taxes that Uruguayan entities, established in the Uruguayan territory, out of Customs Free Zones, had to withhold taxes in special situations. So, there are some uncertainties that new Uruguayan authorities regulations have resolved, as follows:

- Taxes withheld on payments of rent or sale of patents, trade marks, industrial models, etc.
- Payments of Technical services received from individuals or entities not domiciled in the Uruguayan territory.
- Dividends credited or paid to individuals or entities not domiciled in the Uruguayan territory.

In the first two cases, no tax is withheld, in the third case, the credit or payment of dividends will be charged with a withholding tax only if these dividends are taxed in the country of beneficiary residence and there is a tax agreement between that country and Uruguay. So, the foreign investments are absolutely free of any kind of taxes, on profits, on gross income or on the capital invested.

Additionally, all imported goods and equipment are free of any Customs fees when imported. Also these companies are exempted from VAT for their acquisitions or sales.

(Provided by Julio Pilon, AGN ACPA, Uruguay)

Europe

VAT in Belgium

Belgium has significantly changed its VAT guidelines regarding so called "business centres" (i.e. serviced offices such as REGUS). The new regime allows a full deductibility of the VAT (on real estate investments and on running costs) from January 1, 2006 provided the service agreements are suitably drafted with VAT in mind. The new VAT circular dated September 27, 2005 is a direct consequence of a recent case Law regarding this matter: Court of justice CJCE 18/11/2004, C-284/03, TEMCO Europe, <http://europa.eu.int>.

(Provided by Guy Jorion, B.A.T.N., Belgium)

The Cypriot Holding Company

Cypriot holding companies can be attractive because:

- dividends received are not taxed in Cyprus. To qualify the Cypriot company must own at least 1% of the share capital of the foreign company. Investment activities must contribute less than 50% of the foreign company's income unless its profits are subject to tax at 5% or more.

- dividends paid by the Cypriot company to its non-resident shareholders will not suffer any withholding tax in Cyprus.
- capital gains on the disposal of shares are not subject to tax in Cyprus.
- there is no withholding tax on interest and royalty payments to non-residents.

Since Cyprus joined the European Union on 1 May 2004 dividends can be distributed to a Cypriot parent from any country member of the European Union, applying the parent / subsidiary directive, without any withholding tax. These dividends will not be subject to tax in Cyprus (as described above) and also they can be distributed to any part of the world without any withholding tax.

This structure can also be use to extract dividends from companies in a number of countries which are not members of the European Union, but which have signed favourable double tax treaties with Cyprus. For example the treaty with Russia provides for a 5% withholding tax if the investment is not less than US\$100.000. The rest of the profits of the Russian company can be distributed to any part of the world without any tax through the use of a Cypriot holding company.

(Provided by Kypros Protopapas, AGN Joannides & Co Ltd, Cyprus)

North America

Wages earned in Antarctica not qualified for special treatment

US Citizens and Green Card holders can exclude up to US\$80,000 of wages and personal service income from the otherwise worldwide income tax base, if such earnings are derived from activities taking place outside the US. But qualification for the exclusion is complex and requires the equivalent of loss of US residency. The US Tax Court has held that wages earned in Antarctica are not eligible for this income exclusion. The Court held that Antarctica did not qualify as a "foreign country" and that the statute requires earnings to be sourced in a foreign country to qualify. Some might think the decision is as harsh as the climate in question.

Elective tax transparency scaled back

In 1997 the IRS broke open the international tax planning box by granting US taxpayers broad (although not unlimited) right to elect to have US and foreign entities classified as either tax transparent or as classically taxed corporations. The floodgates opened and US Treasury officials were startled by the ensuing rush of transparency elections. IRS has since busied itself filling the holes in the fisc opened by creative taxpayers and their advisors. Recently, IRS issued final rules concerning the tax classification of business entities organized in multiple jurisdictions. These new rules, first announced in late 2004, further restrict the use of tax transparency for these

dual chartered companies.

While nominally targeting companies that have migrated from one jurisdiction to another, the rules appear to also be applicable to some dual resident companies. The new restriction but may also be of interest to those who are taking a hard look at the use of Societas Europae (SE).

Australian superannuation benefits taxable to US citizen

Taxpayer is a long-term resident and citizen of Australia and the surviving spouse of an Australian national who died with beneficial rights under a plan operated by his Australian employer. Both the deceased and surviving Australians had parallel US citizenship, i.e. they were both dual citizens. The IRS ruled that US tax is owed, notwithstanding Article 18 (Pensions) of the US-Australia tax treaty which exempts an Australian resident from US tax on such income. The saving clause found in all, or most US income tax treaties, permits the United States to tax its citizens as if the treaty had not entered into effect.

New option coming for the allocation of global interest expense

The harder one plans, the luckier one gets. An important new international tax provision was enacted in 2004 but is not scheduled to take effect until 2009. This provision will allow a US corporation to allocate its global interest

expense as if all controlled, domestic and foreign related members of its group to be treated as if they were a single corporation. The application of these rules is complex, and the effect of an election will vary substantially from fact pattern to fact pattern. However given the huge dollars at stake for US based multinational groups, multi-jurisdictional planning for this opportunity will begin now for many companies. The time window for making the election is several years away, but it closes fast, so affected multinationals will need to have rationalized their leverage structures and calculated the effects of making and not making the election well in advance of that window opening. Stay tuned, this will become a very hot issue in the not too distant future.

IRS denies all deductions against income where foreign corporation filed late returns

US statutory tax law allows deductions against the income of a foreign corporation only if that corporation files a tax return in accordance with the general return filing requirements of the Internal Revenue Code. IRS adopted a hard line on this rule in 1990. The US Tax Court recently decided that IRS abused its authority in the case of Swallows Holding, Ltd. Swallows Holding, a foreign corporation, recognized rental income and claimed deductions for taxes and licenses on returns that were filed after their due date but before the IRS notified the company of its failure. The Tax Court found that the interpretive rules issued by IRS concerning the statutory return obligations filing were unreasonable and inconsistent with the intent of the statute. IRS is, in my opinion, likely to appeal this decision.

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

Non-resident Corporations Providing Services in Canada

Canada Revenue Agency (CRA) is currently verifying whether non-resident companies that provide services in Canada through an employee have filed tax returns. Where no tax return has been filed, CRA is assessing an annual penalty of up to \$2,500. The law and regulations also require withholding on remuneration paid to employees, as it would for any other employees in Canada.

A non-resident is taxable in Canada if it carries on a business there. A US resident carrying on business in Canada may not, under the Canada-US treaty, need to pay Canadian tax on business income earned in Canada if it has no permanent establishment in Canada. The treaty does not relieve the requirement to withhold tax from payments made in respect of services rendered in Canada, including employment services.

The Income Tax Act requires every person that pays to a non-resident a fee, commission or other amount in respect of services rendered in Canada to withhold 15 percent of the payment; an additional 9 percent withholding is required under the Quebec Taxation Act for services rendered in Quebec. A waiver may be granted,

but it is difficult to obtain. A payer who does not withhold is subject to penalties. A US corporation should receive a refund if it files a Canadian tax return and can establish that it has no Canadian permanent establishment. A non-resident corporation claiming treaty protection should complete a T2 Corporation Income Tax Return and attach Schedule 91 - Information Concerning Claims for Treaty-Based Exemptions when filing the return. Failure by a non-resident corporation to file the T2 in a timely fashion can result in a penalty of \$25 per day, with a minimum penalty of \$100 and a maximum of \$2,500.

Remuneration paid to non-resident employees who provide services in Canada in respect of an office or employment in Canada is subject to the same withholding, remitting and reporting obligations that apply to Canadian-resident employees: the employer must withhold and remit withholding tax, Canada pension plan (CPP) contributions, and employment insurance premiums for each employee unless a waiver of withholding tax has been obtained and/or an exemption has been provided for CPP based on a social security agreement between Canada and the employee's home country. Each year the employer must prepare and file the T4 - Statement of Remuneration Paid slips and the T4 Summary form reporting all amounts paid to its employees and the amounts withheld. This applies even if a withholding waiver has been received from the CRA. An employer that fails to withhold and remit is liable for all unremitted amounts plus penalties and interest. The withholding is merely a payment on account of the employee's actual tax liability to Canada that is assessed when a return is filed. A non-resident employee must file a Canadian income tax return to calculate the tax liability for the Canadian-source employment income.

When employees work in Quebec there is a parallel set of withholding, remitting and reporting obligations that must be undertaken. The Quebec equivalent of the T4 slip noted above is the Relevé 1 - Revenus d'emploi et revenus divers. Employees in Quebec would be subject to Quebec (rather than Canada) pension plan contributions and may be subject to the recently introduced Quebec Parental Insurance Plan; employers may face additional costs by way of contributions to the Quebec Health Services Fund, the Commission des normes du travail and the Commission de la santé et de la sécurité du travail du Quebec. Quebec has its own set of agreements on social security with foreign countries that can reduce instances of double-coverage for particular programs. The Quebec - US agreement only addresses the Quebec pension plan issue, whereas the agreement with France also covers health and work related accidents.

Many non-resident corporations have failed to file a Canadian tax return or withhold tax on remuneration paid to employees who performed services in Canada because they assumed that not having a Canadian permanent establishment eliminated their Canadian tax obligations. Non-resident corporations should ensure that they have complied with their obligations to file a Canadian tax return and to remit the appropriate withholdings from employee remuneration, in order to avoid any penalties.

(Provided by Pierre Kirouac, Bessner Gallay Kreisman, Montreal, Canada)

West Asia and Africa

Economic Overview

Talking about developments taking place in the GCC and the Middle East region, there is a lot to say. Dubai Ports (DP) won its bid to take over control of British port operator Peninsular & Oriental Steam Navigation Company (P&O) from a close contest with Singapore's PSA International. UAE and Australia have just signed a free trade pact. This is indeed a welcome sign especially coming in the wake of the recent offensive cartoons issue which has angered the world Islamic community. Emirates Integrated Telecommunication Co (EITC) will soon list on the Dubai Financial Market before the end of March 2006. Meanwhile, food exporters see good opportunities in the Middle East as growing tourism helps boost sales. People in the UAE with a voracious appetite for reading have good news! Readers Digest is to soon start publishing in the Emirates. Dubai has also launched the Dhs55billion Dubai Aerospace Enterprise which promises to become the global aviation hub based in Jebel Ali Airport City.

The value of Saudi stocks jumped to 2.75 trillion Saudi riyals (\$733.3 billion), up 13 per cent over the previous month. Banks in Bahrain are all set to benefit from a payment solution hub that integrates websites and enables them and merchants to conduct secure online transactions. The outlook for the construction of the \$2 billion natural gas pipeline from Qatar to Kuwait has dimmed due to Saudi Arabia's refusal to approve the pipeline that would pass through its territory. Non-Omanis can now own property as a law has recently been promulgated allowing non-Omanis to own real estate at designated 'tourist complexes'.

(Provided by Dr. Khalid Maniar, Chairman, West Asia & Africa region & Managing Partner, AGN MAK, Dubai, United Arab Emirates)

South Africa - 2006 Tax Budget Proposals

The following is a summary of the most important tax budget proposals announced on February 15, 2006 :

Personal Income Tax

The tax brackets have been changed to provide increased relief across all levels of income for the year of assessment ending February 28, 2007 as follows :

- the income tax threshold for paying tax for persons under the age of 65 is raised from R35,000 to R40,000;
- the tax threshold for tax payers aged 65 and over increases from R60,000 to R65,000;
- the minimum tax rate of 18 per cent now applies to taxable income up to R100,000 (previously R80,000).

Corporate Taxes

- Overall tax rate – the corporate tax rate of 29 per cent and the STC rate of 12.5 per cent remain unchanged. The tax rate for South African branches

or agencies of foreign companies remains at 34 per cent.

- Small business corporations – the turnover limit for eligible companies increases from R6 million for years of assessment ending on or after April 1, 2006. Tax rates for qualifying small business corporations for years of assessment ending between April 1, 2006 and March 31, 2007 will be as follows :

<i>Taxable income</i>	<i>Tax rate</i>
R0 – R40,000	0%
R40,000 – R300,000	10%
R300,000 and over	29%

The definition of "small business corporation" is to be reviewed during the course of 2006.

Other Taxes

- Value-Added Tax – the VAT rate remains unchanged at 14%. The VAT treatment of internationally traded services is to be clarified.
- Capital Gains Tax - the following monetary limits will be increased for tax years commencing on or after March 1, 2006 :
 - the annual exclusion will increase from R10,000 to R12,500
 - the annual exclusion in the year of death will increase from R50,000 to R60,000
 - the primary residence exclusion will increase from R1 million to R1.5 million
 - the exclusion of capital gains on the disposal of qualifying small business assets will increase from R500,000 to R750,000
- Transfer Duty – the transfer duty threshold for natural persons is to increase from R190,000 to R500,000. The transfer duty rates for property acquired by persons on or after March 1, 2006 will be as follows :

<i>Property value</i>	<i>Rates of tax</i>
R0 – R500,000	0%
R500,000 – R1,000,000	5% on the value about R500,000
R1,000,000 and above	R25,000 plus 8% on the value above R1,000,000

The transfer duty rate for companies and trusts will reduce from 10 percent to 8 per cent, with effect from March 1, 2006.

- Tax on Retirement Funds – the tax on retirement funds is to reduce from 18 per cent to 9 per cent, with effect from March 1, 2006.

Tax amnesty for small businesses

- The South African Revenue Service (SARS) is to offer a tax amnesty to small businesses with turnover of up to R5 million for the 2005 year of assessment. In terms of this amnesty, SARS will waive taxes, penalties, additional taxes and interest for years of assessment ending up to and including March 31, 2004, provided that the taxpayer submits a tax return for the 2005 year. The cost of the amnesty will be a once-off penalty calculated at 10 per cent of the taxpayer's taxable income for the 2005 year of

assessment. The amnesty will be denied to those who have already disclosed their income or who have been formally notified that they are under investigation. The first phase in the roll-out of this amnesty will focus on the taxi industry, to encourage the taxi recapitalisation scheme and will run from August 1, 2006 until May 31, 2007. The second phase, for other businesses, will commence later in 2006.

(Provided by Richard Broome, Valentine Sargeant, South Africa)

Europe - Inheritance Tax Survey 2005

As Europeans become richer an increasing proportion of the population is likely to find that they are affected by inheritance and gift taxes. Inheritance tax is frequently overlooked in terms of tax planning, and even relatively straightforward planning opportunities are often not taken.

European Nationals have the freedom to live and work in any European Union country, and increasing numbers are choosing to emigrate, to enjoy a sunnier climate or to realise capital tied up in real estate and take advantage of a lower cost of living to achieve a more comfortable retirement. For those who do not want their savings to be left to the state the impact of inheritance tax must be considered, and the AGN survey provides a useful first indicator and contact details of member firms in each country.

The objective of the Inheritance Tax survey is to compare the levels of inheritance tax payable in different European countries. The results for 2005 show some substantial differences, from an effective tax rate of 17% in Greece to no tax at all in a group of countries including Croatia, Cyprus, Czech Republic, Denmark, Ireland, Italy, Luxembourg, Portugal, Sweden and Switzerland.

The 21 countries covered by the 2005 survey were: Austria, Belgium, Croatia, Cyprus, Czech Republic, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, The Netherlands, Portugal, Russia, Slovenia, Spain, Sweden, Switzerland and the UK.

This year's survey

The 2005 Inheritance Tax survey is based on the death of an individual on 1 January 2005 leaving his wife and two children. He has not made a Will and the assets he owns when he dies are: a house worth €600,000, cash of €1,000,000, company quoted shares valued at €300,000 and company unquoted shares valued at €700,000.

To avoid complication the AGN survey considers the position if there is no Will. Although an up-to-date Will should be an essential element in a family's financial planning, it seems that unwillingness to prepare such a document is common in all the countries surveyed.

The survey establishes whether each country has gift or inheritance taxes before going on to more detailed questions concerning the calculation of the tax rate, such as the relevance of the relationship of the heirs to the deceased. In some countries, such as France, there are 'forced heirship' rules which dictate who although a Will created during the individual's lifetime, to choose who (inside or outside the family) receives which assets. With careful planning they may also have some choice over how much inheritance tax will be payable.

In 1993 only Cyprus had neither gift tax nor inheritance tax. Italy had only a tax on gifts. None of the countries that participated in the survey the previous year has since introduced or abolished either gift or inheritance tax.

In the majority of countries the tax rate is based upon the total value of the assets, but often varies according to the type of the asset. If the family home is the main asset, Germany and Spain are particularly generous in tax terms as only 70% and 58% respectively of the value of the house is used in the calculation of the inheritance tax payable.

For company shares it is usually important to draw a distinction between those which are a small proportion of the shares in a company listed on a recognised stock exchange, and shareholdings in an unquoted or family business. The proportion of the shareholding can also be important, with exemptions available if more than a particular percentage of the total share capital in the company is held. This can mean that giving away a small number of shares results in the exemption no longer applying, and the value of the remaining estate for inheritance tax purposes actually increases!

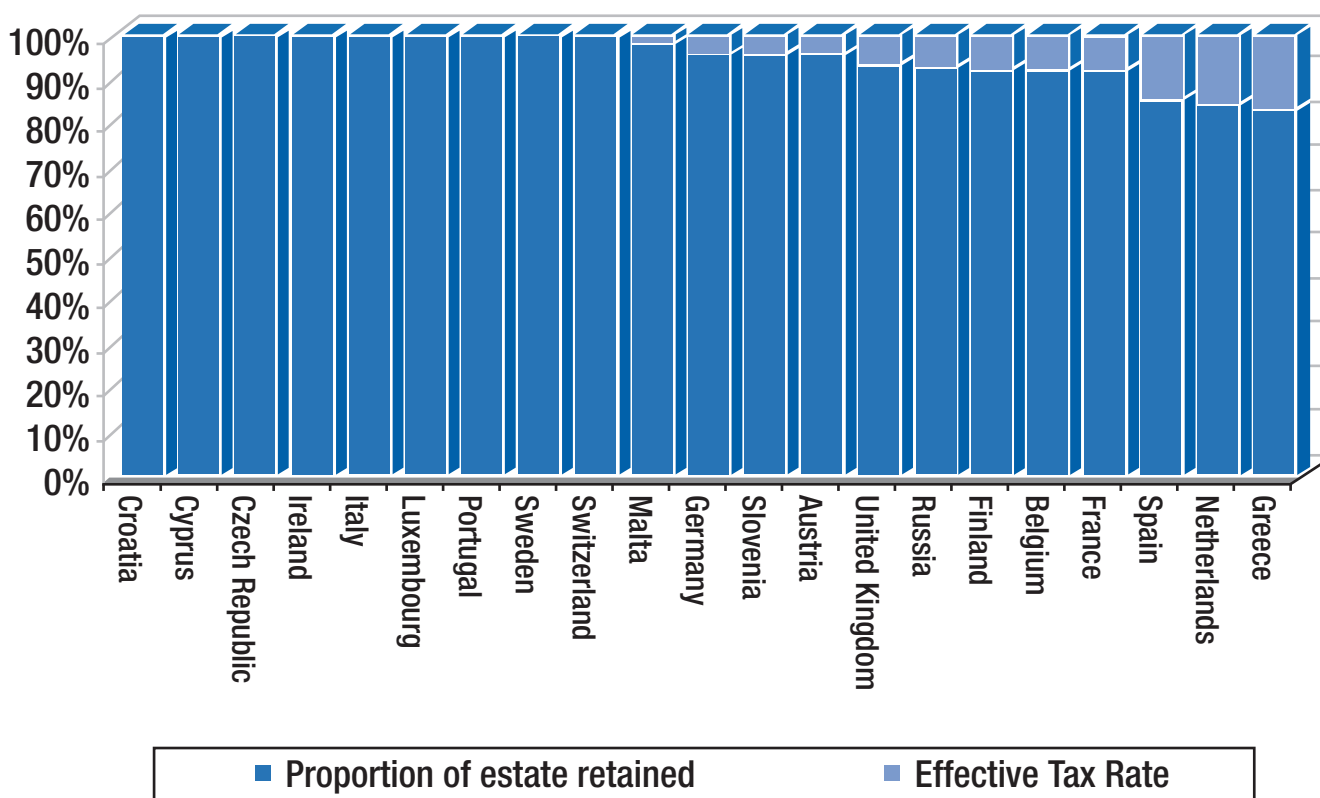
Most countries include cash at 100% of its value in the calculation of the inheritance tax due, but there are exceptions worthy of note. This is Austria at 0%. It may be sensible to sell assets for cash to avoid inheritance tax.

Although the survey focuses on these, inheritance and gift taxes are also not the only taxes to be considered: capital gains, income and property transfer taxes may be equally important. As the American politician Benjamin Franklin famously said in 1789, "In this world nothing can be said to be certain, except death and taxes."

Before taking or refraining from action in relation to inheritance tax and gift tax, specific professional advice should be taken in the countries of the individual's residence, domicile and, possibly, location of assets.

Full details of the AGN Inheritance Tax survey, including a chart comparing the countries surveyed, can be downloaded from the internet at www.agn-europe.org or obtained free of charge from AGN International - Europe's office at 5-6 Francis Grove, London SW19 4DT, telephone +44 (0) 20 8944 5955, e-mail: infoeurope@agn.org

Inheritance Tax - 2005 A European Comparison



(Provided by the European Taxation Tax Force)