

International TaxWatch



AUSTRALIA

AUSTRALIA'S PROPOSED FOREIGN HYBRID LEGISLATION

The Australian government has introduced proposed legislation to clarify its treatment of entities commonly referred to as "foreign hybrids".

Examples of foreign hybrids include Limited Partnerships and Limited Liability Companies in the United Kingdom and/or United States. In their country of residence, such entities are treated as partnerships for tax purposes.

Under current Australian income tax law, foreign hybrids are treated as foreign companies. As a result Australian taxpayers with interests in such entities are subject to Australia's controlled foreign companies (CFC) and foreign investment fund (FIF) regime.

Australia's current CFC and FIF regime can result in the double taxation of income derived by Australian taxpayers who hold an interest in the foreign hybrid. This is in addition to the compliance costs taxpayers are subject to under the CFC and FIF regime.

In recognition of the current tax treatment and the Government's desire to not restrict the ability of Australian businesses to expand overseas, the Government has introduced legislation to treat foreign hybrids as partnerships under Australian tax law.

Under the proposed legislation, 3 types of entities will be treated as a partnership under Australian tax law;

1. Certain limited partnerships and limited liability partnerships (LPs);
2. Certain United States limited liability companies (US LLCs); and
3. Other entities to be specified in future tax regulations (yet to be announced).

The Australian government has mentioned it will not be listing trust-like entities such as Anstalts and Stiftungs as foreign hybrids under the proposed legislation.

The proposed legislation will not apply to foreign hybrids that carry on business in Australia.

Taxpayers who are currently required to treat their interests in a foreign hybrid under the FIF regime have the choice of electing to apply the proposed legislation. Such an election is irrevocable.

The proposed legislation will allow Australian taxpayers to be accurately taxed on income earned from the foreign hybrid, recognise tax paid in foreign tax jurisdictions and open access to foreign losses in the foreign hybrid.

It is noted however that in certain circumstances, the income of the foreign hybrid may be exempt from Australian taxation.

Australia's proposed foreign hybrid legislation presents significant tax planning opportunities for corporate groups in Australia who have interests in foreign hybrids.

The proposed changes mentioned earlier, may result in significant tax savings on existing structures currently subject to tax treatment as companies.

In addition, the proposed changes include the possibility of amending prior tax returns to treat foreign entities as partnerships rather than companies.

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SINGAPORE

FOREIGN INVESTMENT UNDER THE GROUP RELIEF AND ONE-TIER SYSTEMS

With effect from the Year of Assessment 2003, Singapore companies are allowed to set off their current year unutilised losses, wear and tear allowances and donations against the taxable profits of a related company in a "Group".

Commencing from the Year of Assessment 2004, companies in Singapore can elect to move out of the traditional 'imputation Tax System' to the new 'One Tier System'. Under this system, companies would pay a final tax on income at the corporate tax rate and shareholders would receive exempted dividends. The previous imputation system where tax paid by companies are tracked (giving rise to a Section 44A balance) and passed on to shareholders via dividends is abolished. Companies have 5 years to utilise the tax credits paid in the past until 31 December 2007.

The two new changes significantly impact the tax planning for foreign investments into Singapore. Firstly, if a foreign company holds the equity of a number of Singapore subsidiaries, the "Group" would not qualify for Group Relief. This is because, a group must consist of a Singapore incorporated parent company. In addition, to be considered as a member of the same group, the two companies must be Singapore incorporated companies and:

1. at least 75% of the ordinary share capital in one company is beneficially held directly and indirectly by the other; or
2. at least 75% of the ordinary share capital of both companies are beneficially held directly and indirectly by a third Singapore incorporated company.

For planning purposes, companies should review their group structure to ensure their current corporate structure allows the utilisation of Group Relief.

SINGAPORE 2004 BUDGET

The Minister for Finance in his Budget Speech delivered on 27 February 2004 acknowledged the difficulties of 2003, with the combination of the SARS epidemic and a war in Iraq in the first half dashing hopes of a quick turnaround. The economy however, showed signs of recovery towards the end of 2003 with the manufacturing and services sector showing significant growth so that overall GDP grew by 1.1% in 2003.

Compared to the last two budgets, the Minister did not announce any major tax incentives except for the introduction of foreign income exemption for individuals. While the corporate tax rate will be reduced to 20% from the Year of Assessment 2005, being the long-term targeted rate as announced in previous budgets, the top personal income tax rate remains at 22%. The Minister however reaffirmed the Government's intention to bring the tax rate down to 20% when budgetary conditions allow it.

Provided below are highlights of the 2004 Budget outlining proposed tax changes in the Budget which will be of interest from an international tax perspective:

Reduction in Corporate Income Tax Rate

From the year of assessment 2005, the corporate tax rate will be reduced to 20%. This is a reduction from the current corporate tax rate of 22%. The reduction in the corporate tax rate has several flow-on effects on the aspects of the Singapore tax system. The consequences of the reduction are outlined below:

- With effect from 1 January 2004, certain payments to non-residents for the provision of services related to application and use of scientific, technical and industrial knowledge; and management or assistance in management of a business or trade; and director's remuneration is expected to be taxed at the withholding tax rate of 20%. This is of course subject to applicable tax treaties.

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- The reduction in the corporate tax rate will result in an adjustment to Singapore's imputation system. A tax credit attached to a dividend paid on or after 1 January 2004 under the imputation system will have a corresponding tax credit of 20%.

Reduction in Withholding Tax on Royalty Payments

The royalty withholding tax rate of 15% will be reduced to 10% with effect from 1 January 2005. The proposed 10% will be applicable to payments to a non-resident who has not provided any services or business in Singapore and is not connected with a Singaporean permanent establishment.

Tax Exemption For New Companies

A full tax exemption is available for the first \$SGD 100,000 of chargeable income for 'qualifying new companies' for the first three consecutive Years of Assessment falling within 2005 to 2009.

A new company is a 'qualifying company' where it meets the following conditions:

- It is incorporated in Singapore;
- It is a tax resident of Singapore for the relevant Year of Assessment;
- It has no more than 20 shareholders throughout the period related to the Year of Assessment; and
- All shareholders of the new company are individuals relating to the basis period of the Year of Assessment.

Regional Headquarters Incentive

The Economic Development Board administers the Regional Headquarters and International Headquarters incentive packages. The incentive packages are designed to promote Singapore as a prime location for regional and international headquarters.

Businesses qualifying for the regional headquarters incentive currently receive a concessionary tax rate of 15% for 3 years on the incremental qualifying income. Effective immediately, the duration of the concessionary tax rate will be extended from 3 to 5 years.

Tax Exemption for Foreign Sourced Income

At present, Singapore tax residents are subject to tax on all their foreign sourced income, subject to certain exceptions. With effect from Year of Assessment 2005, all foreign sourced income received in Singapore by resident individuals will be exempt from tax. It is not clear how the exemption will integrate with the existing provisions on exempting foreign dividends and foreign sourced service fee income. Further details will be released by the Minister.

Tax Exemption for Singapore Sourced Investment Income

As an accompaniment to the exemption for foreign sourced income of Singapore resident individuals, the Minister has announced a tax exemption on all Singapore sourced investment income derived directly by individuals from financial instruments, provided the income is not considered as gains or profits from any trade, business or profession.

The investments that qualify for the exemption include:

- Interest from debt securities;
- Discount income from debt securities; the tenure of which is 1 year or less;
- Annuities;
- All payments on life insurance policies, including interest from insurance benefits that have not been drawn and investment income on investment linked policies (but excluding sums realised or interest from insurance benefits that have not been drawn under any insurance against loss of profits);

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- Distributions from unit trusts and real estate investment trusts that are authorised under section 286 of the Securities and Futures Act (excluding distributions out of franked dividends); and
- Borrowing fees, loan rebate fees, price differential and compensatory payments arising from securities lending repurchase arrangements.

The policy reason is to ensure that individuals are not bias against investments in Singaporean financial instruments since all foreign sourced income received in Singapore by resident individuals will be exempted from income tax from Year of Assessment 2005.

HONG KONG

HONG KONG FINANCIAL BUDGET 2004

The Financial Secretary of the Hong Kong SAR delivered his 2004/05 Budget Speech on 10 March 2004. In spite of yearly increases in deficit over the past four years, the Financial Secretary budgeted a HK\$42.6 billion deficit for 2004/05.

2003 was a year of great fluctuation. The economy of Hong Kong dropped to a bottom in the first half year due to the severe outbreak of SARS, but it rebounded rapidly after the disease was contained and following the Closer Economic Partnership Arrangement ("CEPA") entered into between Hong Kong and the Mainland China in June 2003. The CEPA agreement and other arrangements, such as the Individual Visit Scheme, granted by the Central People's Government to Hong Kong under the principle of "One Country, Two Systems", will introduce business opportunities to Hong Kong people and overseas enterprises using Hong Kong as a bridge to access the Mainland market and enjoy the continuing economic growth of Mainland China.

The Government will seek to restore fiscal balance in the budget by 2008 and to bring public

expenditure to below 20% of the GDP. The Financial Secretary does not propose any major tax changes in order to sustain the momentum of economic recovery and allow the economy time to recover from earlier economic setbacks.

Revenue

The second phase of increase in Salaries Tax, Property Tax and Profits Tax for unincorporated business in two proposed stages last year will come into effect for 2004/05. No further tax adjustments are proposed and the rates of tax will be as follows:-

Salaries Tax - Standard rate is increased from 15.5% to 16%. Basic Personal Allowance is reduced from HK\$104,000 to HK\$100,000 and other individual allowances are proportionately reduced.

Property Tax - Standard rate is increased from 15.5% to 16%.

Profits Tax - Corporation rate remains at 17.5% and unincorporated business rate is increased from 15.5% to 16%.

Stamp Duty - No adjustment is made to the rate of stamp duty on Hong Kong company share transactions which is 0.2% and on property transactions which varies to a maximum of 3.75% on the purchase consideration.

Expenditure

Total government spending, comprising operating expenditure and capital expenditure, for 2003/04 was estimated to be HK\$252.9 billion against revenue of HK\$203.9 billion. The Government's plans to reduce the operating expenditure from HK\$218 billion in 2003/04 to HK\$212.2 billion in 2004/05 and to a target of HK\$200 billion by 2008/09.

On the question of broadening the tax base of Hong Kong which has been a topic for discussion and study for years, there are different opinions

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among the Councillors, professionals, academics, businessmen and people representing different interests of the general public. The Financial Secretary is very cautious regarding the introduction of a goods and services tax (GST) and will wait for an internal committee to study and come up with a proposal for further discussion. It may require at least three years to implement a GST in Hong Kong.

The Financial Secretary is very optimistic about the economic prospects of Hong Kong and has not addressed the fiscal deficits accumulated over the past years. If the economy continues at its current pace, his conservative position on the revenue side may prove incisive. On the other hand, if the economy declines, the weakness of a narrow tax base will be exposed.

UNITED KINGDOM

UNITED KINGDOM BUDGET 2004

The Chancellor's 2004 Budget emphasised stability and a positive outlook for the UK economy. He has focused on the strong economic growth of the UK economy and its strength in the global economy.

The Budget has brought few surprises from a tax perspective. Some of the more relevant tax from a business taxation perspective are:

Transfer Pricing

The Chancellor has announced changes to extend the UK's transfer pricing rules from cross border transactions to transactions within the UK. The proposed extension is the result of European Court of Justice decisions not allowing Revenue to treat transactions within UK groups more beneficially than transactions between UK and European Union entities.

To enable the change in policy, the following changes have been announced:

- Enable transactions within the UK to be brought within the UK transfer pricing provisions;
- Repeal the thin capitalisation rules and reintroduce them within the transfer pricing provisions;
- Exemption for most small and medium enterprises, except for transactions with countries where the UK does not have a double tax treaty in place;
- Changes to ensure changes do not result in double taxation; and
- An exemption from the transfer pricing provisions for 'dormant' companies.

Tax and Accounting

Companies adopting International Accounting Standards to draw up their accounts will receive broadly equivalent tax treatment as companies that continue to use UK Generally Accepted Accounting Practice.

EU Interest and Royalties Directive

The Government will implement the Directive from 1 January 2004. The Directive removes withholding tax payments between certain 'associated companies' within the EU Member States.

Partnership Losses

The Finance Bill 2004 will include retrospective legislation, effective from 10 February 2004, to address tax avoidance schemes which exploit relief for trading losses through partnerships. The schemes targeted are said to exploit tax reliefs that are intended for people who risk their own money in running genuine businesses, but manipulate tax relief to create claims for losses in excess of the capital at risk. For the first four years of a partnership's trade, a partner who does not spend a significant amount of time in running the trade will only get relief for a loss against

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other income, or in respect of interest on associated borrowing, so far as the loss is attributable to expenditure on or after 10 February 2004, up to the amount contributed to the trade by him.

FRANCE

OWNING REAL ESTATE IN FRANCE THROUGH A LUXEMBOURG COMPANY

From a European perspective, there are tax advantages in owning French real estate through a Luxembourg company (Luxco). To realise the profit out of the structure the Luxco company shares can later be sold or the Luxco can be liquidated after a property sale.

The tax advantages of this structure are:

Value Added Tax (VAT)

Rental income is not subject to VAT in Luxembourg, therefore the company will not be able to apply for a VAT number and as a result will not be able to recover any VAT incurred. It will not need to complete a VAT return.

Corporate and Wealth Tax

Corporate tax in Luxembourg is 30% of net profit including capital gains (unless the gains are exempted under the affiliation privilege) and wealth tax is 0.5% of net assets or a minimum of 62 per annum.

However, under the double tax treaty between France and Luxembourg, income, capital gains and real estate wealth on from real estate in France are subject to tax only in France.

The French Conseil d'Etat held on 18 March 1994 that income earned from real estate in France by the company owning the real estate is part of the company's business income.

Business income of a Luxco owning real estate in France is subject to tax in Luxembourg if the Luxco does not have a permanent establishment

in France, and mere ownership of French real estate does not create a French permanent establishment. Therefore, each country is barred from taxing the rental income due to either internal law or the double tax treaty. This was confirmed again in a court decision in favour of La Coasta SARL in Luxembourg on 3 December 2001.

There will therefore be no corporate tax on the income or capital gains resulting from the sale of real estate in France and wealth tax will be 0.5% of share capital and reserves of the Luxco.

Withholding Tax

Interest paid by a Luxco on a loan from a bank or offshore company or trust is exempt from withholding tax. The payment of dividends to a trust or individual is subject to 20% withholding tax.

The payment of dividends to an EU registered parent company is exempt. If a trust lends money to the Luxco rental income could be paid to the Luxco as interest and or real estate management costs.

On the liquidation of the Luxco, the liquidation proceeds paid to a non-resident individual or trust are treated as if they are a repayment of capital, therefore are free of withholding tax in Luxembourg. Liquidation proceeds paid to a company are treated as if they were a dividend and are exempt from withholding tax if the parent subsidiary directive applies and subject to a 20% withholding tax if it does not.

3% French Tax on Real Estate

The French tax code imposes a 3% tax on the market value of French real estate owned by companies but this does not apply as the France/Luxembourg double tax treaty contains a mutual assistance clause.

The Luxco must however complete a simple undertaking that if required it would provide

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details of the real estate value, names and addresses of its shareholders and directors and their shareholdings and proof of fiscal residence within 60 days

Capital Contribution Duty

Real estate can be contributed into a Luxembourg company in exchange for shares in that company subject to a 1% capital duty. Charged on the value that must be certified by a Luxembourg auditor (Réviseur d'Entreprises).

A foreign investor not liable to French corporate income tax contributing the property to a Luxembourg company is liable to 11.4% registration duty on the value of the shares issued in exchange for the real estate contributed.

Capital Gains

Normally the sale of shares in a foreign real estate owning company is subject to French capital gains tax at a withholding rate of 33.33%. The gain is the excess of the revalued purchase price (including purchase costs) over the sale price less an allowance of 5% of the gain for each year of ownership after the first two. The Luxembourg double tax treaty with France exempts the gain from taxation in France.

France/Luxembourg Double Tax Treaty

A revised treaty has been initialled but will not be ratified by the Luxembourg Government unless France withdraws clauses concerning anti abuse and extensive exchange of information.

NETHERLANDS

NEW CORPORATE INCOME TAX REGIME

New rules have been introduced in response the ruling in September 2003 by the European Court of Justice in the so called Bosal Case. In this case it was held that the restriction on the deduction for interest paid on loans to acquire shares in certain EU companies was against European Law.

The new rules which apply to accounting periods starting on or after 1 January 2004 are designed to avoid a decrease in Dutch tax revenues and include provisions relating to the following:

Thin Capitalisation

The rules apply to all Dutch corporate taxpayers that form part of domestic or international economic units in which legal entities and co-operations are linked organisationally. The rules allow a debt to equity ratio of 3:1, but are not designed to limit the deduction of interest paid on genuine third party loans.

Loss Relief Restrictions

Losses incurred by pure holding or group finance companies can be set against holding or financing income in preceding and following years, but only if strict conditions are met. The new rules are intended to prevent old losses carried forward from being set against new income streams.

If the Dutch corporate income tax assessment on the Dutch holding company with EU Subsidiaries to which the participation exemption applies is not yet final, then interest paid on loans taken up to finance non-Dutch EU subsidiaries and expenses in relation to the subsidiaries can still be deducted from the taxable income.

ITALY

TAX REFORM

Important changes were introduced with effect from 1 January 2004. These include:

Domestic Consolidated Taxation

The new rules apply when Italian Companies, Italian Controlled Companies or foreign companies with a branch in Italy directly or indirectly hold more than 50% of the capital of subsidiaries. The whole of the profit or loss of the Italian subsidiaries which opt for consolidated taxation are offset. Dividends from Italian consolidated companies are excluded.

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The option applies for three years and can be extended at the end of the third year.

International Consolidated Taxation

The Italian company which opts for consolidation must include all the foreign companies in which it owns, directly or indirectly, more than 50% of the capital. However, only the proportion of the profit or loss which relates to the capital held is included. Dividends distributed are excluded from the taxable base.

Thin Capitalisation

The interest paid on a loan to a shareholder owning more than 25% of the capital of a company turning over more than 5.164M will be restricted. The debt equity ratio is 5:1 for 2004 reducing to 4:1 thereafter. Excess interest will be treated as a dividend and subject to tax at 5%.

Dividends Received by Corporations

The dividend received from both foreign and Italian companies will be 9% exempt irrespective of the size of the shareholding, with the balance taxed as business income.

Participation Exemption

Gains and losses from the sale of shares in both Italian and other companies will be exempt providing the shares are investments in a commercial company that is not resident in a tax haven and which have been owned for more than 12 months.

International Ruling (Advanced price Agreement)

Binding agreements with the tax authorities can now be reached covering transfer prices, interest, dividends and royalties, effective for the period in which agreed and the following two periods.

NEWS IN BRIEF

BELGIUM - EUROPEAN DIRECTIVE ON INTEREST AND ROYALTIES ADOPTED

Belgium has incorporated the European Directive of 3 June 2003 (2003/49/CE) on interest and royalties in the Income Tax Code with effect from 1 January 2004, and it applies to interest accrued and paid after that date.

Interest and royalty payments to 'associated companies' will be exempt from Belgium withholding tax. Belgium defines associated companies more broadly than the European Directive. Under the Belgian rules, companies are associated when one owns at least 25% of the share capital of the other, or both are owned at least 25% by a third. The shareholding must have been held for only a year rather than the two years permitted by the directive. Exemption can also be claimed when the participation has been held for less than a year provided that an affidavit is made and the conditions are later met in full. In these circumstances withholding tax is retained but not paid to the tax authorities. Instead it is released to the creditor when the conditions are fulfilled.

AUSTRIA - 2005 FISCAL REFORM ANNOUNCED

The planned amendments include:

- The corporate income tax rate will be cut from 34% to 25%.
- The tax treatment concerning affiliated groups will be changed. For instance the summation of profits and losses within an affiliated group (as well cross-border) will be admissible.
- The reform of the income tax scale will effect a tax relief for people with moderate income and families.

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IRELAND – HOLDING COMPANY REFORM

It is proposed to exempt the disposal of qualifying trading subsidiary companies from capital gains tax and to expand the scope of Ireland's double taxation relief provisions for dividend income paid to parent companies, to help Ireland compete internationally for headquarter and holding company regimes.

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