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# *Worldwide Tax Summaries*

## Corporate Taxes 2011/12

*Quick access to information about corporate tax systems in 146 countries worldwide.*

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# ***Worldwide Tax Summaries***

## Corporate Taxes 2011/12

All information in this book, unless otherwise stated, is up to date as of 1 June 2011.

# Foreword

Welcome to *Worldwide Tax Summaries – Corporate Taxes 2011/12*, which gives you quick access to information on corporate tax rates and rules in 146 countries worldwide.

The country summaries – written by our local PwC tax specialists – include information about changes in legislation, residency, gross income, deductions, tax credits and incentives, tax administration, other taxes, and tax rates. All information in this book, unless otherwise stated, is up to date as of 1 June 2011. An online version of these summaries, plus additional information on individual taxes, is also available to you at www.pwc.com/taxsummaries. Our online tax summaries are updated regularly, to make sure you always have the latest information.

If you have any queries, or need more detailed advice on any aspect of tax, please get in touch with us. The PwC tax network has member firms throughout the world who can offer you high quality advice and support, whenever and wherever you need it, and our specialist networks can provide both a domestic and cross-border perspective to the tax challenges you are facing. We've also included, for reference, a list of some of our key network and industry specialists at the back of this book, to help you locate the right person to help you.

I hope you will find these summaries useful.

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## Significant developments

As of 30 January 2011, the supply of drugs and health services provided by private or public institutions are subject to a reduced valued-added tax (VAT) rate of 10%.

As of 1 February 2011, taxpayers who, in the course of their business activities, provide services in certain listed professions are required to register for VAT purposes in Albania, regardless of their annual turnover. *See Value-added tax in the Other taxes section for the listed professions.*

The Albanian Parliament approved a fiscal amnesty presented by the government for entities and individuals. The fiscal amnesty covers (i) non-declared capital and (ii) tax and customs liabilities.

Please note that a possible change in the corporate income tax (CIT) rate might be approved by the Albanian Parliament. Based on a Draft Law issued recently, the CIT rate will become progressive based on the profit margin (taxable profit/taxable income) of the taxpayer. The Draft Law provides the following tax rates:

- 10% for taxpayers with a profit margin which does not exceed 10%.
- 20% for taxpayers with a profit margin between 20% and 30%.
- 30% for taxpayers with a profit margin greater than 30%.

## Taxes on corporate income

Albanian law applies the principle of worldwide taxation. Resident entities are taxed on all sources of income in and outside the territory of Albania, while non-resident entities are taxed on income generated only in the territory of Albania.

The corporate income tax (CIT) rate in Albania is 10%. CIT is assessed on the taxable profits calculated as taxable income less deductible expenses.

## Corporate residence

Based on Albanian legislation, a legal entity is deemed to be resident in Albania if it has its head office or its place of effective management in Albania.

### Permanent establishment (PE)

PE in Albania means a fixed place of business where an entity carries out its business activities, including but not limited to an administration office, a branch, a factory, a workshop, and a construction or installation site.

The determination of a PE, where applicable, is based on the provisions of a double tax treaty (DTT) which Albania has entered into with a number of countries. In addition, when dealing with DTT provisions, the Albanian tax authorities refer to the Organisation for Economic Co-operation and Development (OECD) commentaries.

## *Other taxes*

### *Value-added tax (VAT)*

The standard VAT rate is 20%, and the standard VAT period is the calendar month.

Taxable transactions include goods and services supplied domestically as well as the import of goods into Albania by a taxable person. The following transactions are also taxable:

- Transactions performed for no consideration or for a consideration less than the market value.
- Barter transactions.
- The private use of taxable goods by a taxable person (self-supply).

The VAT on machinery and equipment imported by Albanian registered entities for own use in their business activity (i.e. not for resale) is subject to the VAT deferral scheme under which the payment of the VAT is postponed up to 12 months with a possibility of extension for an additional 12 months period.

#### Determination of VAT taxpayers

Taxable persons are all individuals and legal entities registered, or required to be registered, for VAT purposes.

The VAT registration threshold in Albania is annual turnover over of 5 million Albanian leke (ALL) (EUR 37,000). Any person providing taxable supplies and whose annual turnover does not exceed ALL 5 million (EUR 37,000) is not required to register, although voluntary registration is possible.

As of 1 February 2011, taxpayers who, in the course of their business activities, provide services in any of the following listed professions are required to register for VAT purposes in Albania, regardless of their annual turnover:

- Lawyer
- Engineer
- Attorney (notary)
- Laboratory technician
- Specialist doctor
- Designer
- Dentist
- Economist
- Specialist dentist
- Agronomist
- Pharmacist
- Certified Public Accountant
- Nurse
- Approved Accountant
- Midwife
- Property evaluator
- Veterinarian
- Hotelier business
- Architect

#### VAT obligations for non-resident entities

Non-resident entities which carry out business activities in Albania are subject to 20% VAT in Albania when services rendered are related to immovable property located in Albania or services are rendered in Albania. In both cases, total turnover must exceed ALL 5 million (EUR 37,000) per annum.

If the above conditions are met, the non-resident entity (i.e. not registered with the Albanian tax authorities) is obliged to register and pay VAT in Albania by nominating a tax representative.

In case of a non-resident entity's non-compliance, the tax liabilities and respective penalties derived from such non-compliance is paid by the local beneficiary of these services.

**Reduced-rate goods and services**
As of 30 January 2011, the supply of drugs and health services provided by private or public institutions are subject to a reduced VAT rate of 10%.

**Zero-rated goods and services**
The following goods and services are subject to 0% VAT in Albania:

- Export of goods.
- The provision of services relevant to the processing of semi-finished goods intended for export.
- The supply of goods and services related to the international transport of goods or passengers.
- The supply of goods and services in relation to trading and industrial activities at sea.

**VAT-exempt goods and services**
The following goods and services are exempt from VAT in Albania:

- The lease of land (unless the rental period does not exceed two months).
- The lease of buildings, except the cases where there is a contract between parties in which the supply is deemed as taxable.
- Financial services.
- Postal services (only if there are no imports or other postal service and the annual turnover doesn't exceed ALL 5 million).
- Gambling, casino, and totalisator services.
- Written media and books.
- Advertising in electronic media.
- Interest payments on leasing transactions.
- Export of services.
- The sale of land and buildings, although the construction process itself is subjected to VAT.
- The supply made by religious or philosophical organisations for the purpose of spiritual welfare against a reduced payment.
- The supplies of packages and materials used for the manufacture and confection of drugs.

**VAT reimbursement**
Taxable entities have the right to claim VAT reimbursement if the period in which VAT credits are carried forward exceeds three months and the total amount of VAT credits is equal to or above ALL 400,000 (EUR 2,965).

VAT registered taxpayers who are in a VAT credit position have the right to request (if all legal conditions are met) the reimbursement of the credit VAT within 30 days after the request is submitted to the relevant tax authority.

### VAT returns
The submission of VAT returns and sales and purchase books must be done electronically by all taxpayers.

Depending on the category of taxpayers, the electronic filing comes into force on the following dates:

- The deadline for the electronic filing of the VAT books is the fifth day of the following month.
- The deadline for the electronic filing of VAT returns and the payment of the related VAT liability is the 14th day of the following month.

### *Customs duties*
Albania uses the Harmonized Code System for tariff classification.

The custom duty rates range from 0% to 15%, depending on the type of goods.

Import of machineries and equipment for use in the taxpayer's business activity, are generally subject to custom duties at the zero rate.

Custom duties on imports of vehicles are 0%.

### *Excise duties*
Albania levies excise tax on the following products:

- Beer: ALL 30/litre for amounts less than or equal to 200,000 hectolitre/year; ALL 40/litre for amounts greater than 200,000 hectolitre/year.
- Wine: ALL 20 to 35/litre, depending on the amount in hectolitre/year.
- Other alcoholic drinks: ALL 100 to 400/litre.
- Tobacco: ALL 1,500 to 2,500/litre.
- Petroleum: ALL 20 to 50/litre.
- Fireworks: ALL 200/kg.
- Pneumatic tyres: ALL 20 to 40/kg for new purchased tyres and ALL 100/kg for used tyres.
- Reflector lamps: ALL 100/unit.
- Plastic, glass, and mixed packaging: ALL 100/litre, ALL 10/litre, and ALL 20/litre respectively.

The excise tax paid on fuel used in green houses as well as in production of industrial and agricultural products is reimbursable.

Plastic, glass, and mixed packaging used as input in the local recycling industries of these materials are reimbursed 50% of the excise paid for the packaging as per amount, terms, and procedures determined with the Decision of the Council of Ministers.

### *Stamp duties and notary taxes*
There are no stamp duties on the sale contract of land or other properties. There are, however, notary taxes which are, in nature, similar to stamp duties. The notary tax on sales contracts that relate to change in ownership of immovable properties is ALL 1,000. The notary tax on sales contracts that relate to change in ownership of movable properties is ALL 700.

Depending on the agreement reached between the seller and the buyer, the notary tax can be paid either by the seller, or by the buyer, or shared between both of them.

### *Property tax*
Property taxes are calculated based on the type of activity the business entity carries out.

| Type of activity | Tax rate (ALL/m2/year) |
|---|---|
| Commercial and services | |
| Health, craft, social, cultural, educational, and scientific services | 140 |
| Production activities | 140 |
| Commercial, administrative activities | 200 |
| Other commercial and services | 200 |
| Other (e.g. buildings owned by non-governmental organisation (NGOs) or foundations; damaged, amortized, non-functional buildings which are state-owned properties or privatised ex-state-owned properties in which no activity is performed) | 50 |

### *Registration taxes*
The fee for the registration of a business entity is ALL 100.

### *Tax on dividends*
The tax rate on dividends is 10% on the gross amount.

Companies have the obligation to pay the tax on dividends to the tax authorities by the 20th day of the month following the payment of the dividend but not later than 30 July of the year the financial results are approved, regardless of the fact of whether the dividend has been distributed or not to the shareholders.

## *Branch income*

Branch offices in Albania are subject to the same taxes as all other forms of legal entities.

## *Income determination*

### *Inventory valuation*
Inventory is valued at the end of each tax period using the methods stipulated in the Accounting Law, which should be applied systematically. The methods stipulated in the National Accountings Standards for the valuation of inventory at year end are the average cost and first in first out (FIFO) methods.

### *Capital gains/losses*
Capital gains/losses derived from the sale of a company's fixed assets are taxed at the same rate as the company's ordinary business income.

### *Dividend income*
Dividends and profit share paid by a resident, non-resident company, or partnership to a resident taxpayer is not subject to CIT for the resident taxpayer. This applies, despite the participation quote, in amounts or number of shares, in shareholder capital of the voting rights or participation in initial capital of the beneficiary.

*See Tax on dividends in the Other taxes section for more information on the taxation of dividend income.*

### Foreign income

Albanian resident corporations are taxed on their worldwide income. If a DTT is in force, double taxation is avoided either through an exemption or by granting tax credit up to the amount of the applicable Albanian income tax rate.

## Deductions

### Depreciation and amortisation

The reducing balance method of depreciation is used for buildings and machinery and other fixed structures installed in the building. They are depreciated at an annual rate of 5%. Computers, software products, and information systems are depreciated at a maximum rate of 25%. All other assets are depreciated at a maximum rate of 20%. Land, fine art, antiques, and jewellery are non-depreciable assets.

The amortisation of intangible assets is calculated separately for each asset using the straight–line method at the rate of 15%.

### Interest expense

Interest paid in excess of the average 12-month credit interest rate applied in the banking system, as determined by the Bank of Albania, is not deductible. Interest may also be limited by thin capitalisation rules *(see Thin capitalisation in the Group taxation section)*.

### Bad debts

Bad debts are only deductible if all of the following conditions are met:

- An amount corresponding with the bad debt was included earlier in income.
- The bad debt is removed from the taxpayer's accounting books.
- All possible legal action to recover the debt has been taken.

### Other deductions

Representation and reception expenses exceeding 0.3% of annual turnover are not deductible.

Sponsorship expenses exceeding 3% of profit before tax and sponsorships of press and publications exceeding 5% of profit before tax are also not deductible.

The costs of in-kind benefits not taxed via payroll, dividends, fines and other tax-related sanctions, expenses for gifts, and any expense which the taxpayer does not support with a fiscal invoice are not deductible.

The amounts allocated to special reserve accounts in banks and insurance companies are deductible, provided that they do not exceed the limits stated in the Bank of Albania regulations.

Employers' contributions towards the life and health insurance of employees are deductible.

### *Net operating losses*
Fiscal losses may be carried forward up to three years. Losses may not be carried forward if more than 25% of direct or indirect ownership of the share capital or voting rights of the company is transferred during the tax year.

Albanian legislation does not allow losses to be carried back.

## *Group taxation*

There is no group taxation in Albania.

### *Transfer pricing*
Transfer pricing adjustments may be made if the conditions set in a transaction between related parties differ from those that would have been set if the parties were independent. In particular, the following are regarded as related parties:

- A legal entity and any person who owns, directly or indirectly, at least 50% of the shares or voting rights in that entity.
- Two or more legal entities if a third person owns, directly or indirectly, at least 50% of the shares or voting rights in each entity.

### *Thin capitalisation*
The interest paid on outstanding loans and prepayments exceeding four times the amount of net assets is not deductible. This rule does not apply to banks and insurance companies.

### *Controlled foreign company (CFC) regime*
There is no CFC regime in Albania.

## *Tax credits and incentives*

The following entities are exempt from CIT:

- Foundations or non-banking financial institutions established to support development policies of the government through credit activities.
- Film studios and cinematographic productions (among other types of entity/ activity) that are licensed and funded by the National Cinematographic Centre.

### *Foreign tax credit*
Albania does not apply foreign tax credits except in the case of DTTs *(see Foreign income in the Income determination section)*.

## *Withholding taxes*

The gross amount of interest, royalties, dividends, and shares of partnerships' profits paid to non-resident companies is subject to a 10% withholding tax (WHT), unless a DTT provides for a lower rate.

The 10% WHT is levied on the gross amount of payments for technical, management, installation, assembly, or supervisory work, as well as payments to management and board members.

If a non-resident company does not create a PE in Albania, and a DTT exists between Albania and the home country of the non-resident company, the payment of WHT can be avoided.

### *Double tax treaties (DTTs)*

Albania has signed 35 DTTs, of which 30 are in force.

Withholding tax rates envisaged by applicable DTTs are provided in the following table:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Applicable from |
|---|---|---|---|---|
| Austria | 5/15 | 5 | 5 | 1/1/2009 |
| Belgium | 5/15 | 5 | 5 | 1/1/2005 |
| Bosnia and Herzegovina | 5/10 | 10 | 10 | N/A |
| Bulgaria | 5/15 | 10 | 10 | 1/1/2000 |
| China | 10 | 10 | 10 | 1/1/2006 |
| Croatia | 10 | 10 | 10 | 1/1/1999 |
| Czech Republic | 5/15 | 5 | 10 | 1/1/1997 |
| Korea | 5/10 | 10 | 10 | 1/1/2009 |
| Kosovo | 10 | 10 | 10 | 1/1/2006 |
| Kuwait | 0/5/10 (3) | 10 | 10 | N/A |
| Egypt | 10 | 10 | 10 | 1/1/2006 |
| Estonia | 5/10 | 5 | 5 | N/A |
| France | 5/15 | 10 | 5 | 1/1/2006 |
| Germany | 5/15 | 5 | 10 | N/A |
| Greece | 5 | 5 | 5 | 1/1/2001 |
| Hungary | 5/10 | N/A | 5 | 1/1/1996 |
| Italy | 10 | 5 | 5 | 1/1/2000 |
| Ireland | 5/10 (5) | 7 | 7 | N/A |
| Latvia | 5/10 | 5/10 (2) | 5 | 1/1/2009 |
| Luxemburg | 5/10 | 5 | 5 | N/A |
| Macedonia | 10 | 10 | 10 | 1/1/1999 |
| Malaysia | 5/15 (6) | 10 | 10 | 1/1/1995 |
| Malta | 5/15 | 5 | 5 | 1/1/2001 |
| Moldova | 5/10 | 5 | 10 | 1/1/2004 |
| Netherlands | 0/5/15 (1) | 5/10 (2) | 10 | 1/1/2006 |
| Norway | 5/15 | 10 | 10 | 1/1/2000 |
| Poland | 5/10 | 10 | 5 | 1/1/1995 |
| Romania | 10/15 | 10 | 15 | 1/1/1995 |
| Russia | 10 | 10 | 10 | 1/1/1998 |
| Slovenia | 5/10 | 7 | 7 | 1/1/2010 |
| Serbia and Montenegro | 5/15 | 10 | 10 | 1/1/2006 |
| Sweden | 5/15 | 5 | 5 | 1/1/2000 |
| Switzerland | 5/15 | 5 | 5 | 1/1/2001 |
| Spain | 0/5/10 (4) | 6 | 10 (7) | 4/5/2011 |
| Turkey | 5/15 | 10 | 10 | 1/1/1997 |

Notes

1. If the recipient company owns directly or indirectly 50% of the capital of the paying company, 0% rate of the gross amount of the dividends applies. If the recipient company owns directly or indirectly 25% of the capital of the paying company, 5% rate of the gross amount of the dividends applies. A tax rate of 15% of the gross amount of the dividends applies in all other cases.
2. A tax rate of 5% of the gross amount of the interests applies in case of interests in a contracting state, which are paid to a loan granted by a bank or any other financial institution of the other contracting state, including investment banks and savings banks and insurance. A tax rate of 10% of the gross amount of the interests applies in all other cases.
3. If the recipient company or any other governmental body is resident of other contracting state, 0% rate of the gross amount of the dividend applies. If the recipient company (other than a partnership) owns directly or indirectly at least 10% of the capital of the paying company, 5% rate of the gross amount of the dividends applies. A tax rate of 10% of the gross amount of the dividends applies in all other cases.
4. If the recipient company (other than a partnership) owns directly or indirectly at least 75% of the capital of the paying company, 0% rate of the gross amount of the dividends applies. If the recipient company (other than a partnership) owns directly or indirectly at least 10% of the capital of the paying company, 5% rate of the gross amount of the dividends applies. A tax rate of 10% of the gross amount of the dividends applies in all other cases.
5. If the recipient company (other than a partnership) owns directly or indirectly at least 25% of the capital of the paying company, 5% rate of the gross amount of the dividends applies. A tax rate of 10% of the gross amount of the dividends applies in all other cases.
6. If the recipient company (other than a partnership) owns directly or indirectly at least 25% of the capital of the paying company, 5% rate of the gross amount of the dividends applies. A tax rate of 15% of the gross amount of the dividends applies in all other cases.
7. A tax rate of 10% of the gross amount of the royalties applies, unless it can be avoided.

## *Tax administration*

### *Returns*

The tax year is the calendar year. The final CIT return is due by 31 March of the year immediately following that tax year.

### *Payment of tax*

Predetermined advance payments of CIT are due by the 15th day of each month. Advance payments of CIT payable by the small business category are payable on a quarterly basis.

According to the tax laws, CIT is paid during the year on a prepayment basis. The amount of monthly CIT prepayments is determined as follows:

| Years of activities | Period from January to April | Period from May to December |
|---|---|---|
| Year 1 | Taxpayer's estimation | Taxpayer's estimation |
| Year 2 | Taxpayer's estimation | CIT of Year 1 divided by months of activity in Year 1 |
| Year 3 | CIT of Year 1 divided by months of activity in Year 1 | CIT of Year 2 less CIT prepaid during January to April in Year 2 divided by 8 months |

Companies should decide on the use of their prior fiscal year after-tax profit within six months of the subsequent year and submit the decision to the tax authorities no later than 31 July. The decision should state the amount allocated as statutory reserves, the amount to be used for investments and/or for increase in share capital, and the amount to be distributed as dividends.

Companies have the obligation to pay the tax on dividends to the tax authorities no later than 30 July of the year the financial results are approved, regardless of the fact of whether the dividend has been distributed or not to the shareholders.

### *Statute of limitation*

With regard to Albania's tax administration practices, the audit cycle's limitation period is five years.

# Angola

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## Significant developments

In April 2011, several changes to some tax codes were published which have significantly changed taxation in the real estate sector. The main changes, which are described in more detail throughout the rest of this summary, are the following:

- The real estate income tax rate on rental income has been reduced to an effective rate of 15%.
- Non-rented property is now rented at a 0.5% real estate income tax rate applied on the property value.
- The real estate transfer tax rate has been reduced to 2%.

## Taxes on corporate income

The standard corporate income tax (CIT) rate of 35% is levied on the taxable income of the following corporate income taxpayer groups (although, in practice, the last two are not applicable in actual Angolan economic reality):

- Group A – Tax is levied on actual profits as shown in taxpayers' accounting records (e.g. public and private companies, permanent establishments (PE) of foreign entities), adjusted accordingly with the provisions of the CIT Code.
- Group B – Tax is levied on taxpayers' presumable profit (taxpayers not included in groups A or C).
- Group C – Taxation is based on profits that taxpayers could normally earn/obtain (e.g. small family companies).

Resident entities are subject to CIT on worldwide income. Non-resident entities deemed to have a PE in Angola are subject to CIT on Angola-source income.

Special regimes, rules, and tax rates are provided for the oil and gas industry and the mining industry.

Exemptions from CIT are provided for:

- Agricultural companies (for up to ten years).
- Cooperatives.
- Culture associations.
- Non-resident shipping operators (as long as reciprocity exists).

### *Investment income tax (IAC)*
Investment income tax (Imposto sobre a Aplicação de Capitais or IAC) is due on interests, dividends, royalties, and other income of a similar nature. In Angola, the IAC code divides such income into two taxable sections as follows:

#### Section A
Section A investment income includes the following:

- Interest on credit facilities.
- Interest on loans.
- Income derived from deferred payments.

Tax is due at the moment that the interest or income is earned or at the moment when it is presumed to have been earned.

Note that a minimum annual interest rate of 6% is deemed on loan agreements and credit facilities.

#### Section B
Section B investment income includes the following:

- Dividends.
- Capital remunerations of members of 'cooperatives'.
- Bond interest.
- Interest on shareholders' loans.
- Income derived from profits of non-public interest entities not collected until the end of the year.
- Royalties.

For the purposes of this group of income, note that:

- The concept of royalties includes the remuneration of any kind attributed to the use of or consent to use copyrighted literature; arts or science works, including movies and films or recordings for radio or television transmissions; patents; brands; drawings or models of a plan; formulas; or secret processes. The concept of royalties also applies to the use of or the consent to use industrial, commercial, or scientific equipment and information related to an experience acquired on the industrial, commercial, or scientific sector.
- A minimum annual interest rate equal to the rate used by commercial banks on credit operations is deemed interest for shareholders' loans, except if proven that these loans do not earn any interest.

Tax is due at the moment the effective attribution of income (dividends) is earned (interest) or paid (other income).

#### Exemptions
The following income is exempt from IAC:

- Banks deposits interest, if paid by banks liable to Angolan CIT.
- Bank loans interest, if earned by banks liable to Angolan CIT.
- Interest on deferred payment of commercial transactions.
- Re-distribution of dividends already taxed.

**IAC rate**
The IAC rate is 15%, except for the following income for which the rate is 10%:

- Dividends.
- Capital remuneration of members of 'cooperatives'.
- Bond interest.
- Royalties.

Tax is withheld by the payer on Section B income.

For Section A income, tax is assessed by the competent local tax office. When the payment of that income is made to a non-resident entity, Angolan law provides that the tax payment obligation shifts to the Angolan resident entity paying the income.

Any IAC paid is regarded as a tax deductible cost and, in addition, 65% of that tax paid is deducted up to the CIT liability. The only exception will be any investment income tax paid on dividends exempted.

## *Corporate residence*

Business entities with a head office or effective management in Angola are considered resident entities and are taxed on worldwide income.

### *Permanent establishment (PE)*
Angola has not signed any double tax treaties, therefore its domestic tax provisions apply with regards to PE.

The Angolan concept of tax PE is inspired in the United Nations (UN) Double Tax Treaty Model. A foreign entity is deemed to create a PE in Angola if it:

- has a branch, an office, or place of management in Angola
- has a construction or installation site, or provides supervision over such site, only when such site or activities exceed a period of 90 days in any given 12 months period, or
- carries out services in Angola, including consulting, acting through employees or other personnel contracted for that end, when such services are provided for a period of at least 90 days in any given period of 12 months.

## *Other taxes*

### *Consumption tax*
There is no value-added tax (VAT) or sales tax in Angola. However, a consumption tax exists, which is similar to that of an excise duty. Local production, importation of goods, and a few services (e.g. hotels, restaurants, electricity, water supply, and telecommunications) are subject to this tax.

The rates vary from 2% to 30%, depending on the service or goods imported or produced locally.

### *Customs duties*
Duties are levied on imports at ad valorem rates varying from 2% up to 30%. The range of taxation for both consumption tax and import duties varies according to the type of goods. The rates are set out in the tariff book.

Listed equipment may be imported temporarily, if a bank guarantee is provided.

A 0.1% statistical fee and a 0.5% stamp duty is also due on importation plus custom fees (from 1% to 3%).

A special exemption regime applies for the oil industry for some listed equipment.

### *Stamp tax*
Stamp tax is payable on a wide variety of transactions and documents, at specific amounts or at a percentage based on value.

Important examples include:

- Receipts: 1%.
- Companies' incorporation: 0.20%.
- Share capital increase: 0.50%.

### *Real estate income tax (IPU)*
IPU is levied on rental income earned by individuals or companies owning real estate assets. It is based on actual rental income when the assets are leased and on the assets' registered value when the assets are not leased.

#### Leased assets
IPU is levied on rental income at a 25% rate.

The rental income is automatically reduced by 40% of its value, as it is presumed to finance all real estate related expenses.

Therefore, in practice, IPU applies at an effective 15% rate on rental income (i.e. 25% multiplied by 60% of rental income), with a minimum amount of 1% of the asset registered value.

A real estate asset is registered at the higher of (i) its valuation (based on criteria and tables to be published which will take into account the area (square metres) and the characteristics of the property) or (ii) the value of its latest transfer.

#### Assets that are not leased
IPU is levied as follows for assets that are not leased:

| Patrimonial value (AOA*) | IPU rate (%) |
|---|---|
| Up to 5 million | 0 |
| Over 5 million (on the excess) (1) | 0.5 |

Notes

* Angolan kwanza

1. An asset registered at AOA 35 million will pay IPU only on AOA 30 million, resulting in an IPU payable of AOA 150,000.

#### Exemptions
The only accepted exemptions of IPU will be the following:

- State public institutions and associations that are granted with the public utility statute.
- Property of Embassies or Consulates of foreign countries, provided there is reciprocity.
- Religious temples.

#### Payment
Rents paid by Angolan entities (individuals or companies) that carry out commercial activity must withhold the 15% IPU from rents paid. The IPU so withheld must be paid over to the tax authorities by the end of the following month.

For any other cases, owners of real estate assets must pay the IPU in January and July of the following year. At the request (by July each year) of the IPU taxpayer, if approved, the IPU is payable over four instalments in January, April, July, and October of the following year.

#### Filing requirements
IPU Model 1 must be filed by IPU taxpayers each January, disclosing the rents effectively received in the preceding year, distinguishing the leases agreed and received.

### *Real estate transfer tax (SISA)*
SISA is levied at a 2% rate for all acts that involve onerous permanent or temporary transmission of real estate. The value liable to tax is the higher of (i) the sale value or (ii) the registered value.

Exemptions of SISA are only applicable to the following entities:

- State public institutions and associations that are granted with the public utility statute.
- Property of Embassies or Consulates of foreign countries, provided there is reciprocity.
- Religious temples.
- Real estate transferred for less than UCF 78,000 (currently UCF 1 = AOA 88) only when (i) at the first sale and (ii) for residential purposes.

## *Branch income*

Branch taxable income is taxed on the same basis as separate legal entities. Income remitted by a branch to the head office is not subject to IAC.

## *Income determination*

### *Inventory valuation*
Inventory is valued at the historic acquisition cost. Any other method of valuation needs to be approved by the Tax Authorities.

### *Capital gains*
Capital gains arising from the disposal of fixed assets are taxed as part of normal income.

Capital gains are determined by the difference between the sales proceeds and the acquisition value, deducted from tax deductible depreciation, adjusted by a devaluation coefficient.

### *Dividend income*

Dividends received are exempt from CIT, provided that the share participation is owned for two consecutive years (or since the incorporation of the entity where the participation is held) and the share participation is not less than 25%.

Dividends from Angolan participations owned by insurance companies to fund their technical reserves are also exempt from CIT.

### *Interest income*

Interest from public bonds is exempt from CIT.

### *Rental income*

Rental income, as being liable to real estate income tax, is not liable to CIT.

### *Royalty income*

Royalty income is taxed as normal income. Any IAC paid is regarded as a tax deductible cost and, in addition, 65% of that tax paid is deducted, up to the CIT liability.

### *Foreign income*

An Angolan resident corporate income taxpayer is taxed on all its foreign income. Any income tax proved to be paid outside the country for activity carried on out outside the country will be credited against the CIT liability.

## *Deductions*

### *Depreciation*

Depreciation should be computed using the straight-line method; any other method must be approved by the tax authorities.

The tax depreciation rates should respect the limits imposed by Government Ruling 755/72, and, in absence in this Ruling, the tax authorities' interpretation, as follows:

| Type of asset | Rate (%) |
|---|---|
| Office building | 2 |
| Industrial building | 4 |
| Computers | 33.33 |
| Office equipment | 10 |
| Furniture | 10 |
| Software | 33.33 |
| Light passenger vehicles | 33.33 |

Depreciation not accounted for at cost is not permitted as a deduction in the following years.

30% of the increase on depreciation resulting from a legal revaluation of fixed assets is not accepted for tax purposes, as well as the total increase in depreciation resulting from free revaluation of the fixed assets.

### Bad debts
Write-off of debts is considered as deductible only if the write-off resulted from a bankruptcy court process.

### Provisions
The only provisions accepted as deductible for tax purposes are:

- Doubtful debts within an annual limit of 2% of the client's current total account value and provided that a 6% accumulated provision limit is not exceeded.
- Inventory depreciation within limits that vary from 1% and 8% (annual and accumulated) depending on the nature of the company's activity.
- Those respecting the limits and rules imposed by the Insurance Supervision Institute for insurance companies, as well as the Central Bank for Financial Institutions.
- Provisions for possible losses resulting from a court process.

### Charitable contributions
Donations are accepted as deductible up to a limit of 2% of the taxable income if the donations are granted to Angolan education, science, charity, and cultural institutes. If granted to Angolan government, central and local administration bodies, the donations are fully deductible.

### Net operating losses
Tax losses are deductible from the taxable income of the following three years. Carryback of losses is not allowed.

## Group taxation

There are no special rules for group taxation in Angola.

### Transfer pricing
Despite the existence of the arm's-length principle in Angolan corporate tax law, there are no detailed regulations on transfer pricing. Taxpayers should be aware that, in light of existing generic rules included in the corporate tax code, the tax authorities do have means to adjust inter-company charges.

### Thin capitalisation
There are no thin capitalisation rules in Angola.

## Tax credits and incentives

### Investment incentives
Profits retained and then reinvested by the company in new installations or equipment during the following three financial years may be deductible from taxable income during the following three years after the investment is finalised. Note that this benefit is not yet regulated.

Special regulations also provide tax and customs incentives for investment projects in strategic economic development areas and sectors. One such incentive can provide up to 15 years of CIT exemption.

### Foreign tax credit

Any income tax proved to be paid outside the country for activity carried out outside the country will be credit against the CIT liability.

## Withholding taxes

Withholding tax (WHT) is applicable on payments for services provided to Angolan entities. For Angolan taxpayers, this is regarded as an advance payment of the CIT due at the year-end. For non-resident companies, this is a final tax.

The payments subject to this WHT are those related to:

- Construction, improvement, repair, or conservation of immovable property withheld at a rate of 3.5% on the gross payments (CIT rate of 35% applicable on a 10% deemed margin).
- Other services, namely technical assistance and management fees, withheld at a rate of 5.25% on the gross payments (CIT rate of 35% applicable on a 15% deemed margin).

Due to the IAC, Angola does not have a separate WHT for dividends, interest, and royalties *(see the Taxes on corporate income section for more information)*.

## Tax administration

### Tax returns

The tax year follows the calendar year, and the annual CIT return must be submitted by the last business day of May of the year following the year to which the income relates.

### Tax payment

Tax is paid in four instalments. The first three correspond to advance payments based on the expected tax to be paid or, if unknown at that date, 75% of the taxable income computed on the previous year multiplied by the tax rate (35%). The instalments are paid in January, February, and March, and the final instalment is paid with the submission of the annual tax return on the last business day of May.

# Antigua and Barbuda



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## Significant developments

There have been no significant corporate tax developments in Antigua and Barbuda during the past year.

## Taxes on corporate income

Companies incorporated in Antigua and Barbuda pay corporate income tax (CIT) on their worldwide income, with relief available under existing double taxation agreements (DTAs). Non-resident companies deriving income from Antigua and Barbuda are liable for CIT and should be registered if they have a physical presence in Antigua and Barbuda.

Antigua and Barbuda imposes a flat CIT rate of 25%.

Taxable income or chargeable income is ascertained by deducting from income all expenses that are wholly and exclusively incurred during the year in the production of the income. Chargeable income is normally arrived at by adjusting the net profit per the financial statements for non-taxable income, non-deductible expenses, and prior period losses up to 50% of chargeable income.

Where a person resident in Antigua and Barbuda makes to another person not resident in Antigua and Barbuda a payment which the payor is entitled to deduct in arriving at chargeable income, then a withholding tax (WHT) must be deducted. In addition, if the income received by the non-resident person would have been subject to tax under the Income Tax Act, then WHT must be deducted by the payor.

### Reduced CIT rate for certain financial institutions

Financial institutions licensed under the Banking Act that maintain, throughout the tax year, residential mortgage rates at or below 7% are subject to a reduced CIT rate of 22.5%.

## Corporate residence

A corporation is deemed to be a resident if it is incorporated in Antigua, if it is registered as an external company doing business in Antigua or if the central management and control of its business are exercised in Antigua.

### Permanent establishment (PE)

A permanent establishment (PE) is not defined in the Income Tax Act; however, any company which would meet the general definition of a PE must be registered.

## *Other taxes*

### *Value-added tax (VAT)*
Antigua and Barbuda Sales Tax (ABST) is a VAT applicable to a wide range of goods and services. The standard rate is 15%, and hotel accommodation carries a transitional rate of 10.5%.

A number of services, including financial services, local transportation, sale of residential land, education, long-term accommodation (greater than 45 days), and medical and veterinary services, are exempt from ABST. Certain supplies are zero-rated, including exports, basic food items, water, electricity for residential use, sale of new residential property, construction of new residential premises, and fuel. Intergroup transactions are taxable.

A period in the ABST Act represent one month. The threshold for registration is 300,000 East Caribbean dollars (XCD) in taxable activity per 12 month period.

### *Customs duties/import tariffs*
All imports are subject to import duties, ABST, Antigua and Barbuda Revenue Recovery Charge, and an environmental levy. In all instances, certain exemptions will apply.

Import duty is levied on a wide range of imported goods at rates from 0% to 70% as specified in the Custom Duties Act. Customs Duty is levied on goods based on the cost, insurance, and freight (CIF) values and rates determined by the Caribbean Community (CARICOM) Common External Tariff.

### *Antigua and Barbuda Revenue Recovery Charge*
Antigua and Barbuda Revenue Recovery Charge is applied at a flat rate of 10% on the CIF value on all goods imported into or produced in Antigua and Barbuda. Exemptions will include entities with which the Government has International Assistance Agreements, certain Government entities, and most supplies or imports of fuel.

### *Environmental levy*
Environmental levy is calculated based on dollar value rates from XCD 0.25 - XCD 2,000 and is used to finance the cost of protecting and preserving the environment.

### *Property taxes*
Property tax is levied at graduated rates on the basis of the market value of real property (as assessed by the Property Valuation Department) and its use (residential or commercial).

Property tax rates are as follows:

- Agricultural land: 0.10%.
- Residential land: 0.20%.
- Residential building: 0.30%.
- Buildings classified as other property: 0.50%.
- Land classified as other property: 0.40%.

Allowances and tax rebates are available as follows:

- Dwelling house allowance of XCD 150,000 from the taxable value.
- Rebates to pensioners of between 10% and 50% depending on the annual income of the pensioner.

- 5% rebate for payment of tax on or before the due date.
- New dwelling house will be exempt from tax for the first two years of being habitable.
- Between 25% and 100% tax rebate available for special development property and property for public use; 25% for hotels.

### *Non-citizens undeveloped land tax*
Undeveloped land tax is levied on the basis of the value of land owned by non-citizens which have not been developed.

Rates of tax are as follows:

- Second year of ownership: 5%.
- Third year of ownership: 15%.
- Fourth and subsequent years of ownership: 20%.

### *Stamp tax*
Stamp tax applies to a very wide range of transactions (e.g. bill of sale, leases, mortgages, contract, bill of lading). Stamp tax on transfer of real property and shares are specifically covered below.

#### Transfer of real property
Stamp tax is imposed on both the buyer and the seller and is levied on the consideration for the sale or the value of property as assessed by the Chief Valuation Officer, whichever is higher. The stamp tax for vendors is 7.5%, and the stamp tax for purchasers is 2.5%.

Non-citizens vendors are required to pay a land value appreciation tax at the rate of 5%, which is assessed on the difference between the value of property when purchased, plus improvements, and the value of property at the time of sale.

Non-citizens purchasers are also required to pay 5% of the value of property with reference to a non-citizens licence required to hold property in Antigua and Barbuda.

#### Transfer of shares
Stamp tax is imposed on both the buyer and the seller and is levied on the market value of the shares or book value of the shares, whichever is higher. The stamp tax for vendors is 5%, and the stamp tax for purchasers is 2.5%.

A non-citizen must obtain a license (at a cost of XCD 400) to hold shares or be a director in a company that owns land or has a lease on land in excess of five acres for a period greater than five years.

### *Life insurance premium tax*
A premium tax of 3% is levied on the premium income (net of agent's commission) of all life insurance companies, whether resident or non-resident.

### *General insurance premium tax*
A premium tax of 3% is levied on the premium income, excluding motor business (net of agent's commission), of all general insurance companies, whether resident or non-resident.

## Branch income

Branch income is taxed on the same basis and at the same rate as that of corporations. A resident branch of a foreign company shall be regarded as a separate company and shall be taxed on the same basis as that of a locally registered corporation.

Recharges of expenses from head office to the branch are subject to WHT at a rate of 25%. The recharges have to be justifiable, consistent, and cannot just be based on a percentage allocation.

## Income determination

### Inventory valuation

Inventories are generally stated at the lower of cost or net realisable value. First in first out (FIFO) and average cost methods of valuation are generally used for book and tax purposes. However, the Commissioner of Inland Revenue will normally accept a method of valuation that conforms to standard accounting practice in the trade concerned. Last in first out (LIFO) is not permitted for tax or book purposes.

### Capital gains

Capital gains are not subject to tax in Antigua and Barbuda.

### Dividend income

Dividends received by a company resident in Antigua from another company resident in Antigua are taxed at the CIT rate of 25%. Credit is given to the recipient for the tax already paid on the dividend in computing the tax liability.

### Stock dividends

An Antiguan corporation may distribute a tax-free stock dividend proportionately to all shareholders.

### Foreign income

An Antiguan corporation is taxed on foreign branch income as earned and on foreign dividends as received. Double taxation is avoided by means of foreign tax credits where active tax treaties exist and through deduction of foreign income taxes in other cases (the United Kingdom (UK) and CARICOM). There is also relief from Commonwealth taxes. *See Foreign tax credit in the Tax credits and incentives section for more information.*

## Deductions

### Depreciation

Depreciation allowed for tax purposes is computed by the diminishing-balance method at prescribed rates. Initial allowances are granted on industrial buildings and on capital expenditures incurred on plant and machinery by a person carrying on a trade or undertaking, as defined. In addition, an annual allowance of 2% is granted on all buildings. Conformity between book and tax depreciation is not required.

Any gain on the sale of depreciated assets is taxable as ordinary income up to the amount of tax depreciation recaptured.

### *Interest*
No deduction is allowed for interest on loans owing to shareholders, directors, their spouses, children or relatives, or to any related parties. Only interest paid to banks and financial institutions licensed under the Financial Institutions (Non-Banking) Act on loans borrowed at commercial rates and terms is deductible.

### *Restriction on rents paid*
Rents paid by a company to shareholders, directors, their spouses, children or relatives, or to any related parties in excess of 5% of the otherwise chargeable profits of the company may not be deducted.

### *Restriction on compensation*
Salaries, wages, directors' fees and other payments made for services rendered by the shareholders, directors, their spouses, children, or relatives in excess of 25% of otherwise chargeable profits may not be deducted.

### *Cultural and social contributions*
A deduction of 50% of all substantial contributions made by any person with respect to sport, education, or culture in Antigua and Barbuda is allowed against a person's assessable income from trade, business, or profession. Contributions must be in excess of XCD 10,000 in any assessment year, and deductions during any assessment year will be limited to XCD 250,000.

### *Net operating and capital losses*
Income tax losses may be carried forward for six years following the year in which the loss was incurred. However, the chargeable income of a company in any one income year may not be reduced by more than one half by losses brought forward. No carryback of losses is permitted.

### *Payments to foreign affiliates*
An Antiguan corporation may claim a deduction for royalties, management fees, and interest charges paid to foreign affiliates, provided the payments are equal to or less than what the corporation would pay to an unrelated entity. The deductibility of any payments to a foreign affiliate will be subject to an arm's-length test.

## *Group taxation*

Group taxation is not permitted in Antigua and Barbuda.

### *Transfer pricing*
There are no provisions for transfer pricing in the tax laws of Antigua and Barbuda.

### *Thin capitalisation*
There are no provisions for thin capitalisation in the tax laws of Antigua and Barbuda.

## *Tax credits and incentives*

Tax incentives are currently available under the following legislation.

### *Fiscal Incentives Ordinance (1975)*
The Fiscal Incentive Ordinance provides manufacturers of an 'approved product' with an exemption from taxes for varying periods, up to a maximum of 15 years. After the

period of exemption, relief by way of tax credits of up to 50% of CIT paid on profits derived from certain export sales may be obtained. The net losses arising during the tax holiday period (i.e. the excess of accumulated tax losses over total profits) may be carried forward and relieved against profits following the expiration of the tax holiday in accordance with the normal rules for set-off of losses.

***International Business Corporations (IBC) Act (1982)***

An IBC is an entity incorporated under the IBC Act for the purpose of carrying on international trade or business. The IBC structure allows for a comprehensive range of business opportunities including international banking, trust business, insurance, manufacturing, and other international trade activities to persons outside of Antigua and Barbuda within a tax-free environment. An IBC is exempt from the payment of CIT, ABST, and WHT.

***The Investment Authority Act (2006)***

The Investment Authority Act provides the framework for the promotion of investment opportunities in Antigua and Barbuda by introducing a system of registration of businesses, an investment code, and a range of incentives that are available to both resident and non-resident investors. The available incentives and concessions to which an investor may be entitled for consideration are as follows:

- Exemption from the payment of customs duty.
- Reduction of property tax.
- Exemption from CIT
- Reduction of stamp duty.
- Exemption from WHT.

The amount of the incentives and concessions depend on the amount of the investment and the number of employees in the proposed business.

The investment categories are as follows:

- Capital investment of up to XCD 1 million or employs up to 26 persons: This investor may qualify for exemption from the payment of customs duty on certain imports, reduction in property tax by up to 10%, exemption from the payment of CIT and WHT for up to three years, and a reduction of stamp duty by up to 10% on the sale of land and buildings used in the business operation.
- Capital investment of over XCD 1 million, employs over 26 persons, and has at least one director or owner who is a resident of Antigua and Barbuda: This investor could qualify for exemption from the payment of customs duty on certain imports, reduction in property tax by up to 20%, exemption from the payment of CIT and WHT for up to five years, and a reduction of stamp duty by up to 20% on the sale of land and buildings used in the business operation.
- Capital investment of over XCD 10 million, employs over 51 persons, and has at least one director or owner who is a resident of Antigua and Barbuda: This investor could qualify for exemption from the payment of customs duty on certain imports, reduction in property tax by up to 30%, exemption from the payment of CIT and WHT for up to ten years, and a reduction of stamp duty by up to 30% on the sale of land and buildings used in the business operation.
- Capital investment of over XCD 25 million, employs over 75 persons, and has at least one director or owner who is a resident of Antigua and Barbuda: This investor could qualify for exemption from the payment of customs duty on certain imports, reduction in property tax by up to 40%, exemption from the payment of CIT and

WHT for up to 12 years, and a reduction of stamp duty by up to 40% on the sale of land and buildings used in the business operation.
- Capital investment of over XCD 75 million, employs over 100 persons, and has at least one director or owner who is a resident of Antigua and Barbuda: This investor could qualify for exemption from the payment of customs duty on certain imports, reduction in property tax by up to 50%, exemption from the payment of CIT and WHT for up to 15 years, and a reduction of stamp duty by up to 50% on the sale of land and buildings used in the business operation.
- Capital investment of over XCD 100 million, employs over 150 persons, and has at least one director or owner who is a resident of Antigua and Barbuda: This investor could qualify for exemption from the payment of customs duty on certain imports, reduction in property tax by up to 75%, exemption from the payment of CIT and WHT for up to 20 years, and a reduction of stamp duty by up to 75% on the sale of land and buildings used in the business operation.

### *The Small Business Development Act (2007)*

The Small Business Development Act provides the framework for the growth of the small business sector in Antigua and Barbuda by introducing a system of registration of small businesses and a range of concessions which are available to the business. The available concessions to any small business that would be entitled for consideration are as follows:

- Concession on customs duty of up to 100% (includes raw material, building material, equipment, vehicles, furniture, furnishings, appliances, fixtures and fittings, tools, spare parts, machinery and equipment used in the construction and operation of the business).
- Property tax reduction of up to 75%.
- CIT exemption for a period not exceeding five years.
- CIT exemption after the initial five year period of up to 10%.
- WHT exemption for a period of up to three years.
- Stamp duty exemption on the registration of a mortgage.
- Stamp duty exemption on the transfer of property and any applicable non-citizen land holding licence.

A small business to which this Act applies must meet all of the following criteria:

- No more than 25 employees.
- Not a wholly owned or majority owned business or subsidiary of a larger company.
- Capital investment not exceeding XCD 3 million.
- Annual sales that do not exceed XCD 2 million.
- Majority owned by citizens of Antigua and Barbuda, or majority owned by non-citizens with all of the following restrictions:
  - Over 50% of the products must be exported.
  - Minimum investment of XCD 500,000.
  - At least 50% of the employees must be citizens of Antigua and Barbuda.
  - At least 40% of the goods and services used in production must be acquired from businesses in Antigua.

### *Foreign tax credit*

Double taxation is avoided by means of foreign tax credits where active tax treaties exist and through deduction of foreign income taxes in other cases (the United Kingdom and

CARICOM). A foreign tax credit is also available to persons in Antigua and Barbuda who have paid or are liable to pay Commonwealth income tax.

**Residents**
The relief available from tax in Antigua and Barbuda for a person resident in Antigua from tax paid in Antigua and Barbuda is the Commonwealth income tax rate if that rate does not exceed one-half the tax rate in Antigua and Barbuda. If the Commonwealth income tax rate exceeds the Antigua and Barbuda tax rate, then the relief will be limited to one-half the tax rate in Antigua and Barbuda.

**Non-residents**
The relief available from tax in Antigua and Barbuda for a person not resident in Antigua from tax paid in Antigua and Barbuda is one-half the Commonwealth income tax rate if that rate does not exceed one-half the tax rate in Antigua and Barbuda. If the Commonwealth income tax rate exceeds the Antigua and Barbuda tax rate, then the relief will be limited to the amount by which it exceeded one-half the rate of Commonwealth income tax.

No relief is available unless similar provisions exist in the laws of the relevant Commonwealth country.

## *Withholding taxes*

Tax is currently withheld from income as follows:

| Recipient | Dividend (%) | Dividend preferred shares (%) | Interest and rentals (%) | Management fees, royalties, and other payments to a non-resident (%) | Interest on bank deposits (%) |
|---|---|---|---|---|---|
| Resident corporations and individuals | 0 | 0 | 0 | 0 | 0 |
| Non-resident corporations | 25 | 25 | 25 | 25 | 25 |
| Non-resident individuals | 25 | 25 | 20 | 25 | 0 |
| **Residents of a CARICOM member state:** | | | | | |
| Corporations | 0 | 15 | 15 | 15 | 15 |
| Individuals | 0 | 15 | 15 | 15 | 0 |

Note that interest payments on bank deposits made to non-resident individuals are not subject to WHT. Interest payments on bank deposits made to non-resident corporations are taxed at the rate of 25%.

Where a non-resident lends money at arm's length for the purpose of promoting industrial, commercial, scientific, housing, or other development, the rate of WHT is 10%. Prior approval must be sought from the Commissioner of Inland Revenue, and it is recommended that Cabinet approval also be obtained.

WHT becomes due at the time of payment or accrual and must be paid within seven days thereof.

### *Tax treaties*
There is a tax treaty with the United Kingdom and a DTA between member states of CARICOM.

The UK tax treaty provides that persons in either the United Kingdom or Antigua and Barbuda are entitled to relief from CIT and WHT. The treaty allows for the following relief:

- Where a UK resident is liable to pay income tax in the United Kingdom in respect of the same income which is taxable in Antigua and Barbuda, one will be entitled to relief at a rate that is equal to the amount by which the tax rate in Antigua and Barbuda exceeds one half the UK rate.
- If the tax rate in Antigua exceeds the UK tax rate, then one will be entitled only to relief at a rate equal to the half the UK tax rate.

## *Tax administration*

### *Returns*

Taxes are assessed on a fiscal-year basis. The taxpayer must file a CIT return, which includes audited financial statements, within three months of the fiscal-year end. The authorities will subsequently raise an assessment.

If a return is not filed on a timely basis, the authorities have the power to issue estimated assessments. There is a 5% penalty for late filing (minimum of XCD 500). The taxpayer can object to assessments raised within 30 days and ask the Commissioner of Inland Revenue to review and revise. In the event that the objection is unsuccessful, the taxpayer may appeal to the Tax Appeal Board. The Commissioner of Inland Revenue has the power to enforce the collection of tax prior to the determination of any objection or appeal. The Commissioner also has the discretion to order a stay on the collection and payment of all or part of any assessed tax until such time as the objection or appeal is finalised if it would be unjust not to do so.

### *Payment of tax*

Advance tax is payable in monthly instalments and is ordinarily based on the tax chargeable and assessed in the previous fiscal-year. The standard amount of each instalment is determined as one-twelfth of the tax chargeable in the previous fiscal-year. If the assessment for the prior year has not been finalised, the Commissioner of Inland Revenue can raise an assessment based on best judgment.

The balance of tax due after deduction of advance tax, as notified in the assessment, is payable at the time of submitting the annual corporate tax return, which must not be later than three months after the financial year-end or one-month after service of the final assessment.

Tax is deemed to be in default if not paid within 30 days of the date on which it becomes due and payable. A penalty of 20% and interest of 1% per month is charged on unpaid taxes in default.

### *Statute of limitations*

The Inland Revenue Department can reassess CIT returns within a six year period. In addition, the Department can make additional assessments of tax, interest, or penalties.

# Argentina

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## Significant developments

The 'Electronic Invoice' regime is expected to become mandatory for certain specific businesses such as software development, consulting, accounting and audit services, exporters, advertising, mobile telecommunications, rendering of services to government, etc. During 2011, the rest of the taxpayers may opt to apply for this regime as well.

On 1 January 2011, the 'tax on gift, inheritance, and charitable donations' ruled by Law 14,044 entered into force in the Province of Buenos Aires.

From a Tax Treaty network perspective, the Tax Information Exchange Agreement (TIEAs) signed with Monaco in October 2009 entered into force in August 2010 and in January 2011 for criminal and tax issues respectively.

## Taxes on corporate income

### Profits tax

The rate of profits tax on net taxable business profits is 35%. Legal entities resident in Argentina are subject to tax on Argentine and foreign-source income. Resident legal entities are able to claim any similar taxes actually paid abroad on foreign-source income as a tax credit. The tax rate applies on net income determined on a worldwide basis.

Corporations, limited liability partnerships, and branches, as well as other entities, are required to make a flat and final income tax withholding of 35% from dividend payments to resident or non-residents beneficiaries, to the extent that the amount of such dividends exceeds the net taxable income determined at a corporate level in accordance with the general tax rules.

Argentine-source income (e.g. royalties, interests) received by foreign entities is subject to withholding tax (WHT) in full and final settlement at source *(please refer to the Withholding taxes section)*.

### Tax on minimum notional income

In addition to the profits tax, there is a tax on minimum notional income. The rate is 1% on the value of fixed and current assets. The presumed tax, imposed annually, is applied only in excess of the profits tax of the same fiscal year. In addition, payment of this presumed tax, not offset by the profits tax, will be treated as payment on account of profits tax chargeable during a maximum period of ten years.

Banking and insurance entities are only subject to this tax on 20% of the corresponding taxable assets.

## *Corporate residence*

Corporate residence is determined on the basis of centres of activity, which may be the location of a company's economic activity or management activity. Centres of activity in Argentina of non-Argentine corporations are treated as permanent establishments (PE).

## *Other taxes*

### *Value-added tax (VAT)*

VAT is assessable on the sales value of products (e.g. raw materials, produce, finished, or partly finished merchandise) with few exemptions, most services (e.g. construction, utilities, professional and personal services not derived from employment, rental), and on import of goods and services. The VAT rate is 21%, although certain specific items are subject to a 10.5% and 27% rate. It is payable by filing monthly tax returns.

The increased rate of 27% applies to 'utilities services' (e.g. telecommunications, household gas, running water, sewerage, and energy) not rendered to dwelling-purposes real estate.

A reduced rate of 10.5% applies to certain transactions, including (but not limited to) the following:

- Construction of housing.
- Interest and other costs on personal loans granted to final consumers by financial institutions.
- Sales and imports of living bovine animals, supply of publicity and advertising in some specific cases.
- Any passenger transportation operating inside the country when the distance does not exceed 100 km.
- Medical assistance in some specific cases.
- Certain capital goods depending on the Custom Duty Code.

VAT paid on purchases, final imports, and rental of automobiles not considered as inventory, cannot be computed by the purchaser as a VAT credit. The same tax treatment applies to other services, such as those provided by restaurants, hotels, and garages.

#### VAT exemptions

Among others, the following transactions are exempt from VAT:

- Sales of books, ordinary natural water, common bread, milk, medicine, postage stamps, aircraft used in commercial activities and for defence or internal safety, and ships or boats acquired by the National Government.
- Supply of services such as: services rendered by the Government (National, Provincial, or Local) or by public institutions, school or university education provided by private institutions subject to public educational programmes; cultural services supplied by religious institutions; hospital and medical care and related activities, transportation services for sick or injured persons in vehicles specially designed for the purpose; tickets for theatre, cinema, musical shows, and sport

events, the production and distribution of motion picture films; local transport of passengers (e.g. taxis, buses) up to 100 km, international transportation.
- Rental of real estate for housing purposes.

### VAT exemption on importation
The following transactions shall be exempted from VAT:

- Final importation of goods qualifying for exemption from customs duties under special regimes for tourists, scientists and technicians, diplomatic agents, etc.
- Final importation of samples and parcels exempted from customs duties.

### VAT export reimbursement regime
Exports of goods and services are treated as a zero-rated transaction. Nevertheless, input VAT related to these transactions can either be used as a credit against output VAT or refunded pursuant to a special procedure.

Services rendered within the country shall be deemed to be exports if they are effectively applied or economically utilised outside the country.

Exporters must file an export return with the tax authorities, reporting the VAT receivables related to their exports to be reimbursed on VAT paid in relation to the export operations. This return has to be filed within the following tax period in which the export took place. A report certified by a public accountant with respect to the value, registrations, and other characteristics related to the refund must be attached to the export return.

The tax credit related to exports and other taxable activities can only be refunded in proportion to the exports, and can be fully refunded to a cap of 21% of the FOB value of the exported products.

There is no specific method stated in the legislation for allocating the tax credit related to exports, but taxpayers are able to use any methods of calculation that would be suitable to their business model. This calculation has to be approved by the tax authorities.

Finally, it is important to highlight that the tax authorities have to approve the tax credit to be refunded.

## *Turnover tax (gross income tax)*
Each of the 24 jurisdictions into which Argentina is divided imposes a tax on gross revenues from the sale of goods and services. Exports of goods are exempt, and certain industries are subject to a reduced tax rate. Rates, rules, and assessment procedures are determined locally.

Information on tax rates of the economically largest jurisdictions is provided as follows:

| Jurisdiction | General rate (%) | Commerce (%) | Services (%) | Industry (%) |
|---|---|---|---|---|
| Province of Buenos Aires | 3.5 | 3 to 4.5 | 3.5 to 4.5 | 1 to 3 |
| City of Buenos Aires | 3.75 to 4 | 3.75 to 4 | 3.75 to 4 | 1 to 3 |
| Córdoba | 4 | 2 to 7.5 | 4 | 0.5 to 1 |
| Mendoza | 3 | 3 | 3 | 1.5 |
| Santa Cruz | 2.5 | 2.5 | 2.5 | 1.5 |
| Santa Fe | 3.5 | 1 to 4.5 | 1 to 4.5 | 0 |

### *Excise taxes*
Excise tax is assessable on a wide variety of items sold in Argentina (not on exports), principally on tobacco, wines, soft drinks, spirits, gasoline, lubricants, insurance premiums, automobile tires, mobiles services, perfumes, jewellery, and precious stones. The bases of the assessment and tax rate of some items are as follows:

| | Rates (%) | |
|---|---|---|
| **Products** | **Nominal** | **Effective** |
| Tobacco | 16 / 20 / 60 | 19.05 to 25 |
| Alcoholic drinks | 20 | 25 |
| Beers | 8 | 8.70 |
| Soft drinks | 4 to 8 | 4.17 to 8.70 |
| Jewellery and precious stones | 20 | 25 |

### *Import and export duties*
The levels of import duty currently range between 0% and 35%, except in cases where a specific minimum duty is applied or which involves merchandise with a specific treatment. These percentages were established considering the individual competitive conditions prevailing in different production sectors and the relative advantages of contributing to the introduction of equipment and technology for local industry. In general, merchandise originating from LAIA (Latin America Integration Association – ALADI) countries is entitled to preferential duty.

In the case of export transactions, goods are valued based on the FOB clause, and the approach is based on their theoretical value, rather than a positive basis as in the case of imports.

Since March 2002, definitive exports of all goods are subject to export duties. The rates vary from 5% to 45%, depending on the tariff code of the merchandise (while 5% is typical, higher rates are considered for exports of agricultural products or hydrocarbons).

### *Stamp tax*
Stamp tax is levied by each of the 24 jurisdictions, and applies principally to contracts and agreements, deeds, mortgages, and other obligations, agreements and discharges of a civil, financial, or commercial nature of which there is written evidence or, in certain instances, that are the subject of entries in books of account. The average tax rate is 1% applicable on the economic value of the contract.

In the city of Buenos Aires, the standard tax rate is 0.8% of the aggregate amount of the transactions, contracts, and deeds that are subject to the stamp tax. Special rates of 0.5%, 1%, and 2.5% are also established; and, in the case of transactions involving uncertain consideration, a fixed tax of 1,000 Argentine pesos (ARS) is applicable (on the fulfilment of certain conditions).

### *Tax on financial transactions – on credits and debits on bank accounts*
Bank account movements (deposits and withdrawals) are subject to this national tax at the following rates:

- 0.6% of deposits and withdrawals in bank accounts opened in local financial entities.
- 1.2% of any transactions made in a bank without using a bank account.

The 34% or 17% of the tax on financial transactions effectively paid on bank account deposit transactions (0.6%) and movement of funds (1.2%), respectively, is creditable against income tax and minimum notional income tax and/or respective tax advances.

### *Wealth tax*

An annual wealth tax is levied on the shares or holding in the capital of local companies owned by individuals or undivided estates domiciled in Argentina or abroad, and/or companies and/or any other type of legal person domiciled abroad. It shall be assessed and paid directly by the local company, as a full and final payment on behalf of the shareholders (the issuing company has the right to recover from the shareholder the tax paid).

The applicable tax rate is 0.5% on the value of the participation, which is generally calculated on the difference between assets and liabilities arising from the financial statements closed at 31 December or during the respective fiscal year.

### *Payroll taxes*

Foreign and local nationals working for a local company must be included on the local payroll and will be considered as local employees for local labour, tax, and social security purposes. Both the local company and the employees will be subject to the corresponding regulations.

All the compensation paid in Argentina or abroad for work performed for the local company will be considered as local compensation and should be reported to the tax and social security authorities, as the case may be, and included in the salary slips and recorded in the local labour books.

The local employer must withhold income tax on an actual and monthly basis and make the corresponding payments to the tax authorities through monthly WHT returns. Individual tax rates range from 9% to 35%, and personal deductions are available.

The local entity must issue salary slips every month for each employee included on its payroll, considering the total compensation mentioned above.

Employer social security contributions add between 23% and 27% to payroll costs. There is a compulsory 13th-month salary. There is no restriction regarding the employment of foreigners, provided they hold working visas.

Workers' (Employees') Compensation: Argentine labour regulations determine different forms of compensation for employees. These include, but are not limited to, the following:

- Vacation compensation.
- Compensation in a case of termination of employment contract with employee (prior notice of dismissal and to a severance payment, both based on seniority).

Main social taxes and contributions assessable on salaries are as follows:

| | Percentage of gross monthly earnings (%) (including 13th month salary) | |
|---|---|---|
| | **Employer (2, 3)** | **Employee (1)** |
| Pension fund | 17/21 | 11 |
| National unemployment fund | – | – |

| | Percentage of gross monthly earnings (%) (including 13th month salary) | |
|---|---|---|
| | Employer (2, 3) | Employee (1) |
| Family allowances fund | – | – |
| Social services institute for pensioner | – | 3 |
| Social health care plan | 6 | 3 |
| Total | 23/27 | 17 |

Notes

1. Social security charges borne by employees are applicable up to a monthly salary cap which currently amounts to ARS 13,879 (updated as of May 2011).
2. Contributions made by employers are applicable to total compensation without application of any cap.
3. Employers' contributions to the national unemployment fund, family allowances fund, and social services institute for pensioners is paid at a unified rate of 17%. The rate is increased to 21% for companies whose main activity consists of rendering services or commerce, provided the amount of their average total annual sales for the last three years exceeds USD 11.56 million (at the current exchange rate of USD 1.00 = ARS 4.15 equivalent to ARS 48 million).

## *Branch income*

The rate of profits tax on net taxable profits from Argentine sources and from activities performed abroad by the branch is 35%. Branches are also subject to Minimum Notional Income Tax.

## *Income determination*

### *Inventory valuation*

Inventory valuation is based on the latest purchase. Thus, the last in first out (LIFO) method may not be elected for tax purposes. Conformity between book and tax reporting is not required.

### *Capital gains/losses*

Capital gains and losses attract normal profits tax treatment, except that losses from the sale of shares and other equity interests may be offset only against the same type of income.

### *Dividend income*

Dividends, including stock dividends, are not included in the tax base by the recipient if distributed by an Argentine company *(see the Withholding taxes section for additional information).* However, tax is levied if the dividends are distributed by a foreign company.

### *Foreign exchange gains/losses*

The general rule is that the foreign exchange results (gain or losses) have to be recognised on an accrual basis. However, in some cases, cash basis is applicable.

Foreign exchange losses can only be offset against foreign source taxable income.

### *Foreign income*

Foreign income received or held undistributed abroad (in case of investments in non-stock companies) by resident corporations is subject to tax. Argentina does not have a controlled foreign company (CFC) regime. Tax losses from a foreign source can only be offset against income from a foreign source.

## Deductions

Expenses necessary to generate, maintain, and preserve taxable income, and related to the company activity, are usually tax deductible, with a few exceptions, to the extent they are fair and reasonable.

### Depreciation and depletion

Depreciation is generally computed on a straight-line basis over the technically estimated useful life of the assets or, alternatively, over the standard useful life (e.g. machinery and equipment: 10 years; furniture: 10 years). Depreciation of buildings and other construction of real estate is 2% per annum on cost (on a straight-line basis), unless it can be proved that useful life is less than 50 years.

Depreciation of automobiles whose original cost exceeds ARS 20,000 is not deductible. Related expenses (gasoline vouchers, insurance, rentals, repairs and maintenance, etc.) are deductible up to an amount of ARS 7,200 per car per year.

Conformity between book and tax depreciation is not required.

Profit or loss on the sale of depreciated property is determined with reference to cost less depreciation, restated for inflation as at March 1992, and is included in ordinary taxable income.

Percentage depletion is available for natural resources (mines, quarries, woods).

### Charitable contributions

When made to societies and associations expressly exempt from assessment to profits tax, donations are admissible deductions up to a maximum of 5% of the donor's net taxable profits, provided certain requirements are fulfilled.

### Representation expenses

If adequately documented, representation expenses are permissible deductions up to 1.5% of the amount of salaries accrued during the fiscal year. According to the Regulatory Decree, representation expenses are payments made in order to represent the company in the market, to improve and maintain its relationship with suppliers and clients, etc.

### Directors' fees

Amounts up to the greater of 25% of after-tax profit or ARS 12,500 per individual are deductible in the financial year to which they apply, provided they are approved and available for the director before the due date of the tax return, or in a later year of payment.

### Taxes

Except for profits tax and the tax on minimum notional income, all taxes are deductible.

### Net operating losses (NOLs)

NOLs may be carried forward five years. Loss carrybacks are not permitted. Furthermore, foreign source losses must be offset by income from similar sources.

Losses on derivatives and hedging transactions can only be offset against income from the same transaction.

### *Payments to foreign affiliates*

Transactions between related parties should be at arm's *length (see Transfer pricing in the Group taxation section for more information)*. This principle is extended to transactions with companies located in low or no tax jurisdictions. Payments to foreign affiliates or related parties and companies located in low or no tax jurisdictions that represent income of Argentine source are tax deductible, provided they are paid before the due date for filing the tax return and the corresponding withholding is paid to the tax authorities. Otherwise they would be deducted in the fiscal year in which they are paid.

Technical assistance and services that involve transfer of technology should be covered by agreements duly registered with the National Institute of Intellectual Property for information purposes. These transactions are governed by the Transfer of Technology Law (Law No. 22,426).

### *Convertibility Law*

Although the Convertibility Law (which by Argentina's currency board established a fixed pegging of one-to-one parity between the peso and the US dollar during the 1990's and up to 2002 and inflation adjustment was not allowed) is no longer in place, the adjustment of inflation for tax purposes is not yet in force. There is a strong debate regarding the reinforcement of this procedure for fiscal years ended up to December 2002. However, a final decision has not yet been reached. The wholesale price index from 2004 to 2010 fluctuated in the range of 8% to 12% (reaching a peak of 15% in 2007) according to government statistics that seem to differ from those estimated by private consultants (2 or 2.5 times higher).

## *Group taxation*

Group taxation is not permitted in Argentina.

### *Transfer pricing*

The transfer pricing regulations governing inter-company transactions, adopt principles similar to those of the Organisation for Economic Co-operation and Development (OECD) pursuant to which companies must comply with the arm's-length principle in order to determine the value of goods and services in their transactions with foreign related companies.

The following taxpayers, among others, must generally file, together with their annual income tax return, a supplementary return (transactions encompassed by regulations governing transfer prices) and transfer pricing study:

- Taxpayers carrying out transactions with related individuals or legal entities set up, domiciled, or located abroad. Two or more persons are considered to be related parties when one of them takes part, either directly or indirectly, in the administration, control, or capital of the other, or when a person or group of persons takes part, either directly or indirectly, in the administration, control, or capital of those persons.
- Taxpayers carrying out transactions with related individuals or legal entities set up, domiciled, or located in countries with low or no taxation, whether related or not.

- Argentine residents carrying out transactions with PEs located abroad and owned by them.
- Argentine residents, owners of PEs located abroad, for transactions carried out by the latter with persons or other type of related entities domiciled, set up, or located abroad.

The Regulatory Decree provides specific rules to determine the fairness of the transfer pricing methodology. These rules are similar to those set by the OECD and contemplate six methods, including the following:

- Comparable Uncontrolled Price (CUP).
- Resale Price Method (RPM).
- Cost Plus.
- Profit Split Method (PSM).
- Transactional Net Margin Method (TNMM).
- Special Method for Export of goods with prices quoted in transparent markets.

There is no specific hierarchy, as each particular transaction must be analysed based on the assets, functions, and risks involved and on information available. Regulations establish that the most appropriate method is that which reflects the economic reality of the transactions.

### *Thin capitalisation*
Thin capitalisation rules apply as a restriction on the deductibility of interest arising from debts of a financial nature, contracted by taxpayers with controlling non-resident entities and can be summarised as follows:

- For interest subject to a 15.05% withholding (i.e. paid on loans granted by certain banking institutions), the portion of interest stemming from financial liabilities exceeding two times the shareholders' equity is not deductible for tax purposes and is treated as dividends.
- Interest subject to a 35% WHT is fully deductible.

According to the Regulatory Decree of the Income Tax Law, the thin capitalisation rules are also applicable to any case where a lower withholding rate of 35% is applicable (for instance, interest payments to a controlling company resident of certain tax treaty countries).

### *Controlled foreign company (CFC) regime*
Argentina does not have a CFC regime.

## *Tax credits and incentives*

### *Foreign tax credit*
National taxpayers are entitled to recognize a tax credit for any taxes actually paid in the countries where they have obtained foreign-source income, in respect of similar national taxes, up to a cap which is the increase in their Argentine tax liability due to the inclusion of the foreign income. Any excess not offset in a given fiscal year may be carried forward to the next five fiscal years.

### *Province of Tierra del Fuego Regime*
Companies set up in the province of Tierra del Fuego enjoy a general tax exemption and important benefits in customs matters, based on a system established by Law No.

19,640 and supplementary regulations. Tax exemption includes income tax, tax on minimum notional income, tax on personal wealth, and excise tax. The VAT benefit consists of the release from payment of the technical balance of the tax (VAT debits less VAT credits). Also, a reduction of the prevailing rate for tax on financial transactions and the exemption from taxation on the transfer of fuels is contemplated.

### *Mining activity*
Law No. 24,196/93 created an investment regime for mining activity and is applicable to natural and legal persons. Mining ventures included within this regime enjoy fiscal stability (i.e. tax rates will remain basically the same) for a term of 30 years, except for VAT, which will adjust to the general regime. Furthermore, the regime grants incentives for profits tax, tax on assets, import duties, and any other tax for introduction of certain assets. Additionally, the possibility to obtain a VAT reimbursement during the exploration stage set forth by Law No. 24,196/93 has been regulated by General Resolution 1641 (Official Gazette 27 February 2004).

### *Forestry*
Law No. 25,080 established an investment regime for plantation, protection, and maintenance of forests. It contains rules similar to those for mining activity tax incentives:

- Fiscal stability for a period of 30 years. The period may be extended to 50 years.
- Refund of VAT resulting from the purchase or final importation of goods, leases, or services effectively for forestry investment project in a period of less than 365 days.

### *Export incentives*
Exports of goods and services are exempt from VAT and excise taxes. The temporary importation of raw materials and intermediate and packaging goods for the manufacture of products for export is free from duties with the obligation of offering sufficient guarantees for the import. A reimbursement regime is in place for VAT credits paid to suppliers in relation to the export activity.

### *Oil and gas industry*
Argentine government has enacted Law No. 26,154 which grants attractive benefits to the oil and gas sector to encourage the exploration of the nation's hydrocarbons reserves.

This legislation grants special incentives to investments in underdeveloped regions, speeding reimbursement of VAT (after a three-month period, inputs will be credited against other federal taxes or returned to the taxpayer), exemption from import duties, and offering an accelerated depreciation – three years – for income tax purposes.

In addition, a three-year relief from minimum notional income tax, which is levied at 1% rate on the company assets, is provided by the law.

The incentive package will be in effect for 15, 12, or 10 years, depending on whether the activities are performed in areas identified as (i) continental platform, (ii) within the country other than continental platform, and (iii) currently in production, respectively.

The benefits noted above will apply to the exploration permits granted as of the enactment of the Law (1 November 2006) and up to five years, for the cases mentioned in (i), four years, for those described in (ii), and three years in the latter cases.

There also exists a Promotion Regime established by the Law No. 26,190, which grants similar benefits for the exploration of alternative sources of energy (e.g. wind energy).

### *Biotechnology industry*
A promotional tax regime for development and production of modern biotechnology was introduced by Law No. 26,270. Pursuant to this law, the beneficiaries of the projects that qualify for this regime will be entitled to the following benefits:

- Income tax: accelerated depreciation of capital goods, special equipment, parts, or components of newly acquired goods destined for the promoted project.
- VAT: Early refund of the tax applicable to the assets acquired for the project.
- Social security contributions: the amount representing 50% of social security contributions actually paid on the payroll salaries involved in the project shall be converted into a tax credit bond that may be applied to payment of national taxes.

### *Software industry*
A Software Promotion Regime was established through the enactment of Law No. 25,922. Taxpayers carrying out software related activities as their main purpose may qualify for the benefits granted by the legislation. The main tax incentives contemplated by the Regime are as follows:

- Fiscal stability for a ten-year period covering national taxes.
- Reduction of social security charges (70% of these charges may be credited against certain national taxes).
- Income tax relief (up to 60% of the applicable tax).

While most of the software related activities qualify for the fiscal stability benefit, the remaining incentives only apply to software research and development (R&D), quality control procedures, and software exports.

### *Province incentives on local taxes*
Most of the provinces have legislation establishing incentives for the development of industries within their boundaries, especially industries that utilise or develop their natural resources and provide work for their residents. The incentives, in general, consist of exemptions from provincial and municipal taxes.

Various provinces have investment promotion regimes. Even when there are certain differences among these regimes, generally they include the following incentives:

- Exemption from provincial taxes such as turnover tax, stamp duty, real estate tax.
- Reduced public utility rates.
- Support for infrastructure and equipment projects.
- Facilities for purchase, rental, or lease without charge of public property.

These regimes are not automatically applied, and a special procedure should be followed to be entitled to the respective benefits.

### *Free trade zones*
The free trade zones offer exporters the possibility to import free from customs duties, statistics rate, and VAT all the necessary equipment for construction of a ‘turnkey plant’ within the zones. Furthermore, exporters manufacturing within the zones enjoy the benefit of buying supplies and raw materials from third countries, without having to pay duties or taxes that lead to increased prices.

Customs authority regulating these goods considers them as stored in a third country; therefore, incoming products are subject to inspection with the sole purpose of classifying quantity and type. In other words, goods enjoy a duty-free status until they enter the Argentine customs territory. Goods may remain in the free zone for a maximum period of five years.

## Withholding taxes

### Equalisation corporate tax

Corporations, limited liability partnerships, and certain other entities are required to make a flat and final income tax withholding of 35% from dividend payments or profit distributions to resident or non-resident payees, to the extent that the amount of such dividends or profit distributions exceeds the taxable income of the distributing company, determined by applying the general tax rules (i.e. without considering any exemptions, abatements, and other adjustments arising from special promotional laws) included in their retained earnings at the end of the fiscal year, immediately preceding the date of payment or distribution.

### Other payments

Other payments to residents and to non-residents are subject to WHT rates as follows:

| Recipient | Interest (%) (1) | Royalties (%) (1, 2) |
|---|---|---|
| Resident corporations | 6/28 (3) | 6 (4) |
| Resident individuals | 6/28 (3) | 6 (4) |
| Non-resident corporations and individuals: | | |
| Non-treaty: | 15.05/35 | 21/28 |
| Treaty: | | |
| Australia | 12 | 10/15 |
| Belgium | 0/12 (5) | 3/5/10/15 |
| Bolivia | 15.05/35 | 21/28 |
| Brazil | 15.05/35 | 21/28 |
| Canada | 12.5 | 3/5/10/15 |
| Chile | 15.05/35 | 21/28 |
| Denmark | 12 (5) | 3/5/10/15 |
| Finland | 15 | 3/5/10/15 |
| France | 15.05/20 (6) | 18 |
| Germany | 10/15 (7) | 15 |
| Italy | 15.05/20 (5) | 10/18 |
| Netherlands | 12 | 3/5/10/15 |
| Norway | 12.5 (8) | 3/5/10/15 |
| Spain | 12.5 | 3/5/10/15 |
| Sweden | 12.5 | 3/5/10/15 |
| Switzerland | 12 | 3/5/10/15 |
| United Kingdom | 12 (5) | 3/5/10/15 |

Notes

1. Withholding from payments of interest and royalties to non-residents is based on a flat rate of 35% applied to an assumed percentage gross profit margin. This margin is not contestable, but the resultant rate may be limited by bilateral treaty. Under the 1998 tax reform, the general margin for interest paid for credits obtained abroad is 100%. However, a margin of 43% is applicable (i)

if the debtor is a local bank, (ii) if the creditor is a foreign financial institution located in a country not considered as a low or no tax jurisdiction, or in countries that have signed an agreement with Argentina for exchange of information and have no bank secrecy laws, which are under the supervision of the respective central bank, (iii) if the interest is paid on a loan dedicated to the purchase of tangible assets other than cars, (iv) if the interest is paid on debt certificates (private bonds) issued by local companies and registered in certain countries that have signed an agreement with Argentina for the protection of investments, and (v) on interest paid on time deposits with local banks. 'Royalties' covers a variety of concepts. The rates given in this column relate specifically to services derived from agreements ruled by the Foreign Technology Law, as follows:

a. Technical assistance, technology, and engineering not obtainable in Argentina: 21% (35% on assumed profit of 60%).
b. Cessation of rights or licenses for invention patents exploitation and technical assistance obtainable in Argentina: 28% (35% on assumed profit of 80%). On non-registered agreements the rate is 31.5% (profit of 90% is assumed) or 35% (profit of 100% is assumed), depending on the case.

Several other concepts of 'royalties' are subject to rates that, in turn, may be limited by treaty. A broad sample of these concepts and the non-treaty effective rates are set forth in *Note 2*.

2. Payments to non-residents (only) for 'royalties', rentals, fees, commissions, and so on, in respect of the following are subject to withholding at the rates given below on the basis of assumed gross profit margins *(Note 1)* unless limited by treaty. The treaty concerned should be consulted to determine any limitation in each case.

| Payment | WHT (%) |
|---|---|
| Freight and passenger bookings (other than those covered by special treaties), news and feature services, insurance underwriting | 3.5 |
| Containers | 7.0 |
| Copyright | 12.25 |
| Rental of movable assets | 14.0 |
| Motion picture, video, and sound tape rentals and royalties; radio, television, telex and telefax transmissions; any other means for projection, reproduction, transmission, or diffusion of image or sound; sale of assets located in Argentina (9, 10) | 17.5 |
| Rental of real estate (9) | 21.0 |
| Any other Argentine-source income (unless the non-resident is or was temporarily resident) | 31.5 |

3. The higher tax rate is applicable on non-registered taxpayers. On interest paid to corporations by financial entities or stock exchange/open market brokers, income tax must be withheld at 3% (10% if not registered); individuals are tax exempt.
4. Resident corporations and individuals who are registered for tax purposes are subject to 6% withholding (28% if not registered).
5. Interest is exempt if paid on credit sales of machinery or other equipment, specific bank loans at preferential rate or loans by public entities.
6. The treaty limits taxation of interest to 20% (registered).
7. The 10% rate is applicable to interest on credit sales of capital equipment, any bank loan, or any financing of public works; otherwise 15%.
8. Interest paid on loans with guarantee of the Norwegian Institute for Credit Guarantees or paid in relation to imports of industrial equipment is tax exempt.
9. Deduction of actual costs and expenses may be optionally exercised.
10. Gains on the sale of shares are exempt, except for companies, PEs, or other entities residing abroad whose main activity based on their statutes consists of investments to be made outside of their country of formation. These entities are subject to income tax withholding at the definite flat rate of 17.5%.

## *Tax administration*

### *Returns*

Tax is assessed on a fiscal-year, self-assessment basis. The due date for filing the profits and the notional income tax return is during the second week of the fifth month after the fiscal year end. Tax returns are filed electronically.

### *Payment of tax*

Instalment payments on account of both profits tax and minimum notional income tax must be made in the course of the tax year. The instalment payments must be made on a monthly basis beginning in the first month after the due date of filing of the tax returns.

### *Penalties*

Penalties derived from tax infractions may be applied by tax authorities, as follows:

- Failing to file the tax return: fines range between ARS 200 and ARS 400 (approximately USD 50 and USD 100).
- Tax omission or incorrect tax determination: The fines range from 50% to 100% of unpaid taxes or incorrect tax calculation.
- Tax avoidance: fines range between two and ten times the avoided tax.
- Certain tax infractions may be penalised by closing the business premises for three to ten days. In addition, fines ranging between ARS 300 and ARS 30,000 (approximately USD 73 and USD 7,300) may be imposed.
- Simple evasion: Entities or individuals evading payment of social security contributions or withholdings, or both, payable to the Tax Authorities under the social security regime, through deceitful declarations, malicious concealment, or any fraudulent or deceitful procedure, either through action or omission, in excess of ARS 20,000 per fiscal period, shall be punished with two to six years' imprisonment. Such amount will be ARS 100,000 in the case of taxes, it being applied by tax and by fiscal year.
- If the infringement qualifies as aggravated evasion: Imprisonment could be extended from three years and six months to nine years in certain situations.

### *Interest on late payments*

Late payment of taxes is subject to a monthly 3% interest rate. Interest will start accruing on the day after the filing due date.

## *Other issues*

### *Exchange control regime*

As a result of the devaluation of the Argentine peso at the beginning of 2002, several regulations were issued to limit the transfer of money abroad. They have been made more flexible up to date.

Regulations referring to the entrance of funds to the country, the obligation of liquidation of foreign currency in the Exchange Market of payments of exports of goods and services, remain in force. The terms to comply with the liquidation obligation vary between 60 and 360 days.

There are no restrictions for the payment abroad of interest, dividends, profits, royalties, and other commercial payments duly supported by the corresponding documentation. Payment abroad for other concepts may be subject to further filing requirements.

In addition, it should be particularly highlighted that a rule issued by the central bank in mid-2005 requires a compulsory one-year temporary deposit equivalent to 30% of funds brought by non-residents to Argentina, which must be kept in a reserve (encaje) for the term of one year. This deposit is made in foreign currency and does not earn interest.

There are some exceptions, for instance, direct investments such as interest in Argentine companies (minimum 10%) or real estate are not subject to this rule, or if the funds were borrowed for the acquisition of fixed assets and the re-payment term is longer than two years.

### *Legal entities*

Foreign companies in Argentina, carrying out their business or activity in Argentina, must have a local legal vehicle, of which the most common legal entity types are the following:

- Branch.
- Corporation (Sociedad Anónima or SA).
- Local Limited Liability Company (Sociedad de Responsabilidad Limitada or SRL).

Argentine Corporations and Limited Liability Partnerships, as Argentine residents, are subject to the Argentine tax system. Branches of foreign companies, whatever the nature of their activities, are taxed under the same rules as those applicable to Corporations and Limited Liability Partnerships.

Several documents are required to register an entity with the relevant authorities. Some of said documentation must be filed in the original language, duly translated and certified with the Apostille issued pursuant to The Hague Convention or legalized by the Argentine Consulate of the company's place of origin.

At present, the minimum capital requirement to incorporate an SA is ARS 12,000 (approximately USD 2,800). There are no special requirements regarding the minimum amount of capital for SRLs.

A Branch does not require capital contributions unless it is engaged in certain specific activities (e.g. banking and financing). The Branch must carry its financial statements separately from those of the foreign company.

The three legal types are subject to the same legal, tax, and accounting regulations.

# Armenia

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## Significant developments

As of 1 April 2011, organisations and individual entrepreneurs will be considered registered at tax authorities from the moment of their state registration in the State Registrar.

As of 1 January 2011, value-added tax (VAT) payers must issue tax invoices either electronically using approved software or by obtaining numbered paper tax invoices from tax authorities.

Beginning with the 2010 financial year, corporate income tax (CIT) payers are no longer required to submit their balance sheet and income statement to the tax authorities.

As of 1 January 2011, returns on excise tax and mandatory social security payments should be submitted on a quarterly (previously monthly) basis.

As of 1 January 2011, tax agents should report withholding taxes (WHT) on payments to non-residents annually by 20 February following the reporting year (previously, this was a quarterly obligation).

Tax treaties with Croatia and Luxembourg became effective on 1 January 2011.

## Taxes on corporate income

Armenian resident entities, and non-resident entities doing business in Armenia through a branch or a representative office, are liable for CIT. Armenia taxes residents on their worldwide income; non-residents are subject to CIT only on their Armenian-source income.

The standard CIT rate is 20%.

Taxable income is defined to be the difference between a taxpayer's gross income and deductible expenses:

- Gross income encompasses all revenues received by a taxpayer from all economic activities, unless the revenues are expressly exempted under the law.
- Deductible expenses encompass all necessary and documented expenses that are directly related to conducting business or earning profit, unless a specific provision in the law restricts the deduction.

Taxpayers engaged in agricultural production are exempt from CIT on that income.

Note that resident entities, branches and representative offices of foreign entities, and individual entrepreneurs are required to withhold income tax at source on payments to non-residents not having a permanent establishment (PE) in Armenia (*see the Withholding taxes section*).

### *Presumptive tax system*

Taxpayers engaged in certain activities must use the presumptive tax system. Under this system, the taxpayer pays a fixed tax based on the location and area occupied by the business and will not be required to pay CIT or VAT. The rate of tax depends on the activity undertaken, as follows:

| Type of business | Base data | Adjustment ratio | Monthly presumptive payment (AMD) |
|---|---|---|---|
| Public catering | Area of the space in square meters | For open catering sites: 0.7 for November to March and 2.2 for April to October | 2,000 times the product of the base data and the adjustment ratio |
| | | For places (units) with limited number of consumers: 0.5 | |
| | | For providing public catering services: between 0.75 and 1.9, depending on the area used | |
| | | For (objects) places conducting public catering service in certain regions of Armenia, an additional 0.7 adjustment ratio is used. | |
| Public bathhouses and washhouses | Area of the buildings in square meters | Bathhouses and washhouses: 1.0 | 2,000 times the product of the base data and the adjustment ratio(s) |
| | | Baths or washhouses not located in saunas or steam baths: 0.5 | |
| Activity related to vehicles | Transportation of passengers by cars: 1.0 | In Yerevan: 3.4<br>Depends on region: 3.1 or 2.8 | 2,000 times the product of the base data and the adjustment ratio(s) |
| | For activities carried out by trucks: the lading in terms of tons | Depends on region: 1.1 to 1.9 | |
| | For activities carried out by buses: the number of seats | Depends on region: 0.5 to 1.2 | |
| Barber's shops | Number of working staff multiplied by calendar workdays within the month | In Yerevan: 1.0<br>Depends on region: 0.6 or 0.8 | Product of base data and adjustment ratio multiplied by 500 |
| Auto repair shops | Number of work sites of technical maintenance of vehicles | In Yerevan: 1.0<br>Other locations: 0.8 | Product of base data and adjustment ratio multiplied by 15,000 |

| Type of business | Base data | Adjustment ratio | Monthly presumptive payment (AMD) |
|---|---|---|---|
| Retail sale of petrol and diesel fuel | Number of filling pipes installed in retail sale sites of petrol and diesel fuel | In Yerevan: 1.2<br>Depends on region: 0.8 or 1.0 | Product of base data and adjustment ratio multiplied by 30,000 |
| Gas filling activities for vehicles | | | 20 per cubic metre of gas sold, but not less than 1,500,000 in Yerevan and 900,000 in other regions |
| Parking lots | Total area (in square metres) separated for temporary parking of vehicles multiplied by calendar workdays within the month | In Yerevan: 1.0 to 8.0<br>Other locations: 0.8 | Product of base data and adjustment ratio multiplied by 5 |

## *Corporate residence*

Resident entities are legal and business entities whose existence is established under Armenian law. Non-resident entities are those whose existence is established under foreign law.

### *Permanent establishment*

The domestic definition for a permanent establishment essentially adopts the definition for permanent establishment found in the OECD Model Tax Convention.

## *Other taxes*

### *Value-added tax (VAT)*

Armenia's current VAT law was enacted in 1997 and is based loosely on the principles of the European Union (EU) VAT Directive. Armenia operates the input-output model of VAT. VAT-registered persons may deduct the VAT paid on their inputs from the VAT charged on their sales and account for the difference to the tax authorities.

The standard rate of VAT on domestic sales of goods and services and the importation of goods is 20%. Exported goods and related services are zero-rated. Advertising, consulting, engineering, legal, accounting, translation, data processing, banking, financial, and insurance services provided to non-residents are zero-rated if the non-resident's place of business is outside Armenia. Various supplies, including most financial and education services, are VAT-exempt.

Services supplied in Armenia by non-residents that are not registered in Armenia are subject to application of a VAT reverse charge.

The liability to account for VAT is based on taxable turnover for transactions implemented in the previous calendar year. If those revenues exceed 58.35 million Armenian drams (AMD), the taxpayer must account for VAT on all sales. If the previous year's revenues were less than AMD 58.35 million (e.g. the taxpayer is in the first year of operations), the taxpayer is obliged to account for VAT only on sales in the current year that exceed AMD 58.35 million. Taxpayers whose revenues are below the AMD 58.35 million threshold may voluntarily elect to account for VAT.

Businesses that require a license costing more than AMD 100,000 to operate and businesses producing/importing excisable goods are required to account for VAT on their sales.

Generally, VAT taxpayers should file VAT returns on a quarterly basis. However, taxpayers with sales (excluding VAT) in the previous calendar year exceeding AMD 100 million are required to file VAT returns monthly. VAT payments must be made and VAT returns filed within 20 days following the end of the reporting period.

### *Customs duties*

The Customs Code of Armenia regulates customs procedures in Armenia. The most frequently used customs regimes are import for free circulation, temporary import, temporary export, and export for free circulation.

Customs levies are payable by persons whose goods cross the customs border of Armenia. Customs levies consist of customs duties, taxes, duties, and other mandatory charges.

Generally, customs duty is imposed as an *ad valorem* duty, which means that the tax is calculated as a percentage of the customs value of the goods. Armenia uses only two *ad valorem* rates: 0% and 10%.

Customs duty is collected on the customs value of the imported goods. Importers must take into account specific rules (based on WTO rules) to determine the customs value on which the import tax will be applied. The general rule is that the customs value will be the price actually paid or payable for the goods when sold for export to Armenia.

Customs fees are payable within three days from the provision of customs services, but not later than the release of goods from customs.

### *Excise tax*

Excise tax is payable on alcoholic beverages and tobacco products, whether imported or produced domestically, as follows:

| | | Tax rate (AMD) | |
|---|---|---|---|
| **Goods** | **Unit of measure** | **Goods produced in Armenia** | **Goods imported into Armenia** |
| Beer | 1 litre | 70 | 105 |
| Grape and other wines, wine ingredients | 1 litre | 10% of factory price, but not less than AMD 100 | 10% of customs value, but not less than AMD 150 |
| Vermouth and other types of wine that contain vegetarian and other aromatic extracts | 1 litre | 500 | 600 |

| Goods | Unit of measure | Tax rate (AMD) Goods produced in Armenia | Goods imported into Armenia |
|---|---|---|---|
| Other brewed drinks (apple cider, pear cider, honey-drinks) | 1 litre | 180 | 200 |
| Ethyl spirit | 1 litre (by recalculation of 100% spirit) | 600 | 700 |
| Alcoholic drinks | 1 litre | 30% of factory price, but not less than AMD 380 | 30% of customs value, but not less than AMD 600 |
| Tobacco substitutes | 1 kilogram | 1,500 | 1,500 |
| Raw oil and oil materials | 1 ton | 27,000 | 27,000 |
| Gases produced from oil and other hydro-carbons (except natural gas) | 1 ton | 1,000 | 1,000 |

### *Land tax*
Land tax is assessed and collected at the municipal level and is paid by landowners and the permanent users of state-owned land. Tax on rented land is levied on the lessor. The land cadastre (valuation system) is used to determine the value of the land. Land tax for agricultural land is calculated at 15% of the net income determined by the cadastral evaluation. For non-agricultural land, the rate is 0.5% to 1.0% of the cadastral value of the land.

### *Property tax*
Property tax is assessed and collected at the municipal level on buildings, motor vehicles, and means of water transport. The tax rate on buildings is 0.3%, which is paid annually on the cadastral value.

Property tax for motor vehicles with up to ten seats is calculated as follows:

| Capacity (horsepower) | Tax rate (per horsepower) |
|---|---|
| Up to 120 | AMD 200 |
| 121 to 150 | AMD 300 |
| 151 to 250 | AMD 300 + AMD 1,000 per horsepower in excess of 150 |
| 251 and over | AMD 500 + AMD 1,000 per horsepower in excess of 150 |

Property tax for motor vehicles with more than 10 seats is calculated as follows:

| Capacity (horsepower) | Tax rate (per horsepower) |
|---|---|
| Up to 200 | AMD 100 |
| 201 and over | AMD 200 |

The annual property tax on motorcycles is calculated at the rate of AMD 40 for each horsepower of tax base. The annual rate of property tax on watercraft is calculated at AMD 150 for each horsepower of tax base.

Beginning from the fourth year after the year of production, the tax base for motor vehicles and means of water transport is reduced by 10% per year, up to a maximum reduction of 50%.

## *Branch income*

When a non-resident company conducts business in Armenia through a subdivision (i.e. a branch or a representative office) and maintains separate accounting records for that subdivision, taxable income generally should be determined on the same basis as for resident entities. Note that a subdivision is taxable on dividends received from Armenian companies and may not carry forward losses, which differs from the treatment of resident entities (*see the Deductions section for more information*). However, the subdivision may be able to overcome these restrictions under a relevant tax treaty.

If it is not possible to determine taxable profit based on the direct method (i.e. taxable income less deductible expenses) for the subdivision of the foreign entity in Armenia, income is determined based on a method agreed upon between the taxpayer and the tax authorities. The law explicitly recognises the allocation method (the taxpayer allocates a portion of its worldwide income and expenses to Armenia) as a possible approach.

Armenia has no special tax rules for non-commercial representative offices established to engage in liaison-type activities. Such offices are subject to the normal CIT, but an exemption from CIT may be available under a relevant tax treaty if the activities of the representative office are not sufficient to constitute a PE for the foreign entity.

*See the Withholding taxes section for a list of countries with which Armenia has a tax treaty.*

## *Income determination*

Taxable profits are defined as the difference between a taxpayer's gross income and deductible expenses. Gross income encompasses all revenues received by a taxpayer from all economic activities, unless the revenues are expressly exempt from inclusion under the law. Deductible expenses encompass all necessary and documented expenses that are directly related to conducting business or earning profit, unless a specific provision in the law restricts the deduction.

### *Inventory valuation*
Inventories are generally stated at the lower of cost and net realisable value. First in first out (FIFO) and average cost methods of valuation are generally used for tax purposes.

### *Capital gains*
Capital gains are included in taxable income. Non-residents are taxable on the realised capital gains from the increase of the value of the assets (including shares) located in Armenia.

### *Dividend income*
Dividends derived by an Armenian entity from another Armenian entity are exempt from tax. Dividends derived by non-residents from Armenian entities are subject to 10% WHT, unless relief is available under a relevant tax treaty (*see the Withholding taxes section*).

### *Interest income*
Interest income attracts normal CIT treatment.

### *Foreign income*
Resident entities are liable to Armenian tax on their worldwide income. Foreign taxes should be available for credit against Armenian tax liabilities, up to the amount of Armenian tax payable on the foreign income.

## *Deductions*

Expenses incurred in the furtherance of a taxpayer's business activities generally are deductible, unless a specific provision in the law provides otherwise. Expenses that are not supported by relevant documentation are not deductible.

The deductibility of following common items is limited for CIT purposes:

- Expenses incurred for advertising outside Armenia are limited to the greater of 3% of gross income or 20% of the value of services or goods exported from Armenia.
- Expenses for training of staff outside Armenia is limited to the lesser of 4% of the gross income of the reporting year or AMD 3 million per employee.
- Expenses for foreign trips are limited to 5% of the gross income of the reporting year.
- Representative expenses are limited to the lesser of 0.5% of the gross income of the reporting year or AMD 5 million.

### *Depreciation*
Fixed assets are required to be depreciated using the straight-line method.

The maximum rates per annum for depreciating fixed assets are:

| Asset | Maximum depreciation rate per annum (%) |
|---|---|
| Other industrial and commercial buildings, constructions and transmission devices | 5 |
| Hotels, resorts, rest houses, educational institutions | 10 |
| Robot equipment and assembly lines | 33.3 |
| Calculating devices and computers | 100 |
| Fixed assets with the value up to AMD 50,000 | 100 |
| Industrial and commercial buildings, constructions and transmission devices located in a designated disaster area (currently Gyumri) | 100 |
| Other fixed assets | 20 |

Land may not be depreciated.

### *Amortisation*
Intangible assets may be amortised using the straight-line method over the lesser of the asset's useful economic life or ten years.

### *Goodwill*
Payments with respect to goodwill and amortisation of goodwill are not deductible in Armenia.

### *Interest expenses*
As a general rule, interest is deductible if the related debt is used to fund business activities of the taxpayer and the interest rate is not more than double the Central Bank of Armenia rate (currently, the deductible interest rate is capped at 24%).

### *Bad debt*
A taxpayer is entitled to deduct bad debts if the taxpayer creates a reserve and allocates the amount of bad debt in the following proportions:

- Up to 90 days from the due date: 0%.
- From 91 to 180 days from the due date: 25%.
- From 181 to 270 days from the due date: 50%.
- From 271 to 365 days from the due date: 75%.

Beyond 365 days, bad debts of less than AMD 100,000 may be deducted. For larger debts, the company would need to have pursued the debt through the courts before a deduction may be taken.

### *Charitable contributions*
Charitable donations and contributions to non-profit organisations are deductible in amounts of up to 0.25% of gross income.

### *Fines and penalties*
Commercial fines and penalty expenses are deductible for CIT purposes. Fines and penalties paid to the state or municipal budgets are not deductible.

### *Lease payments*
Lease payments on operating leases are deductible. The lessor claims a deduction for depreciation of the leased assets. Financial leasing is treated for tax purposes as if a sale had been made. The lessee includes the value of the property in the relevant group of fixed assets and claims depreciation charges. The lessee also deducts the interest and commission elements of the lease payments in the period in which they are payable. Similarly, the lessor recognises taxable income for the total principal amount of the lease at the time when the asset is transferred and recognises the interest and commission element of the payments over the term of the lease.

### *Net operating losses*
Companies are entitled to carry forward losses to the five subsequent income years. Armenian law does not allow the carryback of losses.

### *Payments to foreign affiliates*
Payments to foreign affiliates are deductible, if they meet the normal tests for deductibility.

## *Group taxation*

There are no group taxation provisions available in Armenia.

### *Transfer pricing*
Armenia does not have formal transfer pricing rules. The tax authorities may apply market prices in limited cases, but this does not happen very often.

### *Thin capitalisation*
Armenia does not have thin capitalisation rules.

## *Tax credits and incentives*

Taxpayers engaged in agricultural production are exempt from tax on that income.

Resident companies listed on the Armenian Stock Exchange, as well as companies that list on the Exchange by 31 December 2012, with at least 20% of their shares publicly held by 100 or more shareholders, are entitled to a reduction in CIT.

Provided such companies prepare and publish their financial statements under International Financial Reporting Standards (IFRS), they are entitled to a 50% reduction in their CIT (up to a maximum of AMD 300 million per year). The incentive applies to the 2009 to 2012 income years. The incentive will be repayable (plus penalties) if the company delists, liquidates (other than for bankruptcy), or reduces the public issue below 20% before 31 December 2015.

### *Foreign tax credit*
Tax residents are allowed to credit foreign taxes paid on income received abroad against their Armenian tax liabilities. The amount of foreign tax credit is limited to the amount of Armenian tax that would arise from the equivalent income in Armenia.

## *Withholding taxes*

Payments to non-residents are subject to the following WHT rates:

- Payments for insurance, reinsurance, and transportation are subject to WHT at the rate of 5%.
- Other income received from Armenian sources is subject to WHT at the rate of 10%.

WHT is required to be transferred to the budget not later than the 20th day of the month following the payment of income. A WHT return should be submitted by 20 February following the reporting year.

WHT rates for non-residents may be reduced under a relevant tax treaty.

| | Dividends (%) | | Interest (%) (1) | Royalties (%) |
|---|---|---|---|---|
| **Recipient** | **Non-portfolio** | **Portfolio** | | |
| Non-treaty | 10 | 10 | 10 | 10 |
| Austria | 5 (2) | 10 | 0/10 (3) | 5 |
| Belarus | 10(4) | 10 | 10 | 10 |
| Belgium | 5 (2) | 10 | 0/10 (3) | 8 |
| Bulgaria | 5 (5) | 10 | 10 | 10 |
| Canada | 5 (6) | 10 | 10 | 10 |
| China (People's Rep.) | 5 (7) | 10 | 10 | 10 |
| Croatia | 0 (8) | 10 | 10 | 5 |
| Czech Republic | 10 | 10 | 0/5/10 (9) | 5/10 (10) |

# Armenia

| | Dividends (%) | | Interest (%) (1) | Royalties (%) |
|---|---|---|---|---|
| Recipient | Non-portfolio | Portfolio | | |
| Estonia | 5 (7) | 10 | 10 | 10 |
| Finland | 5 (7) | 10 | 5 | 5/10 (11) |
| France | 5 (2) | 15 | 0/10 (12) | 5/10 (13) |
| Georgia | 5 (7) | 10 | 10 | 5 |
| Greece | 10 | 10 | 10 | 5 |
| India | 10 | 10 | 10 | 10 |
| Iran | 10 (7) | 10 | 10 | 5 |
| Italy | 5 (14) | 10 | 0/10 (15) | 7 |
| Latvia | 5 (7) | 10 | 10 | 10 |
| Lebanon | 5 (7) | 10 | 8 | 5 |
| Lithuania | 5 (7) | 10 | 10 | 10 |
| Luxembourg | 5 (2) | 10 | 10 | 5 |
| Moldova | 5 (7) | 10 | 10 | 10 |
| Netherlands | 0/5 (16) | 10 | 0/5 (12) | 5 |
| Poland | 10 | 10 | 5 | 10 |
| Qatar | 5 (17) | 10 | 5 | 5 |
| Romania | 5 (7) | 10 | 10 | 10 |
| Russia | 5 (5) | 10 | 0 | 0 |
| Switzerland | 5 (18) | 10 | 0/10 (3) | 5 |
| Syria | 10 | 10 | 10 | 12 |
| Thailand | 10 | 10 | 10 | 10 |
| Turkmenistan | 5 (7) | 10 | 10 | 10 |
| Ukraine | 5 (7) | 10 | 10 | 0 |
| United Arab Emirates | 3 | 3 | 0 | 5 |

Notes

1. Several treaties contain a 0% rate on interest paid to or guaranteed by a government or one of its agencies. The table does not analyse such provisions.
2. The ownership threshold for the non-portfolio rate is 10%.
3. The 0% rate applies to the sale on credit of industrial, commercial, or scientific equipment, and capital goods, and interest on loans granted by banking enterprises. The 10% rate applies in other cases.
4. The ownership threshold for the non-portfolio rate is 30%.
5. The ownership threshold for the non-portfolio rate is direct investment of USD 40,000.
6. The ownership threshold for the non-portfolio rate is 25%, and the direct investment must exceed USD 100,000.
7. The ownership threshold for the non-portfolio rate is 25%.
8. The 0% rate applies if the dividends are paid to a foreign company that has owned more than 25% of the Armenian company for at least two calendar years preceding the distribution and the dividends are not subject to profit tax in the foreign company's country of residence.
9. The 0% rate applies to government debt and government-assisted debt; the 5% rate applies to interest on loans or credit granted by banks; and the 10% rate applies in other cases.
10. The 5% rate applies to literary, artistic, or scientific work copyright royalties and to film and broadcasting royalties. The 10% rate applies in other cases.
11. The lower rate applies to consideration for the use of, or the right to use, any computer software, patent, trade mark, design or model or plan, secret formula or process, or information concerning industrial, commercial, or scientific experience (know-how).
12. The 0% rate applies to the credit sale of industrial, commercial, or scientific equipment, to the credit sale of merchandise or services, and to loans granted by a bank. Higher rate applies in other cases.
13. The 5% rate applies to copyright royalties, and the 10% rate applies in other cases.
14. The ownership threshold for the non-portfolio rate is 10%, and the direct investment must exceed USD 100,000.
15. The 0% rate applies to interest on a loan granted by a banking enterprise. The 10% rate applies in other cases.
16. The ownership threshold for the 5% non-portfolio rate is 10%. The 0% rate applies if the dividends out of which the profits are paid have been effectively taxed at the normal rate for CIT and the dividends are exempt income to the Dutch recipient.

17. The ownership threshold for the non-portfolio rate is direct investment of USD 100,000.
18. The ownership threshold for the non-portfolio rate is 25%, and the direct investment must exceed CHF 200,000.

## *Tax administration*

### *Returns*

The annual CIT return for resident entities must be filed by 15 April. The corresponding tax is payable by 25 April.

A separate report with information on sales and purchase invoices exceeding AMD 100,000 must be filed within 20 days following the end of the reporting period. Under new rules, taxpayers will generally no longer have to submit information on tax invoices they issue and receive electronically.

Presumptive returns should be filed and payments should be made within 25 days after the end of the month for importation and production of tobacco products and within 15 days after the end of the month for other activities.

### *Payment of taxes*

Taxpayers are required to make advance CIT payments by the 15th day of the last month of each quarter. Each advance payment is equal to 1/6 of the CIT paid for the previous year. For payments before the previous year's tax is calculated (e.g. January to March), tax is paid based on the last filed tax return, and an adjustment is made in the first advance tax payment made after the previous year's tax is calculated to correct the amount paid. If advance payments exceed the CIT liability for the year, the excess may be refunded.

Advance payments are not required if a taxpayer's profit for the proceeding year was less than AMD 500,000. Thus, newly established companies do not need to make advance payments until 25 April of the year following the start of operations.

Armenia also has a quarterly minimum CIT. If the advance CIT payable is less than 1% of revenues for the previous quarter less depreciation charges (up to a maximum of 50% of revenues), the excess is paid as a minimum CIT. The minimum CIT is applied against CIT payable for the year. Any excess is applied against the CIT liability for the subsequent year.

Taxpayers are required to make either advance payments or minimum CIT, whichever is higher.

Branches of foreign companies pay advance CIT biannually, but only if their CIT for the proceeding year exceeded AMD 2 million. Each advance payment is equal to 1/4 of the CIT paid for the previous year. Branches are not subject to the minimum CIT. The annual tax return for branches is filed by 15 April. The corresponding tax is payable by 25 April.

# Aruba

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## Significant developments

### Corporate income tax (CIT)

The Aruba Government reintroduced a temporary investment allowance as of 1 January 2011. The investment allowance amounts to 6% of the investment and can be applied during the years 2011 and 2012. The investment allowance is a deduction on the taxable profit of a company and is applicable on investments greater then 5,000 Aruban florins (AWG) that are made in a financial year. *See the Tax credits and incentives section for more information.*

As of 1 June 2010, accelerated depreciation has been introduced on assets which are used in the course of an industrial business and whose acquisition or production costs are above AWG 90,000,000. Aforementioned assets may be depreciated in ten equal annual parts. Note that imputation payment companies can not apply this facility.

The Government of Aruba also increased the allowable gift deduction from AWG 10,000 to AWG 50,000. Only donations that are made to designated institutions are deductible for CIT purposes.

### Turnover tax

As of 1 June 2010, a turnover tax exemption was introduced on exports. The exemption is applicable if the entrepreneur has asserted that the turnover is realized in connection with the delivery of goods to customers located outside of Aruba, where the goods in connection with the delivery are sent or transported to a destination outside Aruba.

### Tourist levy (formerly known as room tax)

As of 1 January 2011, the name and character of the room tax has changed. The name room tax has been changed to tourist levy. Also, the lodging or hotel owner must now keep track of a guest information registry in which information which is of importance for the tourist levy is recorded.

Prior to the name change and as part of the establishment of two funds for the promotion of Aruba abroad and the improvement of the tourism product ‘Aruba’, the room tax rate was gradually increased during the year 2010. As of 15 May 2010, the room tax rate increased from 6% to 7.5%, after which the rate was further increased to 9.5% as of 1 September 2010. Furthermore, the taxable base for the room tax on timeshare units was codified and increased.

### Import duties and excise tax

Import duties on green products (e.g. solar panels, hybrid cars) have been decreased as of 1 January 2011.

Excise duties on beer, hard liquor, wines, and on all other wines have been increased as of 1 January 2011 in order to reverse the effect of the reduction of the turnover tax tariff from 3% to 1.5% that occurred on 1 January 2010.

***Oil refinery or oil terminal regime***

In connection with the aim of the Aruba Government to improve the investment climate for the exploitation of oil refineries or oil terminals, a so-called oil refinery or oil terminal regime was introduced as of 1 June 2010. The regime regards application, under certain conditions, of a lower CIT rate. Oil refineries or terminals whose shares are all held directly or indirectly by a company listed on a stock exchange recognized by the Minister are subject to a 7% CIT rate, while all other oil refineries or oil terminals are subject to a rate of 12%.

As of 1 January 2010, an unlimited carryforward loss compensation has also been introduced for companies operating an oil refinery or oil terminal.

Moreover, a 0% dividend tax rate was introduced as of 1 June 2010 for distributions from profits from the operation of an oil refinery and oil terminal.

## *Taxes on corporate income*

Resident companies are taxed on their worldwide income. Non-resident companies are taxed on the following Aruba source income:

- Profits allocated to a PE or permanent representative in Aruba.
- Profits from real estate located in Aruba.
- Profits on loans secured by a mortgage on real estate located in Aruba.

Aruba has a flat CIT rate of 28%. Aruba also has special tax regimes (e.g. the imputation payment company, the Aruba exempt company, the fiscal transparent company, the free zone company, and the so-called oil refinery or oil terminal regime), which are ultimately taxed at a lower tax rate. For a full discussion of these special tax regimes, *see the Tax credits and incentives section.*

CIT is levied on the income as reflected in the profit and loss statement less any allowable deductions based on Aruba tax and case law.

## *Corporate residence*

The place of residency of a corporation, association, society, foundation, or body is determined based on the circumstances. If the aforementioned entities are managed and controlled in Aruba, they will in principle be deemed to be resident in Aruba. If the legal form of an entity is governed by the Aruban law, then its place of residency will be considered continuously to be in Aruba.

If a foreign entity carries on a business through a PE or a permanent representative in Aruba, it will be subject to CIT in Aruba. While Aruba does not have rules and regulation as to the definition and interpretation of the term ‘permanent establishment’, a PE is deemed to exist if the place of execution of a building site or construction, excavation, maintenance, cleaning, assembly, or installation activities surpasses a period of 30 days. The memorandum of explanation refers to the commentary on Article 5 of the Organisation for Economic Co-operation and Development

(OECD) model convention for the definition and interpretation of the term ‘permanent establishment’.

## Other taxes

### Turnover tax

Aruba does not have a value-added tax or sales tax, but it does have a business turnover tax (TOT). TOT is levied at the rate of 1.5% on the delivery of goods or services rendered in Aruba. Goods which are imported into Aruba are not subject to TOT. As of 1 June 1 2010, a turnover tax exemption was introduced on exports. The exemption is applicable if the entrepreneur has asserted that the turnover is realized in connection with the delivery of goods to customers located outside of Aruba, where the goods in connection with the delivery are sent or transported to a destination outside Aruba.

Goods are all physical objects as well as electricity, gas, heating, cooling, and such. Services are all performances rendered against payment. A payment is defined as all proceeds in connection with the delivery of goods or services rendered. If a payment is not completely made via money, the fair market value of the compensation should be taken into account.

In the case of goods, the place of the taxable event is either where the transportation starts (if sold abroad) or at the physical location of the goods at the moment it is delivered. The place of the taxable event with regard to services is generally the place where the entrepreneur is established or from where one has a PE from which the service is rendered. As an exception to the aforementioned general rule, the place of the taxable event for certain services (e.g. services related to a real property) is the place where the actual services are rendered (e.g. the place where the real property is situated).

Some exemptions apply. For example, no TOT is levied on the sale of immovable property if it is also subject to transfer tax. Furthermore, exemptions also apply to interest received or payments for hotel rooms or leasing of apartments (insofar as room tax has been paid on the proceeds) and casino revenues (insofar as gambling duties are due on these revenues).

### Import and excise duties

Import duties are imposed by a tariff, which is set as a percentage of the Cost, Insurance, and Freight value of the product. A classification rule has been published that categorises various imported products into groups. A tariff ranging from 0% to 50% is levied on the various groups of products.

Excise duties are imposed on products such as spirits, cigarettes, mineral oil, and distillery. The taxable base of the excise duties is based on either the weight, volume, and/or the amount of the aforementioned products.

Import duties on green products (e.g. solar panels, hybrid cars) have been decreased as of 1 January 2011.

Excise duties on beer, hard liquor, wines, and on all other wines have been increased as of 1 January 2011 in order to reverse the effect of the reduction of the turnover tax tariff from 3% to 1.5% that occurred on 1 January 2010.

### *Stamp taxes*
Stamp taxes are, in principle, due on all documents as indicated in the Stamp State Ordinance. In practice, it is usually only levied on the documents used in the course of a legal suit.

### *Registration taxes*
Aruba does not impose registration taxes.

### *Ground tax*
A person or entity that, as of 1 January of each year, owns real estate in Aruba or uses real estate based on property rights is subject to ground tax. The ground tax is levied on the registered value, which is determined once every five years by the Tax Authorities, and can only be protested in the first year of the aforementioned period (taking into account the two month objection period as of the date of the assessment). The rate amounts to 0.4% of the registered value of the real estate minus a general exemption of AWG 60,000. If the real estate is not used or is empty for more than six months in a year, a reduction in the ground tax due can be requested from the Tax Authorities.

### *Real estate transfer tax*
If real estate situated in Aruba is transferred, the buyer of the real estate must pay transfer tax on the sales price of the real estate (unless the value registered at the Tax Authorities is higher, in which case the registered value is the basis for the levy). The rate for the transfer of the legal ownership of real estate with a value not exceeding AWG 250,000 is 3%. The rate for the transfer of the legal ownership of real estate with a value exceeding AWG 250,000 is 6% (due on the total amount).

If shares in a real estate company are sold, no transfer tax is due.

### *Foreign exchange commission*
A foreign exchange commission (FEC) is due when residents make a payment abroad in connection with certain legal transactions. The FEC is calculated as 1.3% of the payment abroad. Based on the State Ordinance, a payment abroad is considered:

- a payment with local currency or a payment from a florin account, whether or not by electronic transfer
- a payment with foreign currency or a payment from a foreign currency account, whether or not by electronic transfer, or
- a payment from a foreign currency account held abroad or from an inter-company account held by a person or entity abroad, whether or not by electronic transfer.

FEC is due to the extent the abovementioned payment is a result of one or more of the following legal transactions:

- the purchase of foreign instruments of payments or foreign monetary instruments
- obtaining control over receivables in one or more foreign currencies, or
- the crediting of an account in name of a non-resident of Aruba held at a foreign exchange bank or an institution abroad.

An exemption of the FEC is applicable for the following inter-island bank transactions:

- purchase of Antillean banknotes by Aruba residents and the purchase by Aruba residents of bank cheques in Antillean guilders and drawn from exchange banks situated in the Dutch Antilles

- transfers in Antillean guilders to residents of the Dutch Antilles by Aruba residents, or
- transactions in Aruba and Antillean banknotes between exchange banks on Aruba and on the Dutch Antilles.

Furthermore, FEC will be levied on the purchase of foreign currencies (except Antillean guilders or ANG) with AWG.

According to the policy of the Central Bank of Aruba, another exemption for the FEC applies when cash is transferred to a foreign bank account of an Aruban resident. In order to apply for this exemption, certain formalities must be met. First, the foreign bank account of the Aruba resident must be registered at the Central Bank of Aruba. Secondly, the Central Bank of Aruba must grant a so-called exemption for requirements. Also, certain overviews of transactions regarding the foreign bank account must be filed with the Central Bank of Aruba on a quarterly basis.

### *Tourist levy (formerly known as room tax)*

As of 1 January 2011, the name and character of the room tax has changed. The name room tax has been changed to tourist levy. Also, the lodging or hotel owner must now keep track of a guest information registry in which information which is of importance for the tourist levy is recorded.

Prior to the name change and as part of the establishment of two funds for the promotion of Aruba abroad and the improvement of the tourism product 'Aruba', the room tax rate was gradually increased during the year 2010. The room tax rate has been increased to 9.5% as of 1 September 2010. The new room tax rate is 9.5% of the compensation (including charges) that the tourist pays for the use of lodging or a hotel room.

Also the fixed fees for timeshare units have been increased. As of 1 May 2010, the taxable base for the room tax on timeshare units is set on:

- AWG 179 per day for studio units.
- AWG 193.95 per day for one bedroom units.
- AWG 223.75 per day for other then the abovementioned units.

Abovementioned fixed fees are not applicable in the event the time-share resort also makes space available to other guests under payment of compensation besides its time-share guests. In that case, 9.5% room tax is due per day on the compensation paid by other guests for the use of the unit.

With regard to all-inclusive packages, the taxable base is set on 40% of the price of the all-inclusive package with a minimum of AWG 162 per day, increased with charges (e.g. service charges and energy charges).

Local citizens registered in the Aruban municipal register are not subject to room tax. The owner of a condominium is also exempted from room tax.

## *Branch income*

Branch income is, in principle, determined according to the separate entity approach. Branches of foreign insurance companies apply a specific profit determination method. Furthermore, the transfer of profits to the head office is not subject to taxation.

Branch profits are subject to the normal CIT rate of 28%.

## Income determination

### Inventory valuation

Inventories may generally be stated on a last in first out (LIFO) or first in first out (FIFO) basis, provided the method chosen conforms to sound business practices. Conformity of book and tax reporting is not required.

### Capital gains

Capital gains are taxed as ordinary income. However, capital gains realised on the disposal of a shareholding qualifying for the participation exemption are tax exempt.

The participation exemption applies, in general, if an Aruban company holds shares or participation certificates in companies, associations, or foundations which carry on a business. If shares or participation certificates are held in a foreign entity, the participation exemption only applies if they are not held as an investment and the foreign entity is subject to a tax on profits.

The capital gain realised on the disposal of assets may be carried over to a special tax deferral reinvestment reserve but must be deducted from the acquisition costs of the new asset. In principle, this reinvestment reserve cannot be maintained for more than four consecutive years. If the reserve has not been used after four years, the remainder will be subject to taxation.

Capital losses are tax-deductible unless these losses are incurred on shares to which the participation exemption is applicable.

### Inter-company dividends

Provided the conditions of the participation exemption are met *(see the Capital gains section above),* an Aruban company is exempt from taxation on all benefits from the participation, including inter-company (cash) dividends.

Costs made in connection with the ownership of the participation (i.e. administration costs, interest, management expenses) are not deductible from the taxable result of the Aruba parent company.

### Stock dividends

Stock dividends are allowed and treated as regular dividend income. The stocks will be valued at market value for tax purposes.

### Foreign income

A resident taxpayer is subject to CIT on its worldwide income. Double taxation of certain foreign source income is avoided by means of the exemption method. If there is no legal possibility to exempt income and prevent double taxation, the foreign tax paid can be claimed as a deduction.

## Deductions

### Depreciation and depletion

Depreciation of tangible fixed assets, excluding land, is taken over the estimated useful life of the asset. The basis for the depreciation includes all costs incurred with the purchase of this asset less the residual value. The straight line method is customary; however, the declining balance method is also acceptable.

As of June 1, 2010, accelerated depreciation has been introduced on assets which are used in the course of an industrial business and whose acquisition or production costs are above AWG 90,000,000. Aforementioned assets may be depreciated in ten equal annual parts. Note that imputation payment companies can not apply this facility.

### *Charitable contributions*
The Government of Aruba also increased the allowable gift deduction from AWG 10,000 to AWG 50,000. Only donations that are made to designated institutions are deductible for CIT purposes.

### *Taxes*
Taxes paid by the company, with the exception of CIT, are tax-deductible. Taxes paid by the company with respect to the purchase of an asset (e.g. real estate transfer tax paid while obtaining real estate) should be capitalised in the cost of the asset.

### *Net operating losses*
A net operating loss (NOL) may be carried forward to the five years following the tax year in which the loss was incurred. If the NOL has not been offset against profits within this period, the remaining NOLs will expire. NOLs incurred by an imputation payment company and companies operating an oil refinery or oil terminal as of 1 January 2010 may be carried forward indefinitely. Carrybacks of NOLs are not permitted.

### *Payments to foreign affiliates*
If interest or other payments (e.g. remunerations paid for the use of material and/or immaterial goods or services rendered) are made to entities, these payments should be made at arm's length. If the transaction is not at arm's length, only the arm's-length payment may be deducted from the taxable income.

Even if the transaction is at arm's length, the interest or other payments may still not be deductible from the taxable result of the Aruban company unless the Aruban company asserts that one of the following circumstances is applicable:

- The receiving company is not affiliated *(see below)* to the Aruban company.
- The receiving company is subject to an effective tax rate of at least 15%.
- The shares in the receiving company are all held directly or indirectly by a company whose shares (for at least 50% of the outstanding shares and representing at least 50% of the voting rights) are listed at a qualified stock exchange.

An affiliation with the taxpayer is deemed to exist in each of the following cases:

- The taxpayer has an interest of at least one third in another entity.
- An individual or entity has an interest of at least one third in the taxpayer.
- A third party has an interest of at least one third in another entity, while this third party also has an interest of at least one third in the taxpayer.

If an at arm's-length payment is made to an affiliated company that is subject to taxation but pays an effective tax rate of less than 15%, only 75% of the payment made is allowed as a deduction.

## Group taxation

### Fiscal unity

Based on a policy of the Aruban Tax Authorities, Aruban resident public limited companies (naamloze vennootschap or NV) with at least 99% of the shares in other Aruban resident NVs can file a consolidated tax return (i.e. fiscal unity). In order to apply for this facility, a request must be filed with the Aruban Tax Authorities. Certain conditions must be met for the application of this regime, for instance the companies in the fiscal unity must be of the same tax regime. Advantages of this facility are that the recognition of inter-company profits may be deferred and losses may be offset with profits of other companies within the fiscal unity.

### Transfer pricing

The arm's-length principle (ALP) rule is codified in the Aruban State Ordinance Profit Tax (SOPT). If a corporate entity or individual participates, directly or indirectly, in the management, supervision, or the capital of two or more corporate entities, the conditions related to all transactions between these affiliated parties should be at arm's length. The ALP is applicable on all transfer pricing between affiliated companies with regard to all mutual legal relations (e.g. purchase prices, management fees, remunerations for services provided, royalty payments). The conditions should be business like, whereas the same conditions should apply as they would have been if the same transaction would take place with a third party.

Together with the codification, a documentation obligation was also introduced in the SOPT. The explanatory notes on the bill state that for the meaning and application of the ALP and the documentation obligation, the OECD guidelines for Multinational Enterprises and Tax Administration should be considered. The documentation obligation is applicable at the moment that a transaction takes place. It is not only applied to affiliated transactions after 1 January 2008, but also on (long term) contracts prior to this date. In this regard, the explanatory notes indicates that tax subjects should be allowed a reasonable period to produce such documentation, if such is not present, if requested at certain moments.

Non-compliance to the documentation obligation leads to a reversed burden of proof to the taxpayer. From the explanatory notes of the profit tax return forms, it seems that the Tax Authorities require, as a minimum amount of documentation about the transfer pricing method used, the reason why the method was chosen and a substantiation of the manner of how the price was determined.

In light of the extensive OECD guidelines and considering the small scale economy of Aruba, it is unclear to what extent the aforementioned requirements and the OECD guidelines should be followed. Up to this moment, the legislature has not provided detailed implementation guidelines on the documentation obligation.

### Thin capitalisation

Aruba does not have thin capitalisation rules.

### Controlled foreign company (CFC) regime

Aruba does not have CFC legislation.

## Tax credits and incentives

Aruban corporate income tax legislation no longer provides tax incentives. The legislation does, however, provide incentives for certain special tax regimes that can be used to reduce the overall tax liability, such as the imputation payment company, the Aruba exempt company, the fiscal transparent company, the free zone company, and the so-called oil refinery and oil terminal regime.

### Temporary investment allowance

The Aruba Government reintroduced a temporary investment allowance as of 1 January 2011. The investment allowance amounts to 6% of the investment and can be applied during the years 2011 and 2012. The investment allowance is a deduction on the taxable profit of a company and is applicable on investments greater then AWG 5,000 that are made in a financial year. One of the conditions is that the investment must take place with an Aruban company or entrepreneur. An Aruban company or entrepreneur includes an individual or legal entity that is respectively established and carries out business in Aruba. Permanent establishments (PE) of foreign legal entities are also included in the definition of an Aruban company for investment allowance purposes. Legal entities that are incorporated for the sole purpose of making investments in the context of the investment allowance do not qualify as an Aruban company or entrepreneur for investment allowance purposes.

Certain investments do not qualify for the investment allowance, such as: land, houses, and cars for personal use; stocks and shares; goodwill; animals; and investments designated for the use by third parties or as part of the exploitation of an oil refinery or an oil terminal. Furthermore there are also certain transactions that do not qualify for the investment allowance, such as certain inter-company transactions.

The investment allowance does not apply to investments by oil refineries, free zone companies, and imputation payment companies.

If an investment, on which the investment allowance was claimed, is sold within six years after the start of the calendar year in which the investment took place, a capital disposal charge is due of 6% of the sales price.

### The imputation payment company

The imputation payment company (IPC) is, in principle, an NV or a limited liability company (vennootschap met beperkte aansprakelijkheid or VBA) that pays the regular CIT rate of 28%. However, when certain stringent conditions are met, the shareholder of the IPC can request an imputation payment of 26/72 of the (formal) dividend distributed. Provided that the 0% dividend withholding tax (WHT) is applicable, the effective tax rate can be lowered to 2%.

In order to qualify for the IPC status, the following requirements must be met:

- The IPC must perform qualifying activities *(see below)* in Aruba.
- An Aruba-resident individual must be a member of the board of managing directors of the IPC.
- The articles of association state that the shares of the IPC are registered and that the directors keep a shareholders registry in which all shareholders are registered.
- The articles of association state that the financial statements are drawn up according to internationally accepted principles (like IAS or GAAP) and an audit by a qualified (group of) independent certified public accountant(s) is necessary.

- The board of managing directors must notify the Tax Authorities within a restricted period, and after the dividend has been distributed, that the shareholder will claim the imputation payment.

An independent certified public accountant must provide a yearly opinion regarding the compliance of the abovementioned first three requirements for the IPC status.

The shareholder must also meet certain requirements before the imputation payment can be granted, including:

- The shareholder must hold the (economic and legal ownership of the) shares for an uninterrupted period of at least 12 months to be eligible for the imputation payment.
- The shareholder must file a request (with several enclosures) with the Tax Authorities to receive the imputation payment.

The activities of the IPC are limited. The IPC company is not allowed to conduct non-qualified activities, no matter how small. The following activities are regarded as qualified activities:

- Exploitation of quality hotels. A quality hotel exists when the average revenue per available room (RevPar) amounts at least AWG 354 (USD 200), the hotel has a hotel license, and is operated at its own risk and account. Note that the RevPar can be changed annually.
- Exploitation of shipping enterprises.
- Exploitation of aviation enterprises.
- Developing, acquiring, holding, maintaining, and licensing of intellectual and industrial ownership rights.
- Insuring special entrepreneurial risks (captive insurance).
- Holding of shares or other participation certificates. The IPC may not hold more than 5% of low taxed shares or other participation certificates in foreign companies. The aforementioned are low taxed if they are subject to a 'profit' tax rate of at least 14%.
- Active financing (not being a credit institution) of other enterprises or companies, whether or not intra-group.
- Investing of funds, except in real estate and funds which are put at the disposal of group companies.
- Exploitation of a company aimed on generating sustainable energy.

### *The Aruba exempt company (AVV)*

The Aruba exempt company (Aruba Vrijgestelde Vennootschap or AVV) is a particular form of a NV and is often used for international tax planning purposes. The AVV is, in principle, subject to CIT against the normal CIT rate and the dividend WHT. However, the profit of the AVV may be exempted completely from CIT and dividend WHT if its activities are limited to one or more of the following qualified activities:

- Holding of shares or other participation certificates. The IPC may not hold more than 5% of low taxed shares or other participation certificates in foreign companies. The aforementioned are low taxed if they are subject to a 'profit' tax rate of at least 14%.
- Financing (not being a credit institution) of other enterprises or companies, whether or not intra-group.
- Investing of funds, except in real estate.
- Licensing of intellectual and industrial ownership rights.

As mentioned below, the AVV may, if certain conditions are met, also opt for the fiscal transparency regime for which it will not be subject to CIT and dividend WHT. In this case, the AVV is not required to perform the abovementioned qualified activities in order to enjoy the fiscal transparency status.

***Fiscal transparent company***

An NV, VBA, or AVV may opt, if certain conditions are met, to be treated as a partnership (fiscal transparent company). The fiscal transparent company is not subject to CIT, unless the fiscal transparent company carries on a business on Aruba. In that case, the shareholder would be subject to CIT with regard to the business it carries through a PE.

Dividends distributed by the fiscal transparent company to its shareholder are not subject to dividend WHT, since due to its transparency, all income and asset and liabilities are deemed to be attributed to its shareholder. The main requirements for this status is that all the company's shares must be registered, and a notification for the application for this status must be filed with the Tax Authorities within one month after the company has been incorporated.

***The free zone company***

The free zone is a specially designated area in Aruba where goods can be stored, processed, adapted, assembled, packaged, displayed, spread out, or subject to other treatments or where services can be provided.

Services include activities consisting of maintenance or repairs of goods of a non-Aruba enterprise, maintenance or repairs abroad of goods of a non-Aruba enterprise, or providing advice to or research on behalf of a non-Aruba enterprise/institution/private person. Financial services, however, are not allowed.

**Conditions**

A free zone company has to be a limited liability company that is incorporated according to the laws of Aruba. The free zone company is also only allowed to perform qualifying activities in the free zone (a designated area on Aruba). If activities are performed that are not allowed, the company may be banned from the free zone.

**Taxation**

- All profits generated from activities abroad are subject to 2% CIT. The free zone company must have a license to perform activities for residents. All activities performed for residents are subject to the regular CIT rate of 28%. The free zone company is allowed to generate a maximum of 25% of its turnover with local consumers in its first two years. The percentage of the turnover allowed with local consumers will be annually reduced by 4% after the initial two years. As from year seven, only 5% of the turnover is allowed to be generated with local consumers.
- No import duties are due if the products are imported, used in the activities in the free zone on Aruba, and exported abroad.
- No TOT is due by the free zone company on cross border supply of goods and/or the rendering of services.
- The free zone company is subject to the dividend WHT, which implies an effective tax rate of the free zone company of 11.8% or 6.9% (equal to the IPC).
- On request, the free zone company can be exempted from 1.3% foreign exchange commission (subject to approval of the Central Bank of Aruba). Normally this approval is a formality and no foreign exchange commission is due by the free zone company.

**Other characteristics**
The free zone company does not have to apply for a business license or an establishment license. Furthermore, a free zone company is subject to a so called free zone facility charge of 1.1% of the sales over its turnover.

### *Oil refinery or oil terminal regime*
In connection with the aim of the Aruba Government to improve the investment climate for the exploitation of oil refineries or oil terminals, a so-called oil refinery or oil terminal regime was introduced as of 1 June 2010. The regime regards application, under certain conditions, of a lower CIT rate. Oil refineries or terminals whose shares are all held directly or indirectly by a company listed on a stock exchange recognized by the Minister are subject to a 7% CIT rate, while all other oil refineries or oil terminals are subject to a rate of 12%.

As of 1 January 2010, an unlimited carryforward loss compensation has also been introduced for companies operating an oil refinery or oil terminal.

Moreover, a 0% dividend tax rate was introduced as of 1 June 2010 for distributions from profits from the operation of an oil refinery and oil terminal.

## *Withholding taxes*

### *Dividend WHT*
A dividend WHT is levied on all (formal and non-formal) dividend distributions of Aruba-resident entities. The tax rate is:

- 10% of the dividend distribution.
- 5% of the dividend distribution, if the shares (at least 50% of the outstanding shares and representing at least 50% of the voting rights) of the distributing company are listed at a qualified stock exchange. The same tax rate applies if all the shares of the distributing entity are held directly or indirectly by a company whom shares are (at least 50% of the outstanding shares and representing at least 50% of the voting rights) listed at a qualified stock exchange.
- 0% if the participation exemption *(see Capital gains in the Income determination section) is applicable on the receiving company.*

Dividends distributed from Aruba to countries within the Dutch Kingdom are subject to the Regulation for the Dutch Kingdom (the Regulation).

In certain situations, the Regulation reduces the rate of the dividend WHT from 10% to 7.5% or even 5%. The dividend WHT can be reduced to:

- 7.5% if the parent company owns at least 25% of the paid in capital of the distributing company.
- 5% if the parent company owns at least 25% of the paid in capital of the distributing company and the dividend at the parent company level is subject to a profit tax of at least 5.5%.

If a company is incorporated under Aruba law and transfers its factual place of management to another country, all dividend distributions by this relocated company will remain subject to the Aruba dividend WHT.

Dividend distributions include, among others:

- Formal dividend distributions.
- Liquidation payment.
- Bonus shares.
- Paying back of share capital, unless strict conditions are met.
- Imputation payment.

### *Formal requirements*

Within 15 days (based on the tax return: within one month) after a dividend becomes payable, a dividend WHT return must be filed together with payment of the amount due. A dividend is payable if it is at the disposal of the shareholder (i.e. the board of directors of the distributing company does not have to take any more action in order for the shareholder to claim the dividend). A dividend is also payable if the debt becomes interest bearing because of the distribution.

A statement of approval of the Central Bank of Aruba is required if dividends are distributed to a foreign shareholder. If the dividend exceeds AWG 750,000, a license from the Central Bank of Aruba is required.

## *Tax administration*

### *Returns*

Once a CIT return is issued by the Tax Authorities, the taxpayer is obliged to file the tax return within two months after date of issuance. If, within six months after the tax year has ended, no tax return has been issued, the taxpayer is obliged to request a return within 15 days after the six months period. It may be argued that this obligation does not exist if a taxpayer is not subject to taxation.

If the final CIT return cannot be filed within the required two month period, a request for an extension may be filed. The tax inspector may grant an extension for a maximum period of 12 months.

### *Payment of tax*

The CIT and ground tax are due upon receipt of an assessment. The amount of tax due must be paid within two months after the date of the assessment.

# Australia

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## Significant developments

New measures for the 'taxation of financial arrangements' (TOFA) apply with effect for income years commencing on or after 1 July 2010 (although a taxpayer may have been able to elect to apply the new measures to income years commencing on or after 1 July 2009). These measures provide tax-timing rules – accruals, realisation, fair value, retranslation, financial reports, and hedging – for gains or losses in respect of financial arrangements, along with revenue account treatment of the resulting gains or losses. 'Financial arrangement' is widely defined to cover arrangements that involve a cash settlable legal or equitable right to receive, or obligation to provide, something of economic value in the future. Exemptions from the new regime may be available having regard to the duration of the arrangement or the nature of the relevant taxpayer and the annual turnover or value of assets of that taxpayer. *See the Income determination section for more information*.

In February 2011, the Assistant Treasurer released exposure draft legislation setting out the proposed legislative details of the taxation laws to modernise the controlled foreign company (CFC) rules and to implement new foreign accumulation fund (FAF) rules. The government announced the modernisation of the CFC rules in May 2009 as part of wider reforms to Australia's foreign source income anti-tax-deferral (attribution) rules. The foreign investment fund (FIF) rules were repealed with effect from the 2010-11 income year and are proposed to be replaced with the proposed FAF regime which, in broad terms, is directed at investments in non-CFC foreign companies or fixed trusts which fail 'bright line' investment and accumulation tests. The changes are yet to be finalised and given legislative effect. The commencement date for the new rules is currently unknown. *See Foreign income in the Income determination section for more information*.

Following the outcome of Australia's Federal election, legislation was re-introduced into Parliament in September 2010 to change the tax treatment of expenditure on research and development (R&D) from 1 July 2010. The concessional deductions will be replaced with an R&D tax credit. For companies with an annual turnover of less than 20 million Australian dollars (AUD), there will be a 45% refundable tax credit, equivalent to a 150% tax concession, and for companies with a turnover of greater than AUD 20 million, they will have access to a non-refundable 40% tax credit, equivalent to a 133% tax concession. *See the Tax credits and incentives section for more information*.

In May 2010, the government released its interim response to the recommendations made following the comprehensive review of Australia's tax system (Henry Review) which commenced in May 2008. Since then, one of the key changes proposed by the government is that it will reduce the company tax rate from its current rate of 30% to 29% in the 2013-14 income year (or for small business companies from the 2012-13 income year), in conjunction with the introduction of a proposed new Minerals Resource Rent Tax (MRRT) applicable to iron ore and coal projects in Australia and an extension of the Petroleum Resource Rent Tax (PRRT) to apply to all Australian onshore and offshore oil and gas projects, including the North West Shelf. Legislation to give effect to these proposals will be subject to extensive consultation prior to enactment.

To further develop the Australian tax reform landscape the government will host a Tax Forum on 4 and 5 October 2011 to continue the debate of the Henry Review with a focus on business tax, state taxes, environmental and social taxes, personal tax, and system governance and to assist the government in prioritising its agenda for further tax reforms.

## *Taxes on corporate income*

Companies are subject to federal tax on their income at a flat rate of 30%. There are no state or municipal taxes on income.

## *Corporate residence*

A company is a resident of Australia for income tax purposes if it is incorporated in Australia or, if not incorporated in Australia, it carries on business in Australia and either (i) its central management and control are in Australia or (ii) its voting power is controlled by shareholders who are residents of Australia.

## *Other taxes*

### *Goods and services tax (GST)*

The federal government levies GST at a rate of 10%, and distributes the revenue to state governments. The GST is a value-added tax (VAT) applied at each level in the manufacturing and marketing chain and applies to most goods and services, with registered suppliers getting credits for GST on inputs acquired to make taxable supplies.

Food with some significant exceptions, exports, most health, medical and educational supplies, and some other supplies are ‘GST-free’ (the equivalent of ‘zero-rated’ in other VAT jurisdictions) and so not subject to GST. A registered supplier of a GST-free supply can recover relevant input tax credits, although the supply is not taxable.

Residential rents, the second or later supply of residential premises, most financial supplies, and some other supplies are ‘input-taxed’ (‘exempt’ in other VAT jurisdictions) and are not subject to GST. However, the supplier cannot recover relevant input tax credits, except that financial suppliers may obtain a reduced input tax credit of 75% of the GST on the acquisition of certain services.

Health insurance is GST-free. Life insurance is input taxed. General insurance is taxed. Reverse charges may apply to services or rights supplied from offshore, where the recipient is registered or required to be registered, and uses the supply solely or partly for a non-creditable supply.

### *Luxury car tax*

The luxury car tax is levied by the federal government at the rate of 33% of the value of the car that exceeds the luxury car tax threshold (AUD 57,466 for the 2010-11 financial year) and is payable on the GST-exclusive value above the threshold. No input tax credit is available for luxury car tax, regardless of whether the car is used for business or private purposes.

### *Wine equalisation tax (WET)*
The federal government levies WET at the wholesale level at a rate of 29%, in addition to 10% GST, which is calculated on the price including the WET, and it applies to wine from grapes, fruit and certain vegetables, mead, and sake. Retailers do not receive an input tax credit for WET. A rebate is available to a wine producer of 29% of the wholesale price (excluding WET or GST) for wholesale sales, and of 29% of the notional wholesale selling price for retail sales and applications for own use (up to a maximum of AUD 500,000).

### *Import and excise duties*
Imports into Australia are subject to duties under the Australian Customs Tariff. The top duty rate is 5%, other than for clothing and finished textiles which are currently taxed at 10% (to be reduced to 5% in 2015). A TCF Strategic Investment Program will operate until 2015.

Australia currently has comprehensive free trade agreements with the United States, Thailand, Singapore, New Zealand, and Chile. In addition, a regional free trade agreement between Australia, New Zealand, and Southeast Asian nations commenced on 1 January 2010, which progressively eliminates all barriers to trade in goods, services, and investments.

Excise duties are imposed at high levels on beer, spirits, liqueurs, tobacco, cigarettes, and petroleum products. A fuel tax credit system provides a credit for fuel tax (excise or customs duty) that is included in the price of taxable fuel. Broadly, credits are available to entities using fuel in their business and to households using fuel for domestic electricity generation and heating.

### *Fringe benefits tax (FBT)*
The federal government levies FBT on employers at the rate of 46.5% on the 'grossed-up value' of non-salary and wages fringe benefits provided to employees (and/or the employee's associates) by the employer or associates. The grossing-up of the value ensures tax neutrality between providing benefits and cash remuneration. FBT generally is deductible for income tax purposes. There are some exemptions from FBT, including some minor benefits, remote area housing in certain circumstances, and specified relocation costs. In addition, there are some concessional valuation rules, in particular for living-away-from-home benefits.

In relation to car fringe benefits, a new 'statutory formula' method is proposed to apply to new cars acquired under contracts entered into after 7.30pm (AEST) on 10 May 2011. The new statutory formula will be a flat 20% (phased in over four years) applied to the FBT base of the car, regardless of the annual kilometres travelled, and replace the current four-tiered statutory rate system.

### *Stamp duty*
All states and territories impose a stamp duty on a wide variety of transactions at different rates. All jurisdictions impose a stamp duty on real estate conveyances, but most exempt conveyances of goods (not associated with other property) from stamp duty. The imposition of duty on share transfers involving unlisted entities differs from state to state. Corporate reconstruction exemptions are available. Advice from a

stamp duty specialist should usually be obtained where substantial stamp duty may be imposed because the amount of duty may depend on the form of the transaction.

### *Payroll tax*

States and territories impose a tax on employers' payroll (broadly defined). The various jurisdictions have harmonised their payroll tax legislation, but some differences remain, particularly tax rates and the thresholds for exempting employers whose annual payroll is below a certain level, after taking into account grouping rules. For example, in New South Wales from 1 January 2011 the rate is 5.45% per annum with an annual exemption threshold of AUD 658,000. In Victoria, the rate is 4.9% from 1 July 2010 and the annual exemption threshold is AUD 550,000. A variety of rates and thresholds apply in other state and territory jurisdictions.

### *Insurance tax*

States impose taxes on insurance premiums, which may be substantial.

### *Land tax*

All states and territories (except the Northern Territory) impose a tax based on the unimproved capital value of land. In general, the principal place of residence and land used for primary production is exempt from land tax.

### *Local municipal taxes*

Local taxes, including water, sewerage, and drainage charges, are levied based on the unimproved capital value of land and include a charge for usage (for example water usage).

### *Superannuation guarantee levy*

The federal government effectively requires employers to contribute 9% of an employee's earnings base, subject to limited exceptions, to a registered superannuation fund or retirement savings account on behalf of the employee. Failure to make these contributions will result in the employer being liable for a non-deductible superannuation guarantee charge.

No level of Australian government imposes a social security levy.

## *Branch income*

Branch profits are subject to ordinary corporate rates of taxation, and there is no withholding on repatriated profits.

## *Income determination*

### *Inventory valuation*

Inventory generally may be valued at cost (full absorption cost), market selling value, or replacement price. Where, because of obsolescence or other special circumstances, inventory should be valued at a lower amount, the lower valuation generally may be chosen, provided it is a reasonable valuation. Special rules apply, however, regarding the valuation of trading stock for certain companies joining a consolidated group. Last in first out (LIFO) is not an acceptable basis of determining cost, nor is direct costing in respect of manufactured goods and work-in-progress.

Conformity is not required between book and tax reporting. For tax purposes inventory may be valued at cost, market selling value or replacement price, regardless of how inventory is valued for book purposes. Those who choose to come within the small-business entity measures (broadly defined as taxpayers who carry on business and who, together with certain 'connected' entities, have an aggregated turnover of less than AUD 2 million for the year) may ignore the difference between the opening and closing value of inventory, if on a reasonable estimate this is not more than AUD 5,000.

### *Capital gains*

A capital gains tax (CGT) applies to assets acquired on or after 20 September 1985. Capital gains realised on the disposal of such assets are included in assessable income and are subject to tax at the company's corporate tax rate, if the disposal is by a company. In order to determine the quantum of any gain for any assets acquired before 21 September 1999, the cost base is indexed according to price movements since acquisition, as measured by the official Consumer Price Index until 30 September 1999 (provided the asset has been held for at least 12 months). There is no indexation of the cost base for price movements after 1 October 1999. Disposals of plant and equipment are subject to general rules rather than the CGT rules. Capital losses are allowable as deductions only against capital gains and cannot be offset against other income. In calculating capital losses there is no indexation of the cost base.

Residents of Australia generally are liable for the tax on gains on the disposal of assets wherever situated, subject to relief from double taxation if the gain is derived and taxed in another country. However, the capital gain or capital loss incurred by a company from a CGT event in relation to shares in a foreign company is reduced by a percentage reflecting the degree to which the foreign company's assets are used in an active business, if the company holds a direct voting percentage of 10% or more in the foreign company for a certain period before the CGT event. Attributable income from CGT events happening to shares owned by a controlled foreign company (CFC) are reduced in the same way. Capital gains and capital losses made by a resident company in respect of CGT events happening in respect of 'non-tainted' assets used to produce foreign income in carrying on business through a permanent establishment in a foreign country are disregarded in certain circumstances.

For CGT events occurring on or after 12 December 2006, non-residents are subject to Australian CGT only where the assets are taxable Australian property – that is, Australian real property, or the business assets of Australian branches of a non-resident. Australian CGT also applies to indirect Australian real property interests, being non-portfolio interests in interposed entities (including foreign interposed entities), where the value of such an interest is wholly or principally attributable to Australian real property. 'Real property' for all these purposes is consistent with Australian treaty practice, extending to other Australian assets with a physical connection with Australia, such as mining rights and other interests related to Australian real property. A 'non-portfolio interest' is an interest held alone or with associates of 10% or more in the interposed entity.

CGT rollover relief is available for scrip-for-scrip (stock for stock) takeovers between companies (and also trusts) provided at least 80% of the target entity is acquired. This rollover is not limited to listed or Australian entities. Special rules apply to determine the cost base of interests acquired by the acquiring entity in the target where the scrip-for-scrip arrangement consists of a restructure (broadly where just after completion of the arrangement the market value of the replacement interests issued under the arrangement by the replacement entity is more than 80% of the market value of all the shares (including options, rights, and similar interests to acquire shares) issued by the replacement entity).

Demerger rollover relief is available where the head entity of a group transfers ownership of one or more of its subsidiaries to its shareholders provided at least 80% of the interests in the demerged entity are acquired by the owners of the head entity of the group and they receive interests in the demerged entity in the same proportion as their original interests. There are other requirements which must be satisfied in respect of each of these rollovers.

Rollover relief from CGT is available on the transfer of unrealised gains on assets, which are taxable Australian property between companies sharing 100% common ownership where the transfer is between non-resident companies, or between a non-resident company, on the one hand, and, on the other hand, a member of a consolidated group or multiple entry consolidated (MEC) group, or a resident company that is not a member of a consolidated group. *See the Group taxation section for more information*.

### *Inter-company dividends*

A 'gross-up and credit' mechanism applies to franked dividends (dividends paid out of profits which have been subject to Australian tax) received by Australian companies. The corporate shareholder grosses up the dividend received for tax paid by the paying company (i.e. franking credits attaching to the dividend) and is then entitled to a tax offset (i.e. a reduction of tax) equal to the gross-up amount. A company with an excess tax offset entitlement converts the excess into a carryforward tax loss using a special formula. Dividends paid to another resident company that are unfranked (because they are paid out of profits not subject to Australian tax) are taxable, unless they are paid within a group that has chosen to be consolidated for tax purposes. Dividends paid between companies within a tax consolidated group are ignored for the purposes of determining the taxable income of the group.

An exemption from withholding tax is available for dividends that are 'unfranked' under the dividend imputation rules (*see below*) and are declared to be conduit foreign income (CFI) received by non-resident shareholders (or unitholders) in an Australian corporate tax entity (CTE). These rules may also treat the CFI component of an unfranked dividend received by an Australian CTE from another Australian CTE as not taxable to the recipient, provided it is on-paid within a specified timeframe. Broadly, income will qualify as CFI if it is foreign income, including certain dividends, or foreign gains, which are not assessable for Australian income tax purposes or for which a foreign income tax offset has been claimed in Australia. Alternatively (and subject to certain conditions), if a foreign owned company resident in Australia receives a taxable unfranked dividend with no CFI component from a resident company in which it holds at least 10% of the voting power, a deduction may be allowed to the extent that the dividend is on-paid to a non-resident 100% parent company. In that case, the unfranked dividend on-paid to the non-resident parent generally will attract dividend withholding tax (subject to treaty relief – *see the Withholding taxes section*).

Foreign dividends are not assessable and are not eligible for a tax offset if received by an Australian resident company from a foreign affiliate where the recipient company has a voting power of at least 10% in the foreign affiliate. Income of a non-resident entity in which Australian residents hold interests is not assessable when repatriated to Australia where the income has been previously attributed to those residents and taxed in Australia (*see below*).

Dividends paid out of share capital accounts are unfrankable.

Where a company transfers an amount (e.g. profits) to a share capital account from another account, the capital account will become a tainted share capital account. Until it becomes untainted, any distribution debited to such an account is treated as an unfrankable dividend, and not as a return of capital.

A dividend imputation system allows Australian corporations (and New Zealand companies that have chosen to be a New Zealand franking choice company) to pass tax credits to individual resident shareholders, certain superannuation entities, life insurance companies in respect of their superannuation (Australian retirement plan) business, and certain registered organisations, such as registered trade unions and friendly societies, in respect of Australian tax imposed on profits from which dividends (including stock dividends treated as dividends) are paid.

A resident corporation (or New Zealand company that has chosen to be a New Zealand franking choice company) receiving a franked dividend, that is, a dividend paid out of Australian taxed profits, may further distribute the imputed tax credits to its own resident shareholders.

Franked dividends paid to non-residents are exempt from dividend withholding tax.

Companies that are effectively wholly owned by non-residents (known as 'exempting companies') may provide franking benefits only in limited circumstances. However, non-resident shareholders in receipt of franked dividends from exempting companies are exempt from dividend withholding tax.

There is legislation designed to prevent the selective streaming of franking credits to different shareholders. Selection plans under which shareholders are given a choice of a tax-free bonus share (stock dividend), unfranked dividend or franked dividend in lieu of another dividend are not effective.

Under debt and equity classification rules there may be situations where interest income is treated as if it were a dividend. Similarly, dividends paid on shares that are debt interests will not be frankable.

The dividend imputation system operates in the following way. The company's franking account is credited with tax paid. The corporate entity paying a dividend may determine the extent to which a dividend is franked, subject to anti-streaming rules and benchmarking rules that limit the ability to change the franking percentage in later periods. As indicated above, fully franked inter-company dividends effectively are untaxed under a 'gross-up and credit' method. A shareholder is entitled to franking credits on dividends only in respect of ordinary shares held at risk for at least 45 days (90 days for preference shares). There is an exemption from these franking credit trading rules for individuals, provided the imputation rebates received in the year of income do not exceed AUD 5,000 and the individual is not obliged to make a payment related to the dividend.

### *Foreign income*

On 17 February 2011, the government released Exposure Draft legislation for public comment setting out the legislative design of reforms to modernise the controlled foreign company (CFC) rules and to implement new foreign accumulation fund (FAF) rules. The operative framework of the draft legislation remains broadly unchanged from the consultation papers previously released by the government. The government first announced the modernisation of the CFC rules in May 2009 as part of wider reforms to Australia's foreign source income anti-tax-deferral (attribution) rules. The current basis upon which the foreign income of corporations resident in Australia is taxed is set out below, together with some of the key features of the proposals as released for consultation. The commencement date for the new CFC and FAF rules has not been announced.

- Non-active income of foreign companies controlled by Australian residents (determined by reference to voting rights and dividend and capital entitlements) may be attributed to those residents under rules which distinguish between companies resident in 'listed countries' (e.g. Canada, France, Germany, Japan, New Zealand, the UK, and the US) and in other 'unlisted' countries. In general, if the CFC is resident in an unlisted country and it fails the active income test (typically because it earns 5% or more of its income from passive or tainted sources), the CFC's tainted income (very broadly, passive income and gains, and sales and services income which has a connection with Australia) is attributable. If a CFC is resident in a listed country, a narrower range of tainted income is attributed even if the CFC fails the active income test. It is currently proposed under the new rules that the term 'control' will take its meaning from Australian accounting standards, rather than the current bright-line test of voting interest and entitlements to capital and dividends. With regard to the type of income to be attributed, it is proposed that sales and services income, which has a connection with Australia, derived by a CFC will no longer be attributable. It is proposed that passive income, defined in broadly similar terms to the existing rules, will continue to be attributable, however, a carve out is proposed where the income arises in connection with a permanent establishment of the CFC competing in a market through the ongoing use of labour within the CFC's country of residence, or which are profits from assets or financial arrangements that were held for the predominant purpose of producing active income. It is also proposed that rent from real estate, and passive income received from an active member of the same CFC group will not be attributable provided that payment of the amount does not provide a benefit, such as a deduction, to the attributable taxpayer or an associate.
- When income previously taxed on attribution is repatriated, it is not assessable for tax.
- Dividends received directly by a resident company from a foreign company are not assessable for tax where the resident company has a (non-portfolio) voting interest of at least 10% in the foreign affiliate and does not receive the dividend in its capacity as a trustee. The basis upon which distributions may qualify for such relief (i.e. where the payee has a voting interest of at least 10% in the payer) is currently under consideration as part of the redesign of the CFC rules. The proposal is currently that the relief should only be available where the distribution is in respect of an 'equity interest' (as defined for tax law purposes) and the Australian resident recipient company holds a total participation interest of at least 10% or the Australian resident is an attributable taxpayer. It is proposed that the relief will also be available where the distribution is received by an Australian resident company indirectly through a trust or partnership.
- Active foreign branch profits of a resident company from carrying on business through a permanent establishment in a foreign country and capital gains made by a resident company from the disposal of non-tainted assets used in deriving foreign branch income are not assessable for tax, except income and capital gains from the operation of ships or aircraft in international traffic. A rewrite of the foreign branch exemption has been proposed and represents a continued alignment of the foreign branch exemption with the CFC rules.
- Foreign income of Australian resident corporations and income of such taxpayers which is subject to foreign income taxes that is not effectively exempt (*as broadly described above*) is subject to tax, but, in most cases an offset for foreign income tax

paid is allowed to the extent of Australian tax payable on such income. For income years commencing prior to 1 July 2008, such offsets generally were confined to foreign tax paid in respect of foreign sourced income and computed in three separate classes: passive income, offshore banking income, and other income. In addition, it was possible to carry forward excess credits for a period of up to five years. The ability to carry forward excess credits was removed for income years commencing on or after 1 July 2008, subject to transitional rules permitting conversion of some existing carried forward balances to foreign income tax offsets. For income years commencing on or after 1 July 2008, there is no longer a quarantining of deductions or losses associated with the derivation of foreign source income.

- For the 2009-10 and earlier income years, rules dealt with passive foreign investment funds (FIFs) (including interests in foreign companies, foreign trusts and foreign life insurance policies). Essentially, and subject to important qualifications, the FIF rules tax (attribute) increases or deemed increases in the value of interests held by Australian residents in offshore entities (wherever located), except for some categories that are specifically exempted (e.g. investments in foreign companies listed on approved stock exchanges that are principally engaged in certain active businesses were exempt). The FIF rules were repealed with effect from the 2010-11 income year and are proposed to be replaced with a narrow anti-avoidance rule (proposed Foreign Accumulation Fund (FAF) regime) which, in broad terms, is directed at investments in non-CFC foreign companies or fixed trusts which fail bright line investment and accumulation tests, that is, income should not be attributed provided that more than 20% of the foreign entity's assets are not debt interests or 80% or more of the profits and gains of the entity are distributed within a defined period.
- In certain circumstances, foreign limited partnerships, foreign limited liability partnerships, US limited liability companies and UK limited liability partnerships will be treated as partnerships (i.e. as a flow-through entity) rather than as a company for the purposes of Australia's income tax laws.

### *Stock dividends*

Stock dividends, or the issue of bonus shares, as they are known under Australian law, are in general not taxed as a dividend, and the tax treatment is the spreading of the cost base of the original shares across the original shares and the bonus shares. However, if a company credits its share capital account with profits when issuing bonus shares, this will taint the share capital account (if it is not already a tainted share capital account), causing the bonus share issue to be a dividend. Certain other rules may apply to bonus share issues, depending on the facts.

### *Financial arrangements*

New measures for the TOFA apply for arrangements entered into from income years commencing on or after 1 July 2010, although a taxpayer may have elected to apply the new measures to arrangements entered into from income years commencing on or after 1 July 2009. A taxpayer may also have elected to have the new rules apply to all pre-existing financial arrangements that the taxpayer has at the start of the first income year to which new rules apply.

'Financial arrangement' is widely defined to cover arrangements that involve a cash settlable legal or equitable right to receive, or obligation to provide, something of economic value in the future.

The new measures provide for six tax-timing methods for determining gains or losses in respect of financial arrangements, along with revenue account treatment of the resulting gains or losses to the extent that the gain or loss is made in earning assessable income or carrying on a business for that purpose. The default methods are the accruals method and the realisation method, one or other of which will apply depending on the relevant facts and circumstances of a particular financial arrangement. The accruals method will apply to spread an overall gain or loss over the life of the financial arrangement where there is sufficient certainty that the expected gain or loss will actually occur. A gain or loss that is not sufficiently certain is dealt with under the realisation method. Alternatively, a taxpayer may irrevocably choose one of four elective methods – fair value, retranslation, financial reports, and hedging – to determine the tax treatment of financial arrangements covered by the legislation. Qualification criteria must be met before the elective methods may be used. Generally, these criteria require that the taxpayer prepare a financial report in accordance with Australian (or comparable) accounting standards and be audited in accordance with Australian (or comparable) auditing standards.

Exemptions from the new regime may be available having regard to the duration of the arrangement or the nature of the relevant taxpayer and the annual turnover or value of assets of that taxpayer. Certain types of financial arrangements are excluded from the new rules, including leasing and hire purchase arrangements. Foreign residents are taxable on gains from financial arrangements under the new measures to the extent that the gains have an Australian source.

### *Foreign exchange gains and losses*

Foreign currency gains and losses are recognised when realised regardless of whether there is a conversion into Australian dollars, and are included in or deducted from ordinary income, subject to limited exceptions. There are exceptions to the timing and characterisation aspects of the realisation approach where the foreign currency gain or loss is closely linked to a capital asset. Rollover relief may be available for the issuer of a succession of short-term foreign currency bill or securities, to the extent that money remains outstanding under the facility. To reduce compliance costs with foreign currency denominated bank accounts, taxpayers may elect to disregard gains or losses on low balance transaction accounts that satisfy a de minimis exemption, or may elect for retranslation by annually restating the balance of the account by reference to deposits, withdrawals, and the exchange rates at the beginning and end of each year (or by reference to amounts reported in accordance with applicable accounting standards).

For foreign exchange gains and losses associated with financial arrangements as defined, the compliance impact of the foreign exchange rules will be reduced for those taxpayers eligible to elect the retranslation or financial reports tax-timing methods under the taxation of financial arrangement measures *(as discussed above)*.

Entities or parts of entities, satisfying certain requirements, are able to choose to account for their activities in a currency other than Australian dollars for income tax purposes as an intermediate step to translating the result into Australian dollars.

## *Deductions*

### *Depreciation and depletion*

A capital allowances regime allows a deduction for the decline in value of depreciating assets held by a taxpayer. The holder of the asset is entitled to the deduction and may be the economic, rather than the legal owner. A 'depreciating asset' is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used, but does not include land, trading stock or, subject to certain exceptions, intangible assets. Deductions are available for certain other capital expenditure.

Intangible assets that are depreciating assets (if they are not trading stock) are:

- certain mining, quarrying, or prospecting rights and information
- items of intellectual property
- in-house software
- indefeasible rights to use an international telecommunications submarine cable system
- spectrum licenses under radio communications legislation
- datacasting transmitter licenses, and
- telecommunications site access rights.

Goodwill and trademarks are not depreciating assets, and tax amortisation is not available.

Taxpayers that do not qualify as a small-business must depreciate the asset over its useful life (known as 'effective life'), using either straight-line (known as the 'prime cost' method) or diminishing-value method (straight-line rate multiplied by 200% for depreciating assets acquired on or after 10 May 2006).

Taxpayers may self-determine the effective life of a unit or plant or may choose the effective life contained in a published determination of the Commissioner of Taxation.

Non-small-business taxpayers are able to choose to write-off all items costing less than AUD 1,000 through a low-value pool at a diminishing-value rate of 37.5% per annum.

For those who satisfy the small business entity threshold (broadly defined as taxpayers who are carrying on business and who, together with certain connected entities, have an aggregated turnover of less than AUD 2 million for the year), a simplified depreciation system applies with more attractive depreciation rates.

'Project pool' rules allow expenditure that does not itself form part of a depreciating asset to be deductible over the life of a project that is carried on for a taxable purpose. Amongst other things, items that fall within the rules include the following:

- Amounts paid to create or upgrade community infrastructure for a community associated with the project.
- Site preparation costs for depreciating assets (except horticultural plants in certain circumstances).
- Amounts incurred for feasibility studies for a project.
- Environmental assessment costs applicable to the project.
- Amounts incurred to obtain information associated with the project.
- Amounts incurred in seeking to obtain a right to intellectual property.
- Costs of ornamental trees or shrubs.

The so-called 'blackhole' expenditure provisions allow a five-year straight-line write-off for capital expenditure incurred on or after 1 July 2005 in relation to a past, present or prospective business, to the extent that the business is, was or is proposed to be carried on for a taxable purpose. The expenditure is deductible to the extent that it is not elsewhere taken into account (for example by inclusion in the cost base of an asset for capital gains tax purposes) and that it is not denied deductibility for the purposes of the income tax law (for example, by the rules against deducting entertainment expenditure).

Special rules apply for primary producer assets, such as horticultural plants, water and land care assets, and the treatment of expenditure on research and development (R&D) (*see the Tax credits and incentives section*) and expenditure on certain Australian films.

A luxury car cost limit applies for depreciating the cost of certain passenger motor vehicles (AUD 57,466, cost limit for the 2010-11 income year).

Expenditure on the development of in-house software may be allocated to a 'software development pool' and written off over three years, starting in the year after the expenditure was incurred (40% in year two, 40% in year three, and 20% in year four). Amounts spent on acquiring computer software or the right to use it (except where the acquisition is for developing in-house software) generally is treated as incurred on acquiring a depreciating asset, deductible over its effective life (taken to be four years) commencing in the first year it is first used or installed ready for use. 'Shrink-wrapped' software acquired or manufactured for sale generally will be treated as trading stock.

A loss arising on the sale of a depreciating asset (depreciated value of the asset less sale consideration) is generally an allowable deduction. A gain on the sale of a depreciating asset, to the extent of depreciation recaptured, generally is taxed as ordinary income. Gains exceeding the amount of depreciation recaptured are also taxed as ordinary income.

A one-off tax benefit was available for certain capital expenditure in respect of depreciating assets (*see above*) where the taxpayer commences to hold the asset under a contract entered into between 13 December 2008 and 31 December 2009 (or where the taxpayer commences to construct the asset between those dates).

The cost of income-producing structural improvements, the construction of which started after 26 February 1992 is eligible for write-off for tax purposes on the same basis as that of income-producing buildings, that is, at a rate of 2.5% per annum.

Subject to exceptions referred to below, capital expenditure incurred after 15 September 1987 in the construction or improvement of non-residential buildings used for producing assessable income is amortised over 40 years at an annual 2.5% rate. Capital expenditure on the construction of buildings used for short-term traveller accommodation (e.g. hotels, motels) and industrial buildings (typically, factories) is amortised over 25 years at an annual 4% rate where construction commenced after 26 February 1992. The cost of eligible building construction that commenced after 21 August 1984 and before 16 September 1987 (or construction contracted before 16 September 1987) is amortised over 25 years at an annual 4% rate. There is no recapture of the amortised amount upon disposal of the building, except where the expenditure is incurred after 13 May 1997, in which case recapture will apply, subject to certain transitional rules.

Similar provisions apply in relation to income-producing residential buildings on which construction commenced after 17 July 1985.

The cost of consumables may be either written off immediately, or as used.

The following expenditure attracts an immediate 100% deduction: environmental protection activities, dealing with pollution and waste; landcare operations; exploring or prospecting for minerals (and from 1 July 2012 for exploration of geothermal energy sources); mine site rehabilitation; and certain expenditure in respect of the establishment of carbon sink forests.

Tax depreciation is not required to conform to book depreciation.

Percentage depletion based on gross income or other non-cost criteria is not available.

### *Net operating losses*

Losses may be carried forward indefinitely, subject to compliance with tests of continuity of more than 50% of ultimate stock ownership or compliance with a same business test. For consolidated group companies, the ability to utilise these losses is determined by a modified version of these tests. *See the Group taxation section*. More liberal rules apply when determining continuity of majority underlying ownership of certain widely held companies and companies which are majority-owned by widely held companies or certain other entities. These more liberal rules have two main effects: (i) the continuity of majority underlying ownership test may be satisfied by testing at certain points of time, without testing throughout the intervening periods, and (ii) in certain cases, special concessional tracing rules deem entities to hold voting, dividend or capital stakes in the company so that tracing through to the ultimate beneficial owners of those stakes is not needed. In particular, registered shareholdings of less than 10% are taken to be held by a single notional shareholder, in general avoiding the need to identify small ownership interests and the risk of failing the continuity of ownership test because of small shareholder churn. Companies (including tax consolidated groups) can choose the proportion of their carryforward losses to be deducted in a year. Making this choice deals with the situation where untaxed franked dividends and the imputation credit on such dividends would otherwise absorb carryforward and current year losses.

### *Payments to foreign affiliates*

A corporation can deduct royalties, management service fees, and interest charges paid to non-residents, provided the amounts are commercially realistic and referrable to activities aimed at producing assessable income.

### *Interest*

Special rules classify financial arrangements as either debt or equity interests. These rules focus on economic substance rather than legal form and take into account related schemes, and extend beyond shares. In this situation, interest expense on non-share equity would be treated as a dividend, which is potentially frankable, and would be non-deductible for the paying company/group.

Thin capitalisation measures apply to the total debt of the Australian operations of multinational groups (including branches of those groups). The measures cover investment into Australia of foreign multinationals and outward investment of Australian-based multinationals, and include a safe-harbour debt-to-equity ratio of 3:1. Interest deductions are denied to the extent that borrowing exceeds the safe-harbour ratio. Where borrowing exceeds the safe-harbour ratio, multinationals are not affected by the rules if they can satisfy the arm's-length test (that the borrowing could have been borne by an independent entity). A further alternative test is available for outward investing entities based on 120% of their worldwide gearing.

The thin capitalisation rules apply to inward investment into Australia, where a foreign entity carries on business through an Australian permanent establishment or has direct investments in Australia or in broad terms five or fewer non-residents have at least 50%, or a single non-resident has at least 40% of an Australian entity that has incurred interest expenses that might otherwise be deductible against its Australian taxable income. Separate rules apply to financial institutions. To facilitate their inclusion in the rules, branches are required to prepare financial accounts.

International Financial Reporting Standards (IFRS), equivalents of which apply in Australia from 1 January 2005, make it more difficult for some entities to satisfy thin capitalisation rules because of the removal of internally generated intangible assets from the balance sheets. After a four-year transitional measure that allowed taxpayers to calculate safe harbour debt amounts using the pre-1 January 2005 accounting standards, the law now allows departure from the Australian equivalents to IFRS in relation to certain intangible assets and to exclude deferred tax assets and liabilities and surpluses and deficits in defined benefit superannuation funds from applicable calculations.

### *Financial arrangements*

New measures for the TOFA apply with effect for arrangements entered into from income years commencing on or after 1 July 2010, although a taxpayer may have elected to apply the new measures to arrangements entered into from income years commencing on or after 1 July 2009. The new measures provide for two default methods and four elective methods for determining gains or losses in respect of financial arrangements, along with revenue account treatment of the resulting gains or losses to the extent that the gain or loss is made in earning assessable income or carrying on a business for that purpose. *See Financial arrangements in the Income determination section*.

### *Foreign exchange gains and losses*

Foreign currency gains and losses are recognised when realised, regardless of whether there is a conversion into Australian dollars, and are included in or deducted from ordinary income, subject to limited exceptions. *See Foreign exchange gains and losses in the Income determination section*.

### *Taxes*

In general, goods and services tax (GST) input tax credits, GST and adjustments under the GST law are disregarded for income tax purposes. Other taxes, including property, payroll, fringe benefits tax and other business taxes, excluding income tax, are deductible to the extent they are incurred in producing assessable income or necessarily incurred in carrying on a business for this purpose, and are not of a capital or private nature.

### *Other significant items*

Where expenditure for services is incurred in advance, deductibility of that expenditure generally will be prorated over the period during which the services will be provided, up to a maximum of 10 years.

Subject to limited exceptions, deductions are denied for expenditure on ‘entertainment’, which broadly is defined as entertainment by way of food, drink or recreation, and accommodation or travel to do with providing such entertainment.

The amount of a commercial debt forgiven (other than an intra-group debt within a tax consolidated group) that is not otherwise assessable or does not otherwise reduce an allowable deduction is applied to reduce the debtor’s carryforward tax deductions for revenue tax losses, non-deducted capital losses, non-deducted capital expenditure, and other capital cost bases in a certain order. Any amount not so applied is not assessable to the debtor. Forgiveness includes the release, waiver, or extinguishment of a debt (other than by full payment in cash) and the lapsing of the creditor’s recovery right by reason of a statute of limitations. For the 2009-10 and earlier income years, the net forgiven amount may in certain circumstances be apportioned among a non-consolidated group of companies related to the debtor.

General value shifting rules apply to shifts of value, direct or indirect, in respect of loan and equity interests in companies or trusts. Circumstances in which these rules may apply include where there is a direct value shift under a scheme involving equity or loan interests, or where value is shifted out of an asset by the creation of rights in respect of the asset, or where there is a transfer of assets or the provision of services for a consideration other than at market value. The value shifting rules may apply to the head company of a tax consolidated group or MEC group for value shifts also involving entities outside the group, but not to value shifting between group members, which the tax consolidation rules address. *See the Group taxation section*.

## *Group taxation*

A tax consolidation regime applies for income tax and capital gains tax purposes for companies, partnerships and trusts ultimately 100% owned by a single head company (or certain entities taxed like a company) resident in Australia. Australian resident companies that are 100% owned (either directly or indirectly) by the same foreign company and that have no common Australian head company between them and the non-resident parent are also allowed to consolidate as a multiple entry consolidated group (MEC group). The group that is consolidated for income tax purposes may differ from the group that is consolidated for accounts or for GST purposes. Groups that choose to consolidate must include all 100%-owned entities under an all-in rule and the choice to consolidate is irrevocable. However, eligible tier-1 companies (being Australian resident companies that have a non-resident shareholder) that are members of a potential MEC group, are not all required to join a MEC group, when it forms, but may form two or more separate MEC groups, if they so choose, of which the same foreign top company is the 100% owner. If an eligible tier-1 company joins a particular MEC group, all 100% subsidiaries of the company must also join the group. While the rules for forming and joining MEC groups allow more flexibility than with consolidated groups, the ongoing rules for MEC groups are more complex, particularly for tax losses and on the disposal of interests in eligible tier-1 companies, which are subject to cost pooling rules, although for practical purposes these rules are relevant only if the non-resident is holding or disposing of an indirect Australian real property interest. *See Capital gains in the Income determination section*.

A single entity rule applies to members of a consolidated or MEC group so that for income tax purposes the subsidiary members are taken to be part of the head company, while they continue to be members of the group and intra-group transactions are not recognised. In general, no group relief is available where related companies are not members of the same consolidated or MEC group. *However, see previously under Capital gains in the Income determination section for exceptions with regard to certain capital gains tax rollovers.*

Consolidated groups file a single tax return, and calculate their taxable income or loss ignoring all intra-group transactions.

When a consolidated group acquires 100% of an Australian resident entity, so that it becomes a subsidiary member, the cost base of certain assets (in general, those that are non-monetary) of the joining member are reset for all tax purposes, based on the purchase price plus the entity's liabilities, subject to certain adjustments. In this way, an acquisition of 100% of an Australian resident entity by a consolidated group is broadly the tax equivalent of acquiring its assets. Subject to certain tests being passed, tax losses of the joining member may be transferred to the head company, and may be utilised subject to a loss factor, which is broadly the market value of the joining member divided by the market value of the group (including the joining member). The value of the loss factor (referred to as 'the available fraction') that applies for transferred losses may be reduced by capital injections (or the equivalent) into the member before it joined, or into the group after the loss is transferred.

Franking credits, foreign tax credits carried forward under the former foreign tax credit regime and tax losses remain with the group when a member exits, and the cost base of shares in the exiting member is calculated based on the tax value of its assets at the time of exit, less liabilities subject to certain adjustments.

Generally members of the group are jointly and severally liable for group income tax debts on the default of the head company, unless the group liability is covered by a tax sharing agreement (TSA) that satisfies certain legislative requirements. A member who enters into a TSA generally can achieve a clean exit from the group where a payment is made to the head company in accordance with the TSA.

## *Tax credits and incentives*

### *Inward investment*

Depending on the nature and size of the investment project, state governments may give rebates from payroll, stamp and land taxes on an ad hoc basis and for limited periods.

### *Capital investment*

Incentives for capital investment are as follows:

- Accelerated deductions are available for capital expenditures on the exploration for and extraction of petroleum and other minerals (and from 1 July 2012 for exploration of geothermal energy sources); the rehabilitation of former mineral extraction sites, certain environmental protection activities, the establishment of certain 'carbon sink' forests and for certain expenditure of primary producers.
- Subject to changes proposed with effect from 1 July 2010 (*see below*), deductions of up to 125% of amounts expended apply to eligible R&D expenditure incurred by a company incorporated in Australia on projects whose details are set out in an R&D plan that has previously been approved by the company's board of directors or an authorised person. To qualify the company must lodge a registration application with Innovation Australia not later than 10 months after the end of the relevant income year. The concessional deduction may be cancelled retrospectively if subsequent exploitation of the results is not on normal commercial terms and is not "of the kind to be expected of hypothetical persons dealing with each other at arm's length and from positions of similar or like or roughly equivalent bargaining power". Expenditure in acquiring or gaining access to certain pre-existing technology, known as 'core technology expenditure', is deductible at a rate of 100% of the amount expended if the purpose of acquiring the technology is to carry on eligible R&D. The deduction in any year cannot exceed one-third of the amount of expenditure incurred in that year on R&D related to that core technology. Undeducted core technology expenditure may be carried forward for deduction in future years, subject to the same requirements. There is an R&D tax offset for certain small companies and a 175% premium rate deduction for certain expenditure years where companies increase their R&D expenditure over the average expenditure for the preceding three-year period. In certain circumstances, an Australian company undertaking R&D activities in Australia wholly or principally on behalf of a foreign related entity, may be able to claim the 175% rate.

Special grant programmes may be available to assist corporations in the conduct of certain research and development in Australia. These grants are awarded on a discretionary basis.

Within a consolidated regime, R&D concessions are claimed by the head company on behalf of the group.

As mentioned above, the government proposes to change the tax treatment of expenditure on R&D. For income years commencing on or after 1 July 2010, the current concessional deductions will be replaced with an R&D tax credit. For companies with an annual turnover of less than AUD 20 million, there will be a 45% refundable tax credit, equivalent to a 150% tax concession. This equates to a cash saving of 15% every dollar of R&D spend, and will be refundable where the company is in a tax loss position. For companies with a turnover of greater than AUD 20 million, they will have access to a non-refundable 40% tax credit, equivalent to a 133% tax concession. This equates to a cash saving of 10 cents for every dollar of R&D spend. Generally, only R&D activities undertaken in Australia qualify for the new R&D tax incentive. However, R&D activities conducted overseas also qualify in limited circumstances where the activities cannot be undertaken in Australia. The 175% premium concession and international premium concession will be abolished. Eligibility criteria will be tightened to support 'only genuine R&D'. Legislation to give effect to the proposals was reintroduced into Parliament in September 2010 and is yet to be enacted.

- There are a number of tax concessions aimed at encouraging investments in the venture capital sector. Non-resident pension funds that are tax-exempt in their home jurisdiction, are residents of Canada, France, Germany, Japan, UK, US, or another country prescribed by regulation, and satisfy certain Australian registration requirements are exempt from income tax on the disposal of investments in certain Australian venture capital equity held at risk for at least 12 months. A similar exemption is extended to other tax-exempt non-resident investors, including managed funds and venture capital fund-of-funds vehicles and taxable non-residents holding less than 10% of a venture capital limited partnership. These investors are able to invest in eligible venture capital investments through an Australian resident venture capital limited partnership or through a non-resident venture capital limited partnership. For periods from 1 July 2002 until the end of the 2006-07 income year, the exemption applies only to investors from the United States, United Kingdom, Japan, Germany, France and Canada, Finland, France, Italy, the Netherlands, New Zealand, Norway, Sweden, and Taiwan. Thereafter, the restriction on the country of residence of non-resident investors no longer applies (although general partners of specified classes of limited partnership are excluded). Eligible venture capital investments are limited to specified interests in companies and trusts. Detailed rules in the legislation prescribe the nature of such investments and the characteristics, which such companies and trusts and their investments must possess.
- There is a venture capital tax concession for pooled development funds (PDFs). PDFs are investment companies established to provide equity capital to small and medium-size enterprises. PDFs are taxed on their net income at 25%, except for income from small and medium-size enterprises, which is taxed at 15%. PDFs are entitled to imputation credits on the receipt of franked dividend income. Dividends from PDFs are tax exempt. Gains on the sale of shares in a PDF are exempt from tax, and losses are not deductible. The existing PDF arrangements have been progressively replaced by a newer investment vehicle called an early stage venture capital limited partnership (ESVCLP). The existing PDF arrangements closed to new registrations from 21 June 2007. For income years commencing on or after 1 July 2007 a new investment vehicle called an early stage venture capital limited

partnership (ESVCLP) has been introduced. The thresholds for qualification include requirements that, amongst other things, the committed capital of ESVCLP must be at least AUD 10 million but not exceed AUD 100 million, the investments made must fall within prescribed parameters as to size and proportion of total capital and the ESVCLP must have an investment plan approved by Innovation Australia. Where the thresholds for their application are met, the ESVCLP provisions provide flow-through tax treatment to domestic and foreign partners with the income and capital received by the partners being exempt from taxation. As the income will be tax exempt, the investor will not be able to deduct investment losses.
- The taxable income derived from pure offshore banking transactions by an authorised offshore banking unit in Australia is taxed at the rate of 10%.
- Taxation incentives currently are provided to both investors in, and producers of, films in Australia. However, the provisions which, subject to a number of conditions, provided an accelerated deduction for certain capital expenditures on films made wholly or substantially in Australia are being phased-out, with no deductions being available after the 2009-10 income year. These provisions regarding film incentives have been replaced with refundable tax offsets which are available to companies for certain expenditure incurred in Australia in producing specified classes of film or undertaking specified post, digital or special effects production activities in respect of specified classes of films. The concessions are only available to a company that is either an Australian resident or a non-resident carrying on business through an Australian permanent establishment and which has been issued with an Australian Business Number. The availability of the offsets is subject to a number of conditions, including meeting registration and minimum spend requirements. The rate of the offset varies from 15% to 40% depending upon the nature of the relevant film and activities undertaken.
- There is an Entrepreneurs' Tax Offset (ETO) of up to 25% for businesses run by small business entities, which can include companies with an annual turnover of up to AUD 75,000. The ETO is proposed to be abolished with effect from the 2012-13 income year.

### *Other incentives*

Cash grants for export-market development expenditure are available to eligible businesses seeking to export Australian-source goods and services.

## *Withholding taxes*

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Resident corporations or individuals | 0 | 0 | 0 |
| Non-resident corporations or individuals: | | | |
| Non-treaty | 30 | 10 | 30 |
| Treaty: | | | |
| Argentina | 10/15 (4) | 12 | 10/15 (5) |
| Austria (46) | 15 | 10 | 10 (6) |
| Belgium | 15 | 10 | 10 (6) |
| Canada | 5/15 (7) | 10 (7) | 10 (6, 7) |
| Chile (47) | 5/15 | 5/10/15 | 5/10 (6) |
| China, P.R. (8) | 15 | 10 | 10 (6) |
| Czech Republic | 5/15 (9) | 10 | 10 (6) |
| Denmark | 15 | 10 | 10 (6) |

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| East Timor (Timor Sea Treaty) (10) | 15 (11) | 10 (11) | 10 (11) |
| Fiji | 20 | 10 | 15 (6) |
| Finland (12) | 0/5/15 (37) | 0/10 (38) | 5 (6, 39) |
| France (13) | 0/5/15 (13) | 0/10 (13) | 5 (6, 13) |
| Germany | 15 | 10 | 10 (6) |
| Hungary | 15 | 10 | 10 (6) |
| India | 15 | 15 | 10/15 (14) |
| Indonesia | 15 | 10 | 10/15 (15) |
| Ireland, Rep. of | 15 | 10 | 10 (6) |
| Italy | 15 | 10 | 10 (6) |
| Japan (40) | 0/5/10/15 (40) | 0/10 (40) | 5 (6, 40) |
| Kiribati | 20 | 10 | 15 (6) |
| Korea, Rep. of | 15 | 15 | 15 (6) |
| Malaysia | 0/15 (16) | 15 | 15 (6) |
| Malta | 15 (17) | 15 | 10 (6) |
| Mexico | 0/15 (18) | 10/15 (19) | 10 (6) |
| Netherlands | 15 | 10 | 10 (6) |
| New Zealand (45) | 0/5/15 (45) | 0/10 (45) | 5 (6) (45) |
| Norway | 0/5/15 (35) | 0/10 (41) | 5 (6) (42) |
| Papua New Guinea | 15/20 (20) | 10 | 10 (6) |
| Philippines | 15/25 (21) | 15 | 15/25 (22) |
| Poland | 15 | 10 | 10 (6) |
| Romania | 5/15 (23) | 10 | 10 (6) |
| Russian Federation | 5/15 (24) | 10 | 10 (25) |
| Singapore | 0/15 | 10 | 10 (6) |
| Slovak Republic | 15 | 10 | 10 (6) |
| South Africa (43) | 5/15 (43, 36) | 0/10(43) | 5 (6, 43) |
| Spain | 15 | 10 | 10 (6) |
| Sri Lanka | 15 | 10 | 10 (6) |
| Sweden | 15 | 10 | 10 (6) |
| Switzerland | 15 | 10 | 10 (6) |
| Taipei/Taiwan | 10/15 (26) | 10 | 12.5 (6) |
| Thailand | 15/20 (27) | 10/25 (28) | 15 (6) |
| Turkey (48) | 5/15 (49) | 0/10 (50) | 10 (6) |
| United Kingdom (44) | 0/5/15 (29) | 0/10 (30) | 5 (6) |
| United States | 0/5/15/30 (31) | 0/10/15 (32) | 5 (6, 33) |
| Vietnam | 10/15 (34) | 10 | 10 (6) |

Notes

1. Dividends paid to non-residents are exempt from dividend withholding tax except when paid out of a company that has not borne Australian tax (i.e. unfranked dividends). Dividends include those stock dividends that are taxable. The rates shown apply to dividends on both portfolio investments and substantial holdings other than dividends paid in connection with an Australian permanent establishment (PE) of the non-resident. Unfranked dividends paid to non-residents are exempt from dividend withholding tax to the extent that the dividends are declared by the company to be conduit foreign income. There is also a deduction from 1 July 2000 in certain cases to compensate for the company tax on inter-entity distributions where these are on-paid by holding companies to a 100% parent that is a non-resident *(see Inter-company dividends under Income determination).* Dividends paid to a non-resident in connection with an Australian PE are taxable to the non-resident on a net assessment basis (i.e. the dividend and associated deductions will need to be included

in the determination of the non-resident's taxable income – the dividend is not subject to dividend withholding tax), and a franking tax offset is allowable to the non-resident company for franked dividends received.

2. Australia's interest withholding tax rate is limited to 10% of gross interest although the treaty may allow for a higher maximum limit. An exemption from Australian withholding tax can be obtained for interest on certain public issues or widely held issues of debentures. Provisions exist to ensure that discounts and other pecuniary benefits derived by non-residents on various forms of financings are subject to interest withholding tax. Interest paid to non-residents by offshore banking units is exempt from interest withholding tax where offshore borrowings are used in offshore banking activities (including lending to non-residents). An offshore borrowing is defined as a borrowing from (i) an unrelated non-resident in any currency or (ii) a resident or a related person in a currency other than Australian currency.
3. Royalties paid to non-residents (except in respect of a PE in Australia of a resident of a treaty country) are subject to 30% withholding tax (on the gross amount of the royalty), unless a double taxation agreement provides for a lesser rate.
4. For Australian-sourced dividends which are franked under Australia's dividend imputation provisions and paid to a person who directly holds at least 10% of the voting power of the company, the limit is 10% (although note that Australia does not impose withholding tax on franked dividends). For Argentinean-sourced dividends paid to a person who holds at least 25% of the capital in the company, the limit is 10%. A 15% limit applies to other dividends.
5. Source-country tax is limited to 10% of the gross amount of royalties in relation to copyright of literary, dramatic, musical, or other artistic work; the use of industrial or scientific equipment; the supply of scientific, technical or industrial knowledge; assistance ancillary to the above; or certain forbearances in respect of the above. Source-country tax is limited to 10% of the net amount of royalties for certain technical assistance. In all other cases it is limited to 15% of the gross amount of royalties.
6. Tax is limited to the indicated percentage of gross royalty.
7. Under a protocol signed on 23 January 2002 the maximum withholding tax rate on interest is 10%. The Protocol adopts a 5% dividend withholding tax rate to franked dividends paid by an Australian resident company and in the case of dividends paid by a Canadian resident company (other than a non-resident owned investment corporation) to a company that holds directly at least 10% of the voting power in the dividend company (although note that Australia does not impose withholding tax on franked dividends). Otherwise the maximum withholding tax rate on dividends will continue to be 15%. The protocol has effect in Australia in relation to dividends, interest and royalties derived on or after 1 January 2003.
8. Except Hong Kong and Macau.
9. The treaty between Australia and the Czech Republic allows Australia to impose a 5% withholding tax on the franked part of a dividend in certain circumstances (although note that Australia does not impose withholding tax on franked dividends). In the Czech Republic a rate of 15% applies to the gross amount of dividends if the dividends are paid to a company, which holds directly at least 20% of the capital of the company paying the dividend.
10. East Timor does not have a comprehensive double tax agreement with Australia. However, the Timor Sea Treaty governs the taxation rights between the two countries for petroleum-related activities conducted in the Joint Petroleum Development Area of the Timor Sea by any person or entity, irrespective of the residency status of that person or entity.
11. Where the Timor Sea Treaty applies to third-country resident payees, only 10% of the total gross interest, dividend or royalty payment is subject to Australian withholding tax, as follows: interest – 10% of total gross interest paid is subject to withholding tax at a rate of 10%; dividends – 10% of total gross unfranked dividends paid is subject to withholding tax at a rate of 15%, or at the relevant double tax agreement rate of the recipient; royalties – 10% of total gross royalties paid is subject to withholding tax at a rate of 10%, or at the relevant double tax agreement rate of the recipient. However the other 90% of each such amount is subject to East Timorese withholding tax at the same rates.
12. The current agreement came into force on 10 November 2007 and has effect in Australia in respect of withholding taxes for income derived on or after 1 January 2008 and in respect of other income, profit or gains derived on or after 1 July 2008.
13. On 20 June 2006 Australia and France signed a new agreement. The new agreement has effect in Australia in respect of withholding tax on income derived on or after 1 January 2010, being the calendar year next following 1 June 2009, which was the date on which the new agreement entered into force. The source country will exempt inter-corporate non-portfolio (i.e. minimum 10% shareholding) dividends paid out of profits that have borne the normal rate of company tax. There is a 5% rate limit for all other non-portfolio dividends. A rate limit of 15% will continue otherwise to apply for dividends. A rate limit of 10% applies to interest except no tax will be chargeable in the source country on interest derived by a financial institution resident in the other country or a government or political or administrative subdivision or local authority or central bank of the other country. The rate limit for royalties reduced to 5% from 1 January 2010. Amounts derived from equipment leasing (including certain container leasing) are excluded from the royalty definition and treated either as international transport operations or business profits.
14. The source-country limit under the Indian agreement is 10% for royalties paid in respect of the use of or rights to use industrial, commercial or scientific equipment or for the provision of consulting services related to such equipment. In other cases the limit is 15%.

15. The source-country limit under the Indonesian agreement is 10% for royalties paid in respect of the use of or the right to use any industrial, commercial or scientific equipment or for the supply of scientific, technical, industrial, or commercial knowledge or information, and it is 15% in other cases.
16. A zero dividend withholding tax rate applies to franked dividends paid by an Australian resident company to an entity that holds directly at least 10% of the voting power in the dividend paying company, otherwise a 15% withholding tax rate applies. In relation to dividends paid by a company resident of Malaysia, no withholding tax applies.
17. Source-country tax in Malta is limited to the tax chargeable on the profits out of which the dividends are paid.
18. A zero dividend withholding tax rate applies to franked dividends paid (in Mexico, those dividends that have been paid from the net profit account) to a company that holds directly at least 10% of the voting power in the dividend paying company. In all other cases, a 15% withholding tax rate will apply to dividends.
19. Source-country tax is limited to 10% when interest is paid to a bank or an insurance company, derived from bonds and securities that are regularly and substantially traded on a recognised securities market, paid by banks (except where the prior two criteria apply) or paid by the purchaser to the seller of machinery and equipment in connection with a sale on credit. It is 15% in all other cases.
20. For Australian-source dividends, the limit is 15%. Where dividends are sourced in Papua New Guinea, the limit is 20%.
21. Source-country tax is limited to 15% where relief by way of rebate or credit is given to the beneficial owner of the dividend. In any other case, source-country tax is limited to 25%.
22. Source-country tax generally is limited to 15% of gross royalties if paid by an approved Philippines enterprise. In all other cases, the rate is limited to 25% of the gross royalties.
23. Source-country tax (Australia) is limited to 5% where a dividend is paid to a Romanian resident company that holds directly at least 10% of the capital of the Australian company paying the dividend to the extent that the dividend is fully franked. Source-country tax (Romania) is limited to 5% where a dividend is paid to an Australian resident company that holds directly at least 10% of the capital of the Romanian company paying the dividend if the dividend is paid out of profits that have been subject to Romanian profits tax. In other cases it is limited to 15%.
24. Source country tax generally is limited to 15%. However, a rate of 5% applies where the dividends have been fully taxed at the corporate level, the recipient is a company which has a minimum direct holding in the paying company and has invested a minimum of AUD 700,000 or the Russian ruble equivalent in the paying company; and where the dividends are paid by a company that is a resident in Russia, the dividends are exempt from Australian tax.
25. The agreement with the Russian Federation is the first of Australia's new treaties to include spectrum licenses in the definition of royalties.
26. Source-country tax (Taiwan) is limited to 10% of the gross amount of the dividends paid to a company which holds at least 25% of the capital of the company paying the dividends. A rate of 15% applies in all other cases. To the extent that dividends are franked because they are paid out of profits that have borne Australian tax, they are exempt from dividend withholding tax. *See Note (1) above*. The treaty allows Australia to impose a 10% withholding tax on the franked part of a dividend.
27. The source-country limit where the recipient has a minimum 25% direct holding in the paying company is 15% if the paying company engages in an industrial undertaking; 20% in other cases.
28. The source-country limit is 10% when interest is paid to a financial institution. It is 25% in all other cases.
29. Source country tax is generally limited to 15%. However, an exemption applies for dividends paid to a listed company which satisfies certain public listing requirements and which controls 80% or more of the voting power in the company paying the dividend, and a 5% limit applies to dividends paid to other companies with voting power of 10% or greater in the dividend paying company.
30. Source country tax is generally limited to 10%. However, generally zero interest withholding tax is payable where interest is paid to a financial institution or a government body exercising governmental functions.
31. Source country tax is generally limited to 15%. Exceptions are: no source country tax is chargeable on dividends to a beneficially entitled company, which satisfies certain public listing requirements, and holds 80% or more of the voting power in the company paying the dividend. A 5% limit applies to dividends paid to other companies with voting power of 10% or greater in the dividend paying company. No limit applies to US tax on dividends paid on certain substantial holdings of Australian residents in US real estate investment trusts (REITs). In practical terms US tax on these dividends is increased from 15% to the current US domestic law rate of 30%. The 15% rate applies to REIT investments made by certain listed Australian property trusts subject to the underlying ownership requirements not exceeding certain levels. Investments in REITs by listed Australian property trusts acquired before 26 March 2001 are protected from the increased rate.
32. Source country tax generally is limited to 10%. However, generally zero interest withholding tax is payable where interest is paid to a financial institution or a government body exercising governmental functions. Rules consistent with US tax treaty policy and practice will allow interest to be taxed at a higher 15% rate (the rate that generally applies to dividends) and for tax to be charged on intra-entity interest payments between a branch and its head office.
33. Amounts derived from equipment leasing (including container leasing) are excluded from the royalty definition.
34. Source-country tax is limited to 15% (Australia) and 10% (Vietnam).

35. A zero withholding rate will apply in certain cases to inter-corporate dividends where the recipient holds directly at least 80% of the voting power in the dividend paying company for the 12-month period prior to payment. A rate of 5% applies to all other inter-corporate dividends where the recipient holds directly 10% or more of the voting power of the company paying the dividend. A general limit of 15% applies to all other dividends.
36. Prior to 1 January 2009, a zero withholding tax rate applied to dividends paid out of profits that have borne the normal rate of company tax and are paid to a company which holds directly at least 10% of the capital of the dividend paying company. A 15% rate applied in all other cases.
37. For dividend income derived on or after 1 January 2008, a zero withholding rate applies to inter-corporate dividends where the recipient holds directly 80% or more of the voting power of the company paying the dividend. A 5% rate limit applies on all other inter-corporate dividends where the recipient holds directly 10% or more of the voting power of the company paying the dividend. A 15% rate applies in all other cases.
38. A rate limit of 10% will apply to interest except no tax will be chargeable in the source country on interest derived by a financial institution resident in the other country or a government or political or administrative subdivision or local authority or central bank of the other country.
39. Amounts derived from equipment leasing (including certain container leasing) are excluded from the royalty definition and treated either as international transport operations or business profits. The rate of 5% applies to royalties derived on or after 1 January 2008. Before that date, a 10% rate applied.
40. On 31 January 2008 Australia and Japan signed a new agreement. The new agreement has effect in Australia in respect of withholding taxes on income derived on or after 1 January 2009. The source country will exempt inter-corporate dividends where the recipient holds directly 80% or more of the voting power of the company paying the dividend and certain limitation of benefit thresholds are met. A 5% rate limit will apply on all other inter-corporate dividends where the recipient beneficially holds directly 10% or more of the voting power of the company paying the dividend. A rate limit of 10% will otherwise apply for dividends. However where the dividends are paid by a company that is a resident of Japan, which is entitled to a deduction for the dividends in Japan, the rate limit is 15% where more than 50% of the assets of the paying company consist, directly or indirectly of real property situated in Japan and 10% in all other cases. Special rules apply to distributions to Japanese residents by REITs. A rate limit of 10% applies to interest except no tax will be chargeable in the source country on interest derived by a financial institution resident in the other country or a government or political subdivision or local authority or central bank or other specified entity of the other country. From 1 January 2009, a 5% withholding tax rate on royalties applies. Before 1 January 2009, a general limit of 10% withholding tax on royalties applied. Under the new agreement, amounts derived from equipment leasing (including certain container leasing) will be excluded from the royalty definition and treated either as international transport operations or business profits.
41. A general rate limit of 10% applies to interest. However, in respect of interest derived on or after 1 January 2008 no tax will be chargeable in the source country on interest derived by a government of the other country (including its money institutions or a bank performing central banking functions) from the investment of official reserve assets and on interest derived by a financial institution resident in the other country (excluding interest paid as part of a back-to-back loan arrangement).
42. The rate limit for royalties of 5% applies to royalties derived on or after 1 January 2008. Before that date, a 10% rate applied.
43. On 31 March 2008 Australia and South Africa signed a protocol amending the agreement. The provisions of the new Protocol relating to Australian withholding taxes have effect in respect of income derived by a non-resident on or after 1 January 2009. A 5% rate limit will apply on all inter-corporate dividends where the recipient beneficially holds directly 10% or more of the voting power of the company paying the dividend. A rate limit of 15% will otherwise apply for dividends. From 1 January 2009, a general rate limit of 10% applies to interest. However no tax will be chargeable in the source country on interest derived by a government of the other country (including a bank performing central banking functions) and on interest derived by a financial institution resident in the other country (excluding interest paid as part of a back-to-back loan arrangement). From 1 January 2009, a 5% rate on royalties applies. Before 1 January 2009, a general limit of 10% withholding tax on royalties applied.
44. On 28 October 2008, it was announced that the Australian and the United Kingdom governments would commence negotiations on a revised tax treaty. Submissions were due to be lodged with Australian Treasury by 14 November 2008.
45. On 26 June 2009, a new double tax agreement was signed between Australia and New Zealand. The new treaty takes effect for withholding tax purposes on 1 May 2010. From 1 May 2010, a zero withholding tax rate will apply in certain cases to inter-corporate dividends where the recipient holds directly at least 80% of the voting power in the dividend paying company. A rate of 5% will apply on all other inter-corporate dividends where the recipient holds directly 10% or more of the voting power of the company paying the dividend. A general limit of 15% will apply for all other dividends, including those paid prior to 1 May 2010. From 1 May 2010, source country tax on interest will continue to be limited to 10%. However, no tax will be chargeable in the source country on interest derived by a government or a political subdivision or local authority of the other country (including a government investment fund or a bank performing central banking functions) or on interest derived by a financial institution which is unrelated to and dealing wholly independently of the payer (excluding interest paid as part of a back-to-back loan arrangement and, for New Zealand payers, where that person has not paid approved issuer levy). From 1 May 2010, the royalty withholding tax rate reduced from 10% to 5%.

46. The government announced on 4 February 2010 that negotiations to update Australia's tax treaty with Austria would take place in March 2010.
47. Australia and Chile signed a new double taxation agreement (DTA) on 10 March 2010. The new agreement has not yet entered into force.
48. On 29 April 2010, the Australian and Turkish Governments signed a DTA. The DTA will enter into force when both countries advise that they have completed their domestic requirements.
49. Once in force the DTA will apply a 5% withholding tax rate to inter-corporate dividends where the recipient owns directly 10% of the voting power of an Australian resident company or directly owns 25% of the capital of a Turkish resident company where the profits out of which the dividend is paid has been subject to the full rate of corporation tax in Turkey. In all other cases, a 15% withholding tax rate will apply.
50. Once in force the DTA will apply a general limit of 10% withholding tax on interest. However, interest derived from the investment of official reserve assets by the either the Australian or Turkish Government, the Australian or Turkish central bank or a bank performing central banking functions in either Australia or Turkey shall be exempt from interest withholding tax.

### *Other payments*

A Pay-As-You-Go (PAYG) withholding regime applies to require the deduction and remittance of taxes on behalf of foreign resident individuals and entities that are in receipt of the following types of payments:

| Type of payment | Rate of withholding |
|---|---|
| Payments for promoting or organising casino gaming junket arrangements | 3% |
| Payments for performing artists, sportspersons, including payments to support staff such as art directors, bodyguards, coaches, hairdressers and personal trainers | – if recipient is a company, 30% |
| | – if recipient is an individual, the applicable non-resident marginal tax rate, (this effectively codifies existing ATO practice in relation to these types of payments) |
| Payments under contracts entered into after 30 June 2004 for the construction, installation and upgrading of buildings, plant and fixtures and for associated activities | 5% |

### *Managed investment trust distributions*

For income years commencing on or after 1 July 2007, a non-final withholding tax at the rate of 30% applied to distributions (fund payments) to non-residents, directly or through an intermediary, of income (other than dividends, interest, royalties, foreign source income and capital gains on assets that are not taxable Australian property) by a managed investment trust with defined connections to Australia. For fund payments made in income years commencing on or after 1 July 2008, a new regime applies, with divergent outcomes, depending upon whether or not the recipient of such fund payments is resident of a country identified as being one with which Australia has an effective exchange of information (EEOI) arrangement and which is regulated as such for purposes of these rules. For regulated EEOI countries, a final withholding tax at a 7.5% rate currently applies. For residents of non-EEOI regulated countries, a final withholding tax at a 30% rate applies.

EEOI countries have been identified by regulation to be the Antigua & Barbuda, Jersey, Isle of Man, the British Virgin Islands, Guernsey, Gibraltar, Netherlands Antilles and Bermuda and the countries with which Australia has concluded DTAs other than Austria, Belgium, Greece, Korea, Malaysia, the Philippines, Singapore, and Switzerland. The Australian government has announced its intention to regulate the following EEOI countries in due course: Belize, Cayman Islands, Bahamas, Monaco, San Marino, Singapore, St. Christopher and Nevis, and St. Vincent and the Grenadines. Australia has entered into EEOI agreements with Aruba, Anguilla, Belgium, Dominica, Grenada, Malaysia, Marshall Islands, Mauritius, Montserrat, Saint Lucia, Samoa, Turks and Caicos Islands, Vanuatu, and the Cook Islands; however, these countries have not yet been identified in regulations to be EEOI countries.

## *Tax administration*

### *Returns*

A corporation (including the head company of a tax consolidated group) generally lodges/files a tax return on the basis of a 1 July to 30 June year of income. However, a corporation may apply to adopt a substitute year of income, for example, 1 January to 31 December. A return is lodged/filed under a self-assessment system that allows the Australian Taxation Office (ATO) to rely on the information stated on the return. Where a corporation is in doubt as to its tax liability regarding a specific item, it can ask the ATO to consider the matter and obtain a binding private ruling.

### *Payment of tax*

A PAYG instalment system applies to companies other than those whose annual tax is less than AUD 8,000 that are not registered for GST. Most companies are obliged to pay instalments of tax for their current income year by the twenty-first days of the fourth, seventh and tenth months of that year and by the twenty-first day of the month immediately following that year. Instalments are calculated on a quarterly basis by applying an instalment rate to the amount of the company's actual ordinary income (ignoring deduction) for the previous quarter. The instalment rate is notified to the taxpayer by the ATO and determined by reference to the tax payable for the most recent assessment. The ATO may notify a new rate during the year on which subsequent instalments must be based. Taxpayers can determine their own instalment rate, but there may be penalty tax if the taxpayer's rate is less than 85% of the rate that should have been selected.

Final assessed tax is payable on the first day of the sixth month following the end of that income year or such later date as the Commissioner of Taxation allows by a published notice.

# Austria



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## Significant developments

On 20 December 2010, the 'Budgetbegleitgesetz 2011' passed the Austrian parliament. The Budgetbegleitgesetz 2011 includes numerous amendments having significant impact on the Austrian Income Tax Act, the Austrian Corporate Income Tax Act, and the Austrian Stamp Duty Act, such as the following:

- The research and development (R&D) premium was increased from 8% to 10% *(see the Tax credits and incentives section)*.
- The stamp duty on loan and credit agreements has been disposed of *(see the Other taxes section)*.
- The minimum holding requirement for the exemption from 25% Austrian withholding tax (WHT) on dividend payments between domestic companies was reduced to 10% *(see Note 5 of the Withholding taxes section)*.
- Interest expenses relating to the acquisition of shares from related parties are generally not deductible any more *(see the Deductions section)*.

In December 2010, the 'Betrugsbekämpfungsgesetz 2010', an act regarding the fight against fraud, was enacted. This act affects inter alia tax limitation periods. *See the Tax administration section for more information.*

Austrian transfer pricing (TP) guidelines were issued by Austrian tax authorities on 3 November 2010. The guidelines represent the Austrian authority's understanding of the Organisation for Economic Co-operation and Development (OECD) TP guidelines and are of relevance for the interpretation of Austrian income tax law by the tax administration. *See the Group taxation section for more information.*

In June 2010, a reform of the Austrian Corporate Income Tax Act ('Abgabenänderungsgesetz 2010') was enacted, which resulted in the introduction of an advanced ruling opportunity. With the implementation of this new regulation, legally binding information in the fields of TP, group taxation, and mergers & acquisitions (M&A) can be requested from the Austrian tax authorities for the payment of an administrative fee. The advanced ruling opportunity is applicable as of the beginning of the 2011 fiscal year onwards. *See the Group taxation section for more information.*

## Taxes on corporate income

### Basis of corporate income tax (Körperschaftsteuer)

Corporations (i.e. GmbH, AG) are subject to unlimited taxation in Austria of their entire (domestic and foreign) income if they have their legal seat or place of effective management in Austria. A non-Austrian corporate tax resident (with neither a legal seat nor place of effective management in Austria) is subject to limited taxation on certain sources of income in Austria.

### *Rates of corporate income tax (Körperschaftsteuer)*

Due to the qualification of corporations as independent tax subjects, a distinction must always be made between tax ramifications at the level of the company and those at shareholder level. At the level of the company, profits are taxed at the standard corporate income tax (CIT) rate of 25%, regardless of whether profits are retained or distributed. At the shareholder level, the profit distributions are usually subject to WHT of 25%.

There is also a minimum CIT, payable by companies in a tax-loss position. The minimum CIT amounts to 437.50 euros (EUR) for limited liability companies (GmbH) and EUR 875 for stock corporations (AG) for each full quarter of a year. To promote the formation of new companies, the minimum CIT is reduced to EUR 273 for the first four quarters. The minimum CIT can be carried forward without time limitation and be credited against future CIT burdens of the company.

There is no additional local income tax levied at the company level.

## *Corporate residence*

A corporation is resident in Austria for tax purposes if either it is registered in Austria (legal seat) or its place of effective management is located in Austria. The 'place of effective management' is located where the day-to-day management of the company is actually carried out and not where singular board decisions are formally made.

However, the definition of place of effective management under Austrian tax law does not significantly deviate from its definition under the OECD guidelines.

### *Permanent establishment (PE)*

An Austrian PE is defined under Austrian tax law as a fixed establishment where a business is carried out, in particular:

- the place where the management is carried out
- plants, warehouses, purchase and sales establishments, and other establishments where an entrepreneur or one's permanent representative carries out one's business, or
- construction sites, which last for more than six months.

However, the definition of PE is different in some tax treaties. The Austrian tax authorities generally follow the commentary to the OECD model convention regarding the PE concept.

## *Other taxes*

### *Value-added tax (VAT) (Mehrwertsteuer)*

Generally, the Austrian VAT law is based on the 6th European Union (EU) VAT Directive. Under the Austrian VAT law, companies and individuals carrying out an active business on a permanent basis are qualified as entrepreneurs for VAT purposes. As entrepreneurs, they have to charge the supply of goods or services provided to their customers with Austrian VAT at a rate of 20%. A certain limited range of goods and services (such as food, books, passenger transportation, cultural events) is taxed at the reduced rate of 10%. Certain other transactions are exempted from Austrian VAT (e.g. export transactions).

**Input VAT**

Entrepreneurs are entitled to deduct Austrian input VAT insofar as the input VAT does not result from goods/services purchased which are directly linked to certain VAT exempt sales (e.g. interest income, insurance premium). However, certain transactions are exempt from Austrian VAT (e.g. export transactions) without limiting the ability of the entrepreneur to deduct the related input VAT. To be entitled to deduct input VAT, the entrepreneur must obtain an invoice from one's supplier which fulfils certain formal requirements.

**VAT filing and payment**

Entrepreneurs have to file monthly or quarterly VAT returns by the 15th day of the second month following the month concerned or by the 15th day of the second month following the quarter concerned. The balance of the VAT due and the input VAT deducted has to be paid to the tax office (if VAT burden) or is refunded by the tax office (if in a net input VAT position) to the electronic tax account of the entrepreneur. A separate report has to be filed by the entrepreneur at the tax office showing the cross-border intra EU-transactions made.

### *Excise taxes*

Excise taxes are imposed on certain products including petroleum (approximately EUR 40 to EUR 600 per 1,000 litres), tobacco products (13% to 47% of price), and alcoholic beverages.

### *Customs duties*

Certain cross-border inbound movements of goods from non-EU countries trigger Austrian customs duty. The duty is levied according to the Austrian customs duty scheme, which is based on the EU-customs duty scheme. It defines the customs duty tariffs, dependent on the nature of the good.

### *Stamp duty*

Stamp duty is imposed in connection with certain legally predefined transactions for which a written contract has been established (e.g. lease contracts, bills of exchange, assignments of receivables). The Austrian administration's understanding of a 'written contract' is very broad and covers not only paper contracts but also contracts concluded by electronic means (e.g. electronically signed emails).

The stamp duty is triggered upon the establishment of a legal relationship if at least one Austrian party is contractually involved or, even if a contract is concluded between non-Austrian parties only, if the subject of the contract relates to Austria (e.g. lease contract on Austrian real estate). However, various possibilities are available for most legal transactions subject to stamp duty to structure them in a way without triggering stamp duties (e.g. setting up of contracts abroad, offer-acceptance procedure, usage of audio-tapes).

As of 2011, loan and credit agreements are no longer subject to stamp duty. This modification of the Stamp Duty Act refers to new agreements signed after 1 January 2011 as well as to agreements which are set up in written form in 2011 for loans/credits concluded before 2011.

The stamp duty rates for the most common legal transactions are as follows:

| Legal transactions | Duty (%) |
|---|---|
| Lease agreements | 1.00 |
| Certificates of bonds | 1.00 |
| Loan agreements (for written agreements set up until the end of 2010) | 0.80 |
| Credit agreements non-recurring or revolving during a period of five years (for written agreements set up until the end of 2010) | 0.80 |
| Credit agreements with a maturity exceeding five years (for written agreements set up until the end of 2010) | 1.50 |
| Bill of exchange | 0.13 |
| Assignment of receivables | 0.80 |

### *Capital transfer tax (Gesellschaftsteuer)*

Capital transfer tax is imposed at a rate of 1% on the initial contribution of capital, other contractual or voluntary contributions in cash or in kind, and certain hybrid financing instruments to Austrian corporations. However, in many cases a taxable event for capital transfer tax purposes can be eliminated by careful structuring (e.g. contributions made by the indirect shareholder of an Austrian company (so called 'grandparent contributions') do not trigger capital transfer tax).

### *Real estate tax*

Local authorities annually levy real estate tax on all Austrian real estate property whether developed or not. The tax is levied on the assessed standard ratable value ('Einheitswert') of immovable property. The assessed value is usually substantially lower than the market value. The effective tax rate depends on the intended use of the real estate and is calculated using a special multiplier.

Tax rates:

- Agricultural area and forestry
  - 1.6% for the first EUR 3,650 of the assessed standard ratable value.
  - 2% for the amount of the assessed standard ratable value exceeding EUR 3,650.
- Buildings and property are taxed at 2% of the assessed standard ratable value. This multiplier is reduced for:
  - Single family houses
    - to 0.5% for the first EUR 3,650 of the assessed standard ratable value, and
    - to 1% for the next EUR 7,300.
  - Leasehold und shared property
    - to 1% for the first EUR 3,650 of the assessed standard ratable value, and
    - to 1.5% for the next EUR 3,650.
  - All other property
    - to 1% for the first EUR 3,650 of the assessed standard ratable value.

After the assessed standard ratable value is multiplied by the relevant multiplier, the real estate tax is calculated by using a special municipal rate fixed by each municipality (maximum 500%). Finally, the tax amount is reduced by a general reduction of 25% as stated by law and increased by a 35% inflation adjustment.

### *Real estate transfer tax*

Tax is levied at 3.5% on any transaction which causes a change in the ownership of Austrian real estate or in the person empowered to dispose of such property. Real estate transfer tax is generally calculated on the basis of the acquisition price. However, in the case of corporate restructuring under the Reorganisation Tax Act and in case of real estate transfers free of consideration, the two-fold (in the case of the former) and the threefold (in the case of the latter) assessed standard ratable value for tax purposes is taken as the tax base.

Real estate transactions with a tax base of EUR 1,100 or below are exempt.

Note that an additional 1% registration fee (same tax base as Real Estate Transfer Tax) becomes due upon incorporation to the land register.

## Branch income

Austrian branches of foreign corporations are taxed in the same way as Austrian corporations, except that inter-company dividends received by Austrian branches of non-EU corporations are not tax exempt *(see the Income determination section)* and Austrian tax losses can be carried forward only if they exceed non-Austrian profits. Books and records generally can be kept abroad but must be brought to Austria in case of a tax audit (upon official request).

## Income determination

Taxable income is determined based on statutory accounts under Austrian generally accepted accounting principles (GAAP) adjusted for certain deductions and additions prescribed by the tax law.

### Inventory valuation

In general, inventories are valued at the lower of cost or market. If specific identification during stock movements is not possible, other methods, such as last in first out (LIFO) and first in first out (FIFO) are permitted when shown to be appropriate. Conformity between financial book keeping and tax reporting is required.

### Capital gains/exit taxation/inbound transfer

Generally, capital gains (short and long-term) are part of the normal annual result of a corporation and therefore are taxed at the ordinary CIT rate (25%).

A special tax treatment applies to capital gains with respect to the exit of taxable assets. In the case of a transfer of assets which formed part of a business from Austria to a foreign country (e.g. allocation of assets to foreign branch), latent capital gains generally are taxed at the time of the transfer. However, if these assets are transferred to an EU member state, capital gains taxation can be postponed upon request until the assets are sold or transferred outside the European Union.

In case of an inbound transfer, generally, the fair market value of the assets is considered for Austrian income tax purposes (step up). Therefore, any hidden reserves accumulated abroad are not taxed in Austria.

### Dividend income

Dividends received from an Austrian company at the corporate shareholder level are generally excluded from the tax base (no minimum stake, no minimum holding period). This tax exemption refers to domestic dividends only, not to capital gains or losses.

Additionally, dividends received from companies located within the European Union or from countries within the European Economy Area (EEA) with which an agreement on comprehensive administrative assistance was established (currently only Norway) are also tax exempt if the foreign company is subject to a tax similar to the Austrian CIT and if the foreign CIT rate is not below 15%.

In cases where the dividends from foreign investments are taxable, foreign CIT can be credited against the Austrian CIT.

### *International participation exemption for dividends and capital gains*
Dividends received from a foreign company are also tax exempt at the corporate shareholder level if the Austrian company holds at least 10% of the issued share capital for a minimum holding period of one year (international participation exemption). Furthermore, both capital gains and capital losses derived from shares qualifying for the international participation exemption are tax neutral. This means a deduction of capital losses is no longer available. However, the parent company can exercise an (irrevocable) option for each single participation acquired to treat both capital gains and capital losses as taxable (spread of losses and depreciations over a period of seven years). The option refers to capital gains (losses) only and does not affect the tax treatment of ongoing dividend distributions.

In the case of presumed tax abuse, the participation exemption for dividends and capital gains is replaced by a tax credit (switch-over-clause). The credit system is applied if the foreign subsidiary does not meet an active-trade-or-business test (i.e. passive income from royalties, interest, etc. is greater than 50% of total income of subsidiary) and is not subject to an effective foreign minimum CIT rate of more than 15%. The domestic and foreign participation exemptions are available to Austrian resident corporations and to Austrian branches of EU corporations only, but not to Austrian branches of non-EU corporations.

### *Portfolio dividends*
Portfolio dividends (i.e. dividends from an investment below 10%) received from corporations located in member states of the European Union, as well as dividends from corporations which are located in those EEA countries with which Austria has concluded an agreement on mutual assistance and collection of taxes (currently only Norway), are generally exempt from CIT. However, the switch-over to the credit method outlined under ‘Dividend income’ above has to be considered.

Currently, the exemption of portfolio dividends applies to dividends from EU/EEA countries only, but not to those from third countries. As a result of a decision of the ECJ of February 2011 (C-436/08 and C-437/08, Haribo/Salinen), the restriction of the exemption to portfolio dividends received from countries within the EU/EEA is contrary to EU law. Therefore, an extension of the exemption to third country portfolio dividends is planned to be implemented as a consequence of the ‘AbgÄG 2011’. Furthermore, the requirement of an agreement on the collection of taxes with the source country will have to be eliminated.

### *Stock dividends*
A conversion from revenue reserves (retained earnings) to capital by a company does not lead to taxable income for the shareholder (but triggers 1% capital transfer tax). However, capital reductions are treated as taxable income if within ten years prior to the capital reduction the above-mentioned increase in capital was repaid to the shareholder. Otherwise, they are tax exempt.

### *Interest income*
Interest income is taxed at the general CIT rate of 25%.

### Rents and Royalties
Rental income is treated as normal business income.

### Foreign income
Austrian resident corporations are taxed on their worldwide income. If a double taxation treaty (DTT) is in force, double taxation is mitigated either through an exemption or by granting a tax credit equal to the foreign WHT at the maximum (capped with the Austrian CIT incurred on the foreign source income). If foreign WHT cannot be credited at the level of the Austrian corporation (e.g. due to a loss position), Austrian tax law does not allow to carry forward the foreign WHT to future assessment periods. However, if the source of the income is a non-treaty country, exemption or a tax credit shall be available based on unilateral relief (representing a discretionary decision of the Austrian Ministry of Finance only but no legal entitlement for the applicant). Austrian tax law does not provide for a deferral of taxes on foreign income. Special rules for taxing undistributed income of foreign subsidiaries are applicable only to foreign investment funds.

Please note that Austrian Tax Law does not define special controlled foreign company (CFC) rules. However, under certain circumstances, the Austrian tax administration, under a substance over form approach, taxes passive income of foreign subsidiaries of Austrian companies located in low tax jurisdictions *(see switch-over-clause under International participation exemption for dividends and capital gains above).*

## Deductions

### Accrued expenses
Certain accruals (such as provisions for liabilities and impending losses) running for more than 12 months as of the closing date of the accounts are accepted for tax purposes at 80% of their value only. Exempted from this reduction are provisions for personnel benefits (severance payments, pensions, vacations, and anniversary awards) for which specific reduction and computation methods have been provided and provisions which were already calculated by discounting a future obligation.

In general, lump-sum accruals and accruals for deferred repairs and maintenance are not allowed for tax purposes.

### Depreciation and amortisation
Only the straight-line method is accepted for tax purposes, whereby the cost is evenly spread over the useful life of an asset. For certain assets, depreciation rates relevant for tax purposes are prescribed by the tax law and shown in the following chart:

| Assets | Rate (%) |
|---|---|
| Buildings (industrial use) | 3.0 |
| Buildings (banking, insurance) | 2.5 |
| Other buildings | 2.0 |
| Automobiles | 12.5 |

Goodwill arising in the course of an asset deal for tax purposes must be amortised over 15 years. Goodwill arising in the course of a share deal can be amortised only if the acquired company is included in a tax group *(see the Group taxation section).* Goodwill arising as a result of a corporate merger cannot be amortised.

Trademarks are usually amortised over 15 years. Other intangibles have to be amortised over their useful lives.

Tax depreciation is not required to conform to financial depreciation under Austrian GAAP. If depreciated property is sold, the difference between tax value and sale proceeds is taxed as a profit or loss in the year of sale.

### *Interest payments*
Interest payments (also inter-company) are generally tax deductible if they meet the general arm's-length requirements. *See Thin capitalisation in the Group taxation section for more information.*

### *Financing costs*
According to current tax law, interest expenses resulting from the debt financed acquisition of shares are usually tax deductible. This is so even if the Austrian participation exemption regime applies *(see the Income determination section)*.

As of 2011, interest expenses relating to the debt-financed acquisition of shares from related parties or (directly or indirectly) controlling shareholders are generally non-deductible. This disallowance of interest also applies in circumstances where the shareholder acquiring the shares has been funded by a debt-financed equity contribution (insofar as the equity contribution was made in direct connection with the share acquisition). Interest expenses resulting from intra-group share acquisitions conducted prior to 1 January 2011 are also covered by the new regulation. The deductibility of interest expenses incurred in connection with the acquisition of shares from a third party is not impacted.

Other financing costs (e.g. fees, legal advice) directly related to tax exempt dividend income are not deductible. However, foreign exchange expenses or profits accumulated in connection with the financing of tax exempted international participations are treated as a deductible or taxable (respectively) item.

### *Charitable contributions*
Charitable contributions are tax deductible up to a limit of 10% of the prior year profit.

### *Meals and entertainment*
The deductibility of costs for business lunches generally is limited to 50% of actual expenses incurred (provided the business lunch had the purpose of acquiring new business).

The deductibility of entertainment expenses is restricted to advertising expenses.

### *Payment to directors*
Payments to a member of the supervisory board ('Aufsichtsrat') are tax deductible up to a limit of 50%. Payments to members of the executive (managing) board are tax deductible without special limitation.

### *Organisational and start-up expenses*
Generally, organisational and start-up expenses are tax deductible.

### *Fines and penalties*
Fines and penalties are generally not tax deductible.

***Taxes***
Austrian and foreign taxes on income and other personal taxes, as well as VAT insofar as it relates to non-deductible expenditures, are non-deductible. Other taxes, such as payroll or capital transfer taxes, are deductible.

***Net operating losses***
Tax losses can be carried forward without any time limit. However, tax loss carryforwards generally can be offset against taxable income only up to a maximum of 75% of the taxable income for any given year. Some exceptions apply (e.g. in connection with tax groups or in the case of liquidations), allowing a company to charge tax loss carryforwards available against 100% of annual taxable income.

The Austrian tax law does not provide for a carryback of tax losses.

**Loss-trafficking (Mantelkauf)**
Tax loss carryforwards may be lost in the case of a share deal being classified as loss-trafficking (so called 'Mantelkauf') or in the course of a legal restructuring leading to similar results.

Under Austrian tax law, a share deal against compensation is classified as a Mantelkauf, if, from a substance over form perspective, the 'economic identity' of a company is changed due to the transaction. The change of economic identity of a company is realized if all of the following structural changes are made to the acquired Austrian company having the tax loss carryforwards available:

- Change of shareholder structure.
- Change of the organisational structure.
- Change of the business structure.

All three conditions cumulatively have to be met. There is no exact time period defined within which they have to be met; however, meeting them within one year after the share transfer usually is regarded as a strong indication for a Mantelkauf.

***Payments to foreign affiliates***
Generally, there are no restrictions on the deductibility of royalties, interest, and service fees paid to foreign affiliates, provided they are at arm's length (which should be appropriately documented by agreements, contracts, calculation sheets, etc.). Payments to affiliated companies not meeting arm's-length standards are treated as a hidden distribution of earnings (i.e. they are not tax deductible, and WHT is usually triggered at source). *See Transfer pricing in the Group taxation section for more information.*

Note that the domestic implementation of the EU Interest Royalty Directive which abolishes WHT on cross-border payments of interest and license fees (regardless of whether taken out by deduction or by assessment) between affiliated companies in the member states should be considered.

## *Group taxation*

In 2005, a new group taxation system replaced the 'Organschaft' concept under which Austrian resident companies as well as foreign companies (with restrictions) may be taxed as a unit. Under the 2005 system, two or more companies can form a tax group, provided the parent company directly or indirectly owns more than 50% of the shares in the subsidiaries. The tax group also can include foreign group members. If a group member withdraws from the group within a minimum commitment-period of three years, all tax effects derived from its group membership must be reversed.

Within a tax group, all of the taxable results (profit and loss) of the domestic group members are attributed to their respective group parent. From foreign tax group members, tax losses in the proportion of the shareholding quota are attributed to the tax group parent. Foreign tax losses utilised by the Austrian tax group parent are subject to recapture taxation at the time they are utilised by the tax group member in the source state, or in the moment the group member withdraws from the Austrian tax group. Under the recapture taxation scheme, the Austrian tax group has to increase its Austrian tax base by the amount of foreign tax losses used in prior periods (limited to the amount of tax losses actually utilised by the foreign tax group member).

For the purpose of the application of the recapture taxation scheme, a withdrawal from the tax group is also assumed if the foreign group member significantly reduces the size of its business (compared to the size of the business at the time the losses arose). Reduction of size is measured on the basis of business parameters such as turnover, assets, balance sheet totals, and employees, while the importance of the respective criteria depends on the nature of the particular business.

Goodwill arising in the course of a share deal (acquisition of an active business company from a third party contractor) must be amortised over 15 years, provided that the acquired company is included in a tax group.

Write-downs of participations in tax group members are not tax deductible.

### *Transfer pricing*
Under Austrian Tax Law there are no explicit TP regulations available defining in detail the local requirements with regards to arm's length, the documentation standards required, penalties, etc. In general, Austria applies the OECD TP guidelines referring to the OECD model tax convention. Furthermore, Austrian TP guidelines were recently issued by Austrian tax authorities. The guidelines represent the Austrian authority's understanding of inter-company business relationships with regards to their arm's-length classification and are based on the OECD TP guidelines.

According to these guidelines, all business transactions between affiliated companies must be carried out under consideration of the arm's-length principle. Where a legal transaction is deemed not to correspond to arm's-length principles, the transaction price is adjusted for CIT purposes. Such an adjustment constitutes either a constructive dividend or a capital contribution. Currently, there is the option of applying for a non-binding ruling of the tax authorities. Additionally, a reform of the Austrian CIT Act was recently enacted, which contains the introduction of an advanced ruling opportunity. With the implementation of this new regulation, binding information in the fields of TP, group taxation, and M&A can be requested from the Austrian tax authorities against payment of an administrative fee (the fee rate depends on the size of the applicant's business). The advanced ruling opportunity is applicable as of the 2011 fiscal year.

### *Thin capitalisation*
There are no explicit tax regulations available under Austrian tax law stipulating the minimum equity required by a company ('thin capitalisation rules'). Basically, group financing has to comply with general arm's-length requirements. Therefore, an Austrian group entity being financed by an affiliated entity must be able to document

that it would have been able to obtain funds from third party creditors under the same conditions as from an affiliated financing entity. Therefore, the appropriate ratio between an Austrian company's equity and debt will mainly depend on the individual situation of the company (profit expectations, market conditions, etc.) and its industry. Nonetheless, the fiscal authorities in administrative practice (i.e. no 'safe-harbour' rule) tend to accept a debt-equity ratio of approximately 3:1 to 4:1. However, the debt-equity ratio accepted by tax authorities also strongly depends on the average ratio relevant for the respective industry sector. If in inter-company loan for tax purposes is not accepted as debt, it is reclassified into hidden equity and related interest payments into (non-deductible) dividend distributions.

Furthermore, under Austrian commercial law (for companies subject to statutory audits), a minimum equity ratio of 8% is claimed. If the equity ratio of the company falls below 8% and its earning power (virtual period for debt redemption) at the same time does not meet certain requirements, a formal and public reorganisation process will have to be initiated.

## *Tax credits and incentives*

### *Research and development (R&D) incentives*

R&D costs are fully deductible at the time they accrue. As of 2011, an R&D premium of 10% (i.e. R&D expenses x 10% = tax refund) may be claimed for R&D activities performed in Austria.

Prior to 2011, an R&D premium of 8% was available for all R&D activities, not just those performed in Austria. An alternative R&D allowance of 25% to 35% of qualifying R&D expenses was also available.

The R&D premium (and allowance prior to 2011) is also available in case of contract R&D; however, R&D incentives cannot be claimed by both principal and agent.

### *Employment incentives*

A tax bonus payment of 6% or, alternatively, an allowance of 20% can be claimed for expenditures in connection with the training of employees. These incentives can be claimed for external training expenditures and for in house training expenditures, provided that there is a dedicated in-house training department (for in-house training expenditures, only the allowance can be applied for).

A new premium scheme for apprenticeships started in June 2008. This premium is based on the amount of actual wage as set out in the applicable collective contract and provides tax free subsidies, depending on the duration of the apprentice's employment.

### *Investment incentives*

For investment in certain regions, government grants and subsidies are available and are generally individually negotiated.

### *Foreign tax credit (matching credit)*

Generally, foreign WHT can be credited against Austrian CIT *(see Foreign income in the Income determination section)*. In special cases (e.g. China, Korea, Brazil), the DTT provides for a matching credit, which allows the credit of a pre-defined amount which exceeds the actually paid foreign WHT.

## *Withholding taxes*

### *Dividend WHT*

Under Austrian domestic law, there is generally a 25% WHT on dividends (profit distributions) paid to a foreign parent company. The WHT has to be deducted and forwarded by the Austrian subsidiary to the tax office.

To end up with the reduced WHT rate as defined under the DTT applicable, Austrian tax law provides for the following alternative methods of WHT relief: refund method or exemption at source method.

#### Refund method

The Austrian subsidiary generally has to withhold 25% WHT on profit distributions to the foreign parent company, and the parent company has to apply for a refund (of the difference between 25% WHT and the lower DTT rate). In the course of the refund process, the Austrian tax administration analyses whether the foreign shareholder can be qualified as beneficial owner of the dividends paid. If the refund is approved by the Austrian tax authority, dividend distributions within the following three years can be done without deduction of WHT (for distributions of a comparable size and provided the foreign holding structure did not change in the meantime).

#### Exemption at source method

Relief at the source is available only if the direct parent company issues a written declaration confirming that it is an ‘active’ company carrying out an active business that goes beyond the level of pure asset management and has its own employees and office space at its disposal (substance requirements).

#### WHT on dividends paid to EU companies

With regard to dividends paid to EU resident corporate shareholders, Austria has implemented the EU Parent/Subsidiary Directive according to which domestic WHT is reduced to zero. The requirements for the reduction are that the EU resident parent company, which also has to meet the substance requirements mentioned above *(see Exemption at source method),* must directly own at least 10% of the share capital of the Austrian subsidiary for a period of at least one year. In case of foreign EU shareholders being qualified as pure holding companies, the Austrian tax administration does not allow an exemption at source but claims the application of the refund method.

Provided the requirements according to the EU Parent/Subsidiary Directive are not met, Austrian WHT has to be deducted. If an EU parent company cannot credit the Austrian WHT deducted against the CIT of its resident state (e.g. because the foreign dividend income is exempted from the CIT or due to a loss position of the shareholder), it is entitled to apply for a refund of the Austrian WHT. This application has to include a confirmation/documentation that the Austrian WHT could (fully or partly) not be credited at the level of the parent company.

### *Interest WHT*

Interest payments to non-resident companies are not subject to WHT (provided no Austrian real estate property is used as security).

### *Royalties WHT*

On royalties paid to a non-resident company, Austrian WHT at a rate of 20% has to be deducted. This tax rate can be reduced under an applicable DTT or under the application of the EU Interest Royalty Directive which was implemented in Austrian Tax Law.

## *Tax treaties*

The following table lists the countries with which Austria has signed a DTT and provides details of the amount of Austrian WHT.

| Recipient | Dividends (%) (1, 2) | Interest (%) (3) | Royalties, licenses (%) (4) |
|---|---|---|---|
| Resident corporations | 0/25 (5) | 0/25 | 0 |
| Resident individuals | 25 (6) | 0/25 | 0 |
| **Non-residents:** | | | |
| **Non-treaty:** | | | |
| Corporations and business enterprises | 25 | 0 | 20 |
| Individuals | 25 | 0 | 20 |
| **Treaty:** | | | |
| Albania (7) | 15/5* | 0 | 5 |
| Algeria | 15/5+ | 0 | 10 |
| Argentina (8) (DTC was recalled by Argentina in 2008) | | | |
| Armenia | 15/5+ | 0 | 5 |
| Australia | 15 | 0 | 10 |
| Azerbaijan | 5/10/15 (9) | 0 | 5/10 (10) |
| Bahrain (11) | 0 | 0 | 0 |
| Barbados (12) | 15/5+ | 0 | 0 |
| Belarus (White Russia) | 15/5* | 0 | 5 |
| Belgium | 15 | 0 | 0/10** |
| Belize | 15/5* | 0 | 0 |
| Bosnia and Herzegovina (13) | 10/5* | 0 | 5 |
| Brazil | 15 | 0 | 10/15/25 (14) |
| Bulgaria (15) | 0 | 0 | 5 |
| Canada | 15/5+ | 0 | 10 |
| China | 10/7* | 0 | 10/6 (16) |
| Croatia | 15/0+ | 0 | 0 |
| Cuba | 15/5* | 0 | 5/0 (19) |
| Cyprus | 10 | 0 | 0 |
| Czech Republic (17) | 10/0+ | 0 | 5 (18) |
| Denmark (20) | 15/0+ | 0 | 0 |
| Egypt | 10 | 0 | 0/20 (21) |
| Estonia | 15/5* | 0 | 10/5 (22) |
| Finland | 10/0+ | 0 | 5 |
| France | 15/0+ | 0 | 0 |
| Georgia | 10/5+/0** (23) | 0 | 0 |
| Germany | 15/5+ | 0 | 0 |
| Greece (24) | 15/5* | 0 | 7 |
| Hong Kong (25) | 10/0+ | 0 | 3 |
| Hungary | 10 | 0 | 0 |
| India | 10 | 0 | 10 |
| Indonesia | 15/10* | 0 | 10 |
| Iran | 10/5* | 0 | 5 |
| Ireland | 10 | 0 | 0/10** |

# Austria

| Recipient | Dividends (%) (1, 2) | Interest (%) (3) | Royalties, licenses (%) (4) |
|---|---|---|---|
| Israel | 25 | 0 | 10 |
| Italy | 15 | 0 | 0/10** |
| Japan | 20/10** | 0 | 10 |
| Kazakhstan | 15/5+ | 0 | 10 |
| Korea | 15/5* | 0 | 10/2 (26) |
| Kuwait | 0 | 0 | 10 |
| Kyrgyzstan | 15/5* | 0 | 10 |
| Latvia (27) | 10/15* | 0 | 10/5 (28) |
| Libya (29) | | | |
| Liechtenstein | 15 | 0 | 10/5 (30) |
| Lithuania | 15/5* | 0 | 10/5 (31) |
| Luxemburg | 15/5* | 0 | 0/10** |
| Macedonia (34) | 15/0+ | 0 | 0 |
| Malaysia | 10/5* | 0 | 10/15 (32) |
| Malta | 15 | 0 | 0/10 (33) |
| Mexico | 10/5+ | 0 | 10 |
| Moldova | 15/5* | 0 | 5 |
| Mongolia | 10/5+ | 0 | 5/10 (35) |
| Morocco (36) | 10/5* | 0 | 10 |
| Nepal | 15/10+/5* | 0 | 15 |
| Netherlands | 15/5* | 0 | 0/10** |
| New Zealand (37) | 15 | 0 | 10 |
| Norway | 15/5* | 0 | 0 |
| Pakistan (38) | 15/10+++ | 0 | 10 |
| Philippines | 25/10+ | 0 | 15 |
| Poland | 15/5+ | 0 | 5 |
| Portugal | 15 | 0 | 5/10 (39) |
| Romania | 5/0* | 0 | 3 |
| Russia | 15/5* (40) | 0 | |
| Russian Federation (41) | 0 | 0 | 0 |
| San Marino | 15/0+ | 0 | 0 |
| Saudi Arabia (42) | 5 | 0 | 10 |
| Serbia (43) | 15/5* | 0 | 5/10 (44) |
| Singapore | 10/0+ | 0 | 5 |
| Slovakia (45) | 10 | 0 | 5 |
| Slovenia | 15/5* | 0 | 5 |
| South Africa | 15/5* | 0 | 0 |
| Spain | 15/10** | 0 | 5 |
| Sweden | 10/5* | 0 | 0/10** |
| Switzerland | 15/0+++ (46) | 0 | 0 |
| Syria (47) | 10/5* | 0 | 12 |
| Thailand | 25/10* | 0 | 15 |
| Tunesia | 20/10* | 0 | 10/15 (48) |
| Turkey (49) | 15/5* | 0 | 10 |
| Ukraine | 10/5+ | 0 | 5 |
| United Arab Emirates | 0 | 0 | 0 |
| United Kingdom | 15/5* | 0 | 0/10** |

| Recipient | Dividends (%) (1, 2) | Interest (%) (3) | Royalties, licenses (%) (4) |
|---|---|---|---|
| United States | 15/5+ | 0 | 0/10 (50) |
| Uzbekistan | 15/5+ | 0 | 5 |
| Venezuela (51) | 15/5++ | 0 | 5 |
| Vietnam (52) | 15/10*/5*** | 0 | 10/7.5 (53) |

Notes

1. Dividend distributions attributable to a prior release of paid-in surplus or other shareholder contributions (classified as capital reserves) are deemed to be a repayment of capital, i.e. no WHT is incurred. At the shareholder's level, dividends received and those classified as contribution refund will reduce the tax basis assessment for investments. To the extent to which the tax basis would become negative, such dividends are treated as taxable income (unless taxation is eliminated by a tax treaty).
2. Under certain treaties, the amount of the WHT is dependent on the extent of the proportion of issued share capital held by the recipient. Where this is the case, all rates are given. Those marked with + refer to an investment of 10%, ++ to 15%, those marked with +++ refer to an investment of 20%, those marked with * refer to an investment of 25%, those marked with ** refer to an investment of 50%, and those marked with *** refer to an investment of 70%.
3. Interest on cash deposits in euro or foreign currency in bank accounts and fixed interest bearing securities in foreign currency (issued after 31 December 1988) and on fixed interest bearing securities denominated in Austrian Schillings or EUR (issued after 31 December 1983) are subject to a 25% WHT. If the recipient is an individual, this WHT is final (no further income taxation and inheritance taxation). Companies receiving interest payments may obtain an exemption from WHT if they provide the bank or other custodial agent with a written confirmation from the recipient that such interest payments constitute a part of the recipient's operating revenues (exemption statement). Interest payments to non-residents without a PE in Austria are generally not subject to WHT. At interest payments between affiliated companies, the regulations stipulated by the EU interest directive have to be taken into consideration.
4. In case of payments to countries marked with **, the rate is 0% unless more than 50% of the issued share capital of the company paying the royalties is held by the recipient, in which case the rate given applies. At royalty payments between affiliated companies, the regulations stipulated by the EU interest directive have to be taken into consideration.
5. If the recipient holds a participation of less than 10% (25% prior to 2011) in the distributing company, the dividends are subject to a 25% WHT. Since dividends distributed by an Austrian corporation to another Austrian corporation are generally not subject to taxation, the WHT is credited against CIT upon assessment of the recipient corporation for the respective tax year.
6. WHT on dividends from Austrian companies is final, i.e. no further income tax is collected from the recipient (provided it is an individual).
7. The treaty was signed on 14 December 2007 and entered into force on 1 September 2008. It is applicable as of the beginning of fiscal year 2009.
8. The treaty was recalled by Argentina in 2009. Austrian tax citizens are protected by section (§) 48 BAO (Bundesabgabenordnung (Austrian Fiscal Federal Code)) against double taxation. Austria will try to enter into new negotiations with Argentina.
9. 5% for shares of at least 25% and worth at a minimum of USD 250,000; 10% for shares of at least 25% and worth at least USD 100,000; 15% in all other cases.
10. 5% for industrial licenses and know-how not more than three years old; 10% in all other cases.
11. The treaty entered into force on 17 February 2011 and is applicable as of the beginning of fiscal year 2011.
12. The treaty entered into force on 1 April 2007 and is applicable as of the beginning of fiscal year 2008.
13. The treaty was signed on 16 December 2010. It has not yet been decided when it will enter into force.
14. 10% for copyright license fees in connection with literature, science, and art; 25% for trademarks license fees; 15% in all other cases.
15. The new treaty has entered into force on 3 February 2011 and is applicable as of the beginning of fiscal year 2011.
16. 6% for industrial, commercial, or scientific equipment; 10% in all other cases.
17. The treaty entered into force on 22 March 2007 and is applicable as of the beginning of fiscal year 2008.
18. 5% for license income from copyrights, brands, plans, secret formulas or procedures, computer software, industrial, commercial or scientific use of equipment, and information.
19. 0% for copyright royalties in connection with the production of literary, dramatic, musical, or artistic work; 5% in all other cases.
20. The new treaty was signed on 25 May 2007 and entered into force on 27 March 2008. It is applicable as of the beginning of fiscal year 2009.
21. 20% for films.
22. 5% for leasing of mobile goods, and 10% for other licenses.
23. 0% for shares of at least 50% and worth at a minimum of EUR 2,000,000; 5% for shares of at least 10% and worth at least EUR 100,000; 10% for shares in all other cases.
24. The treaty entered into force on 1 April 2009 and is applicable as of the beginning of fiscal year 2010.

25. The treaty entered into force on 1 January 2011 and will be applicable as of the beginning of fiscal year 2012 (Austria: 1 January 2012, Hong Kong: 1 April 2012).
26. 2% for license income from industrial, commercial, or scientific use, and 10% for other licenses.
27. The treaty entered into force on 16 May 2007 and is applicable as of the beginning of fiscal year of 2008.
28. 5% for the use of commercial or scientific equipment; 10% in all other cases.
29. The treaty was signed on 16 September 2010. It has not yet been decided when it will enter into force.
30. 5% in case of direct (or indirect over a patent-realisation-company) payments of royalties by companies of the other member state (with an industrial establishment in the other member state), and 10% for other licenses.
31. 5% in case of license income from industrial, commercial, or scientific use, and 10% for other licenses.
32. 15% for films.
33. 0% for copyright license fees in connection with literature, art, and scientific use, and 10% for other licenses.
34. The treaty was signed on 7 September 2007 and entered into force on 20 January 2008. It is applicable as of the beginning of fiscal year 2008.
35. 10% for the right of use of copyrights to artistic, scientific, or literary as well as cinematographic works, and 5% for other licenses.
36. The new treaty was signed on 13 September 2006 and entered into force on 13 November 2006. It was applicable as of the beginning of fiscal year 2007.
37. The treaty was signed on 21 September 2006 and entered into force on 1 December 2007. It is applicable as of the beginning of fiscal year 2008.
38. The treaty entered into force on 1 June 2007 and is applicable as of the beginning of fiscal year 2008.
39. For Portugal, the rate of WHT is 5%, but 10% if more than 50% of the issued share capital is owned by the recipient.
40. 5% if capital share amounts to at least 10% and worth at least USD 100,000; 15% in all other cases.
41. The treaty applies to Tajikistan and Turkmenistan. With Russia, a new treaty has been ratified.
42. The treaty entered into force on 1 June 2007 and is applicable as of the beginning of fiscal year 2008.
43. The treaty entered into force on 17 December 2010 and is applicable as of the beginning of fiscal year 2011.
44. 5% for copyright license fees; 10% for other licenses.
45. Until a new treaty will be established, the treaty with Czechoslovakia remains applicable.
46. For dividend distributions retroactive as of 1 January 2000.
47. The treaty was signed on 3 March 2009. It has not yet been decided when it will enter into force.
48. 15% for films.
49. The new treaty was signed on 28 March 2008 and entered into force on 1 October 2009. It is applicable as of the beginning of fiscal year 2010.
50. 10% for films.
51. The treaty entered into force on 17 March 2007 and is applicable as of the beginning of fiscal year of 2008.
52. The new treaty was signed on 2 June 2008 and entered into force on 1 January 2010. It is applicable as of the beginning of fiscal year 2011.
53. 7.5% for fees for technical services; 10% for royalties.

## *Tax administration*

### *Tax returns*

The standard tax assessment period in Austria is the calendar year. However, a company's financial year may deviate. When the tax and financial years deviate, the tax assessments for a year are based on the profits derived in the financial year(s) ending in the respective calendar year (e.g. if tax year 1 June 2009 – 31 May 2010: assessment FY 2010).

### *Tax return due dates*

Generally, the CIT return has to be submitted electronically by June 30 of the calendar year following the year in which the fiscal year of the company ends. However, if the company submits the tax return via a certified tax advisor, the tax return can be submitted by 31 March of the second following year at the latest, if the company will not be formally requested by the tax office to file it earlier.

### *Statute of limitation*

The right to assess CIT is subject to a general limitation period of five years after the end of the calendar year in which the fiscal year ends. Additionally, the limitation period can be extended for another two years in cases where certain interruptive events (e.g. tax audit, tax assessment) take place within the general limitation period.

As a result of the 'Betrugsbekämpfungsgesetz 2010', the maximum limitation period in case of tax evasion was prolonged from seven to ten years. The new limitation period is applicable for cases for which the ten-year limitation period has not expired as of 1 January 2011.

In certain cases, the maximum limitation period can be extended to 15 years.

### Payment of tax

CIT is prepaid in quarterly instalments during the calendar year, with a final settlement subsequent to the annual assessment. Prepayments of CIT generally are based on the most recently assessed tax year's tax burden (unless the taxpayer can show that its tax charge for the current year will be lower).

The difference between CIT as per the final assessment and the prepayments made is interest bearing from 1 October of the year subsequent to the year when the tax claim arose up to the date when the assessment is released (late payment interest). Interest at a rate of currently 2.38% is applied to underpayments (as well as overpayments) of tax.

### Electronic filing of annual CIT returns

The annual CIT return (as well as the annual VAT return) has to be filed by electronic means. In the case of a company that cannot reasonably be expected to file tax returns electronically due to the lack of technical prerequisites, filing of the tax return is allowed to be done via pre-printed forms.

### Audit cycle

In general, companies are audited every three to four years. The audit period usually covers three to four fiscal years, so generally each fiscal year is audited.

## Other issues

### Choice of business entity

The most important types of companies in Austria are the limited liability corporation (GmbH), and the joint stock corporation (AG). Foreign investors generally choose the GmbH since it provides a higher degree of corporate law control and allows for lower equity provision.

As a legal entity, the GmbH exists upon registration with the Companies' Register. The application for registration must contain the notarised signatures of all managing directors. The articles of association must be drawn up in the form of a notarial deed (written document executed by a public notary) and must, as minimum requirements, include the name of the company as well as its seat, the business purpose, the amount of registered capital, and the capital contribution of each of the various owners.

A GmbH's minimum registered capital amount is EUR 35,000. Generally, one half of the registered capital must be raised in cash while the remainder may be contributed in the form of assets (contributions in kind). Of the original capital contribution, 25%, or at least EUR 17,500, must actually be paid in upon incorporation. Under certain conditions, the capital can be provided exclusively in the form of assets (incorporation in kind, in this case the contribution is subject to an audit verifying the market value of the assets contributed). The articles of association may provide for additional capital contributions payable by the owners on the basis of a resolution adopted by the shareholder meeting.

The minimum share capital of an AG is EUR 70,000. For an AG, the same payment regulations apply as for a GmbH, but the owners can agree upon a further capital contribution going beyond the nominal value of the shares (premium). The premium is shown on the company's balance sheet as a capital reserve.

Since 2004, the company type Societas Europaea (SE) can be chosen in Austria. The SE is a stock corporation based on community law. The advantages of this legal form are the simplification of organisational structures (in particular for international groups) and the possibility of cross-border transfers of corporation seats without loss of the legal identity. The SE allows the choice of a business location under an economic point of view as well as the choice of the most favourable legislation. The minimum share capital required for the incorporation of a SE is EUR 120,000 while the statutory seat of the corporation must be located in the same country where the place of management is located in.

### *Restructuring measures (M&A from a business perspective)*

Transfers of assets and undertakings can be realised with retroactive effect and be tax neutral within the framework of the Austrian Reorganisation Tax Act.

The legislation administers the following areas (Article I-VI):

- Mergers (within EU also cross border) of corporations.
- Special conversion (from corporations to partnerships).
- Contribution of businesses and exchange of shares.
- Merger of partnerships.
- Demerger of partnerships.
- Demerger of corporations.

If the reorganisation qualifies for the application of the Austrian Reorganisation Tax Act, the reorganisation steps are realised tax neutrally and with a retroactive effect as of the reorganisation due date. Existing tax loss carryforwards can be transferred under certain conditions as well. Furthermore, several other tax privileges are granted under the Reorganisation Tax Act for stamp duties, capital transfer tax, etc.

# Azerbaijan

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## Significant developments

There have been no significant corporate tax developments in Azerbaijan during the past year.

## Taxes on corporate income

### Tax rates

According to the changes into the Tax Code (Code) in June 2009, effective as of 1 January 2010, the profit tax rate is reduced from 22% to 20%.

### Tax base

Taxable profits are defined to be the difference between a taxpayer's gross income and deductible expenses.

Gross income encompasses all revenues received by a taxpayer from all economic activities, unless the revenues are expressly exempted under the law.

Deductible expenses encompass all properly documented expenses that are incurred in the furtherance of a taxpayer's business activities.

### Taxable persons

Profit tax is imposed on domestic enterprises, as well as permanent establishments (PE) of non-residents.

### Simplified tax system

The Code also stipulates payment of taxes based on a simplified system for enterprises not registered as VAT payers and whose annual gross revenue is less than 150,000 Azerbaijan new mantas (AZN) starting from 1 January 2010, except for enterprises producing excisable goods, credit and insurance organizations, and investment funds and professional participants in the securities market. The simplified tax is imposed on gross revenue at a rate of 4% in Baku and at a rate of 2% in other regions of Azerbaijan. A special rate of simplified tax is set for enterprises involved in residential construction at a fixed amount of AZN 10 per square metre plus an applied co-efficient, which is determined by regional executive authorities.

### Other special corporate tax regimes

There are other tax regimes applicable under special agreements concluded between the Azerbaijan government and foreign oil companies: production sharing agreements (PSA) and host government agreements (HGA). The PSA and HGA regimes apply to all enterprises involved in these agreements, including foreign oil companies functioning as contractors and foreign service companies providing services to the contractor or the operating company.

As of 1 January 2010, there are 31 signed and ratified PSAs and two HGAs, each with its own separate tax regime. Each PSA and HGA contains a tax article that outlines the tax regime for that particular agreement. While there are several similarities with respect to tax terms in the various PSAs, there are some differences, other than merely differing tax rates (e.g. taxation of foreign subcontractors) or reporting requirements. Additionally, tax protocols for each PSA and HGA, which provide specific guidance regarding the procedures for payment of taxes and filing of reports, are negotiated with the Ministry of Taxes and other executive authorities.

## *Corporate residence*

A resident enterprise is any legal entity established in accordance with the legislation of the Azerbaijan Republic and performing entrepreneurial activity or any entity that is managed in Azerbaijan.

### *Permanent establishment (PE)*

A PE of a foreign legal entity is also subject to taxation with respect to the income attributable to such PE. A PE is an establishment of a foreign legal entity, through which it fully or partially performs commercial activities (for these purposes, a PE may be considered a management unit, office bureau, agency, construction site, etc.) for more than 90 consecutive days within any 12-month period. Activities of auxiliary or preparatory nature (e.g. exclusively storing or exhibiting goods or products belonging to a non-resident, purchasing goods, or collecting data by a non-resident enterprise for its own purposes) do not create a PE.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is levied on the supply of goods and services and on the import of goods.

#### VAT rates

The standard rate of VAT is 18%.

Zero rating applies to the following:

- Exportation of goods and services.
- Importation under the PSA and HGA regimes.
- Importation of goods, the supply of goods, and the implementation of works and provision of services to grant recipients on the expense of financial aid (grants) received from abroad.
- International and transit cargo and passenger transportation, as well as the supply of works and services directly connected with international and transit flights.
- The supply of gold and other valuables to the National Bank of Azerbaijan.

#### Taxable persons

Any person who is, or is to be, registered as a VAT payer is regarded a taxable person.

Companies are required to register for VAT if their taxable income exceeds AZN 150,000 for the previous 12 months beginning from 1 January 2010 (previously, it was AZN 22,500 and three months respectively).

**Taxable transactions**
Supply of goods and services in Azerbaijan and imports into Azerbaijan are subject to VAT.

**Taxable amount**
The taxable base is established by starting with the value of the goods and services without adding the VAT amount, but including any customs duty and excise duty if applicable.

The value of taxable imports consists of the value of the goods determined in accordance with the customs legislation and taxes and duties (other than VAT) to be paid upon importation to Azerbaijan.

The amount of VAT to be paid is the difference between the amount of VAT received on taxable supplies of goods and services and VAT paid on the purchase of goods and services necessary to generate taxable supplies of goods and services.

The Cabinet of Ministers can grant exemptions for the import of goods and equipment used for production purposes or to provide advanced technology know-how. Such exemptions are granted for a specific period and in a specific area, and can only be granted if it is impossible to satisfy the respective needs from local resources.

***Excise duty***
Excise duties are imposed on tobacco products, alcoholic beverages, light vehicles, leisure and sports yachts, petroleum, and lubricants.

**Taxable persons**
Excise duties are paid by companies and organizations, including companies with foreign investment, as well as branches, divisions, and other independent subdivisions of companies in Azerbaijan that render services and sell self-produced goods.

**Taxable operations**
The following operations are subject to excise duties:

- Release of excise goods produced in Azerbaijan outside the premises of the building in which they were produced.
- Import of excise goods pursuant to the customs legislation of Azerbaijan.

***Property tax***
Property tax is levied on both movable and immovable tangible assets owned by individuals and companies.

**Property tax rates**
Property tax is imposed on the average annual book value of the taxable property at the rate of 1%.

**Taxable persons**
Taxable persons are comprised of the following:

- Resident companies, including companies with foreign investment that are treated as residents under Azerbaijani law, international organisations engaged in economic activities, and other enterprise.
- Branches and affiliated companies of such taxpayers.
- Agencies and representative offices of foreign legal entities located in Azerbaijan.
- Non-resident companies performing activities through a PE on the territory of Azerbaijan.

Enterprises can combine their assets and cooperate as joint owners. Joint owners are liable to pay tax according to their interest in the property concerned.

**Tax base**
The tax base varies according to the residency status of the taxpayer. Resident companies are subject to tax on their tangible assets recorded on their balance sheet. Non-resident companies carrying out a business activity through a PE in Azerbaijan are only subject to tax on their tangible assets connected with the PE.

The following assets are exempt:

- Facilities used for the purposes of the environment, fire protection, and civil defence.
- Product lines, railways and motorways, communication and power lines, and melioration and watering facilities.
- Automobile transport taxed for the road tax.
- Facilities of companies involved in education, health, culture, and sports that are used only for the purposes of such areas of activity.

**Administration**
Companies are required to report the average annual value of taxable property and pay tax on a quarterly basis, subject to any necessary recalculations at the end of the year. Tax payments are due within 15 days of the second month of each quarter. The payment should be 20% of the previous year property tax amount.

The tax on water and air transport means is estimated on 1 January each year by the tax offices based on data provided by the organizations responsible for registration of means of transport. The tax is assessed on the person named in the registration document.

When an asset changes ownership during the tax year, the tax liability is defined as the liability of the new owner.

### *Land tax*
Land tax is levied on Azerbaijan's land resources that are in the possession of or used by individuals or companies.

**Land tax rates**
The rate of land tax for agricultural land is AZN 0.06 per unit. The units are determined by the relevant authority on the basis of the purpose, geographical location, and the quality of agricultural land in the administrative regions.

The rate of land tax for industrial, construction, transport, telecommunications, trade and housing servicing, and other dedicated land varies from AZN 2 to 10 per 100 square metres, depending on the city or region.

**Taxable persons**
Companies and individuals who own, hold, or use land must pay land tax.

**Taxable base**
Land plants that are in ownership or used are subject to land tax. Exemptions apply to various types of land owned or used for public purposes by the state or other public authorities. The government may grant further tax exemptions and reliefs.

**Assessment and procedure of payment**
Companies must compute the exact amount of the land tax each year on the basis of documents evidencing the title of ownership, possession, and use. The computation must be submitted to the tax authorities by 15 May of each year. The tax must be paid by 15 August and 15 November in equal amounts.

Individuals receive each year, before 1 July, a calculation from the authorities for the tax amount due by them. The tax must be paid by 1 August.

## *Branch income*

In addition to profit tax paid by a PE of a non-resident, the amount transferred from the net profit of such PE to the non-resident is taxed at the source of payment at a rate of 10%.

## *Income determination*

Profit tax is levied on an enterprise's taxable profits. Profits are defined as the difference between the gross income and deductions defined by law.

### *Inventory valuation*
Inventory valuation is determined according to national accounting standards.

No inventory valuation method is stipulated for tax purposes.

### *Capital gains*
There is no separate capital gains taxation in Azerbaijan. Proceeds from the disposal of capital assets are included in the ordinary taxable income.

### *Dividend income*
Dividends received from Azeri sources and previously subject to withholding tax (WHT) (taxed at the source of payment) are not included in the taxable profits of the Azerbaijani recipient.

### *Inter-company dividends*
Inter-company dividends distributed to residents and non-residents are subject to WHT (taxable at sources upon payment). Therefore, the received dividend amounts of legal entities and physical persons are not taxable for profit (income) tax purposes.

### *Foreign income*
Resident taxpayers must pay tax on worldwide income. A non-resident enterprise operating in Azerbaijan through a PE must pay tax on the gross income generated from Azerbaijan sources less any related deductions attributable to the PE.

According to the Tax Code, if a resident of the Azerbaijan Republic directly or indirectly holds more than 20% of shareholders' equity or possesses more than 20% of the voting shares of a foreign legal entity that, in turn, received income from a state with a favorable taxation, then such income shall be included in the resident's taxable income.

A state with a favorable taxation is considered a country in which the tax rate is two or more times lower than that determined under the Tax Code of Azerbaijan Republic, or a country in which the laws on confidentiality of information about companies exist, which allow secrecy to be maintained concerning financial information, as well as the actual owner of property or income receiver.

Gross income of a non-resident enterprise generated from Azerbaijan sources and not connected with a PE will be taxed at the source of payment without any deductions allowed for expenses.

A non-resident enterprise generating income through the assignment of property not connected with a PE shall pay tax on the gross income received during a calendar year from Azerbaijan sources, after deducting expenses for the period that relates to such income.

## Deductions

All expenses connected with generating income, except for non-deductible expenses and expenses with limited deductibility, specifically defined by the law, are deductible from income.

Road, property, land, and mining taxes are also deductible.

### Non-deductible expenses

Non-deductible expenses are:

- Capital expenses.
- Expenses connected with non-commercial activity.
- Entertainment and meal expenses, accommodation, and other expenses of a social nature incurred for employees.

### Expenses deductible within certain limits

- Interest on loans received from overseas and/or from related parties may be deducted, limited to the interest rate on loans with similar currency and maturity at the interbank credit auction. In absence of such an auction, deductions for interest may not exceed rates of 125% of the interbank auction credit rates published by the National Bank of Azerbaijan Republic.
- The amount of repair expenses deductible each year is limited to the amount of the tax written down value of each category of fixed assets as of the end of the previous year. For buildings and premises the limit is 2%, for machinery and equipment the limit is 5%, and for other fixed assets the limit is 3%. An amount exceeding these limits shall be taken as an increase of the residual balance value of the fixed assets in the appropriate category.
- Actual business trip expenses are deductible from income within the standards established by the Cabinet of Ministers.
- A legal entity engaged in insurance activities is entitled to deduct allocations to reserve insurance funds within the standards established by the legislation of the Azerbaijan Republic.

- A taxpayer shall be entitled to a deduction for doubtful debts connected with goods, work, and services that have been realised where income from them was previously included in the gross income received from entrepreneurial activity. Doubtful debt deduction shall be allowed only if the debt is written off as worthless in taxpayer's books.
- Banks and credit entities engaged in certain types of banking activities shall be entitled to deduct from income the amounts assigned for establishment of special reserve funds, depending on the classification of assets in compliance with legislation, and in accordance with procedures established by the relevant executive authority.

### *Depreciation*
Depreciation may be calculated at the following rates:

- Buildings and premises: up to 7%.
- Machines, equipment, and calculation appliances: up to 25%.
- Means of transportation: up to 25%.
- Working cattle: up to 20%.
- Expenses incurred for geological and exploration works, as well as for preparatory works for the production of natural resources: 25%.
- Intangible assets with an undetermined period of use: up to 10%. For those with a determined period of use, pro-rata amount as per the useful life, in years.
- Other fixed assets: up to 20%.

### *Net operating losses*
Taxable losses incurred by legal entities may be carried forward for five years to offset future taxable profit, without limitations.

## *Group taxation*

Each taxpayer is liable to fulfil one's own tax liabilities. Azeri tax legislation does not have the concept of 'group taxation'.

## *Tax credits and incentives*

The rate of profit tax levied on production enterprises belonging to community organizations for disabled persons, and involving at least 50% of disabled persons, shall be reduced by 50%.

In determining eligibility for these privileges, disabled persons substituting permanent employees, contractors (i.e. who work under contractor agreements, civil legal contracts), or disabled persons till the age of 18 are not included into the average number of employees.

Banks, insurance, and re-insurance companies are exempt from profit tax on profit distributed for increasing their nominal equity (so called, charter capital) until 2012.

Taxpayers producing agriculture products are exempt from profit tax, VAT, and property tax until 2013.

### *The Law on the Special Economic Regime for Export-Oriented Oil and Gas Activities*

The Law on the Special Economic Regime for Export-Oriented Oil and Gas Activities was adopted in April 2009 and will remain effective for 15 years. This law avails the following tax incentives to contractors and subcontractors (excluding foreign subcontractors without permanent establishment in Azerbaijan):

- Local companies are permitted to choose between (i) profit tax at a rate of 20% or (ii) 5% WHT on gross revenues.
- Foreign subcontractors are taxable only by a 5% WHT.
- A 0% VAT rate.
- Exemption from dividend tax and taxation on branch's net profits.
- Exemption from customs duties and taxes.
- Exemptions from property tax and land tax.

In order to derive these benefits, the relevant taxpayer should obtain a special confirmation certificate from the Ministry of Industry and Energy.

### *The Law on Special Economic Zones*

The Law on Special Economic Zones (SEZ) became effective in June 2009. The companies operating in these zones shall have the following tax benefits:

- A 0.5% tax levied on profits from supplied goods, performed services, or works.
- A 0% VAT rate.
- Customs exemptions.

In order to operate in a SEZ, a special residency certificate is necessary. However, the following companies may not apply for this certificate:

- Parties producing or processing oil and gas.
- Parties producing alcoholic beverages and tobacco.
- Television or radio broadcasting companies.

As of January 2011, no SEZ were established in Azerbaijan.

### *Foreign tax credit for residents*

Azeri legal entities are taxed on worldwide profit; however, any tax paid overseas up to the tax amount that would be calculated under Azeri law will be allowed to offset the Azeri profits tax. The tax credit may not exceed the tax that would be imposed on such income in Azerbaijan. This credit applies only to residents of Azerbaijan.

## *Withholding taxes*

Income received from Azerbaijan sources not attributable to a PE (base) of a non-resident in Azerbaijan is subject to WHT at the following rates:

- Dividends paid by resident enterprises: 10%.
- Interest paid by residents, PEs of non-residents, or on behalf of such PEs (except for interest paid to resident banks or to PEs of non-resident banks): 10%.
- Rental fees for movable and immovable property: 14%.
- Royalties: 14%.
- Leasing, risk insurance, or reinsurance payments: 4%.
- Telecommunications or international transport services: 6%.

- Other Azeri-source income: 10%.

If a resident enterprise or a PE of a non-resident receives interest, royalties, or rental fees taxable at the source of payment in Azerbaijan, it is entitled to consider the tax deducted from the source of payment, providing the documents supporting the tax deduction are in place.

## *Tax administration*

### *Returns*

Resident enterprises and PEs of non-residents must file profit tax returns for a calendar year by 31 March of the following year. During liquidation of a legal entity or a PE of a non-resident, the tax return should be submitted within 30 days after the adoption of a decree on liquidation.

A non-resident that has no PE in Azerbaijan and receives income subject to WHT (except for dividends and interest) may file a tax return with respect to such income and expenses, connected with the generation of the income, for purposes of reassessment of profit tax at the rate of 20%.

If a taxpayer applies for an extension of time to file the profit tax return prior to the expiration of the filing deadline and at the same time settle the full tax amount due, the filing deadline may be prolonged for up to three months. The prolongation of the terms for filing the return will not modify the terms of tax payment.

Legal entities and entrepreneurs that withhold tax at the source of payment are obliged to file the WHT report with the tax authority within 20 days following the end of the quarter.

### *Tax payments*

Taxpayers must make advance quarterly tax payments of profit tax by the 15th day of the month following the end of the calendar quarter. Payments are determined either (i) as 25% of tax for the past fiscal year or (ii) by multiplying the amount of actual income through the quarter by a ratio of tax to gross income for the previous year.

# Bahrain

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## Significant developments

There have been no significant corporate tax developments in Bahrain during the past year.

## Taxes on corporate income

There are no taxes in Bahrain on income, sales, capital gains, or estates, with the exception in limited circumstances to businesses (local and foreign) that operate in the oil and gas sector or derive profits from the extraction or refinement of fossil fuels (defined as hydrocarbons) in Bahrain. For such companies, a tax rate of 46% is levied on net profits for each tax accounting period. A company's accounting period should normally follow the (Gregorian) calendar year.

## Corporate residence

Income Tax Law No. 22 of 1979 does not define residence. In the case of businesses operating in the oil and gas sector, profits from taxable activities in Bahrain are taxed in Bahrain irrespective of the residence of the taxpayer.

## Other taxes

There are no other taxes on corporate income levied in Bahrain. However, companies are subject to stamp duties, customs duties, as well as a series of corporate registration fees, licence fees, and certain municipal taxes (e.g. taxes on leases of property and registration of land title).

## Branch income

Profit from branch income is taxable in Bahrain if it is derived from activities in the oil and gas sector.

## Income determination

There are no specific rules with respect to the calculation of specific items of income, such as inventory valuation, capital gains, inter-company dividends, foreign income, or stock dividends. However, the income tax law requires the taxable profits to be calculated using generally accepted accounting principles.

## Deductions

The law generally allows deductions for all costs associated with taxable activities in Bahrain, such as the cost of production, refinement, remuneration of employees associated with these taxable activities (including social insurance and pensions paid for the benefit of these employees), and other operational losses.

### Depreciation and depletion

Tax deductions may be claimed with respect to reasonable amounts for depreciation, obsolescence, exhaustion, and depletion incurred during the taxable year for properties used by the taxpayer in a trade or businesses from which income, taxable under the income tax law, is derived. Generally, such amounts may be claimed on a straight-line basis over the estimated remaining useful life of the properties, unless otherwise approved by the Minister of Finance.

### Taxes

All taxes and duties not imposed by the Bahrain income tax law, including customs duties, may be deducted from the taxable income as stipulated in Bahrain's income tax law.

### Other significant items

All reasonable and justifiable costs of production and exploration of products sold during the current taxable year are deductible for tax purposes, provided that these expenses have not been deducted elsewhere in calculating net taxable income.

### Net operating losses

Unutilised losses may be carried forward and deducted up to an amount equivalent to the net income in future years as defined by the Bahrain income tax law. Carryback of losses is not permitted.

### Payments to foreign affiliates

There are no specific restrictions in the income tax law pertaining to payments made to foreign affiliates.

## Group taxation

There is no legislation or mechanism for group relief or the taxation of group activities in Bahrain.

## Tax credits and incentives

There are no tax incentives in Bahrain.

## Withholding taxes

There are no withholding taxes on the payment of dividends, interest, or royalties.

### Tax treaties

Bahrain has double tax treaties in force with various countries including Algeria, Austria, Belarus, Brunei, Bulgaria, China, Egypt, France, Iran, Ireland, Jordan, Lebanon, Luxembourg, Malaysia, Morocco, Netherlands, Pakistan, Philippines, Singapore, Syria, Thailand, Turkey, and Yemen.

## *Tax administration*

### *Returns*

An estimated income tax statement must be submitted on or before the 15th day of the third month of the taxable year. Where applicable, a taxpayer may also be required to file an amended estimated income tax statement quarterly, unless a final income tax statement has been provided.

Approved accountants must prepare a certified tax return for the return to be acceptable to the authorities.

### *Payment of tax*

Taxes are payable in 12 equal monthly instalments. Payments are due starting the 15th day of the fourth month of the taxable year. Income tax as per the final/amended income tax statement will form the basis of tax payments for the next 12 months, and any excess income tax paid will be credited and used in the first invoice following the establishment of the credit by the Minister.

# Barbados



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## Significant developments

During calendar 2010, Barbados signed double tax treaties with Panama, Portugal, and Spain. A protocol to the double tax treaty with the Peoples Republic of China was also concluded.

On 1 December 2010, the rate of the value-added tax (VAT) increased to 17.5% from 15%, and the environmental levy was abolished.

## Taxes on corporate income

Companies resident in Barbados are taxed on their worldwide income for the profits of the company earned in a fiscal period not to exceed 53 weeks. Non-resident companies are generally only taxed on income derived from sources and operations conducted within Barbados.

### Corporate income tax (CIT) rates

The following rates apply to taxes on corporate income:

| Type of entity | CIT rate (%) |
|---|---|
| Regular companies | 25 |
| Small companies (1) | 15 |
| Manufacturing companies (2) | 15 |
| Approved developers in special development areas | 15 |
| International business companies, international banks, and international societies with restricted liability | 2.5 to 1 |
| Life insurance companies (computed on gross investment income) | 5 |
| Companies engaged in the construction of houses (3) | 15 |

Notes

1. This concessionary tax rate is available to any small company as defined in the Small Business Development Act.
2. This concessionary tax rate is available only to companies registered as manufacturers with the Barbados Customs & Excise Department.
3. Selling price of the houses must be less than 400,000 Barbados dollars (BBD), including the house and land.

# Barbados

## Corporate residence

A corporation is deemed to be resident in Barbados if its management and control is exercised in Barbados.

## Other taxes

### Value-added tax (VAT)

As of December 1, 2010, VAT is levied at the rate of 17.5% (previously 15%) on the value of a wide range of goods and services imported or supplied in Barbados by VAT registered persons. A number of services, including financial services, real estate, medical services, and education are exempt. Intergroup transactions are taxable.

Persons operating under Barbados' VAT regime must be registered for VAT. Beginning 1 December 2010, the threshold for VAT registration is BBD 80,000 (previously BBD 60,000), but voluntary registration is permitted for persons whose annual turnover is less than BBD 80,000 (previously BBD 60,000).

Certain supplies are zero-rated, including exports, basic food items, prescription drugs, crude oil, and the supply of certain items to the international financial services sector, e.g. legal and accounting fees. There is a concessionary rate of 8.75% as of 1 May 2011 (previously 7.5%) applicable to the supply of accommodation by guest houses, hotels, inns, or any similar place, including a dwelling house normally let or rented for use as a vacation or holiday home.

Registered persons may deduct input tax from their output tax in calculating the tax payable for that VAT accounting period. Where input tax exceeds output tax, the registrant will be entitled to a refund of VAT.

### Land tax

The following land tax rates are currently in effect:

| **On the improved value of each parcel of land on which there is a dwelling house that is used exclusively for residential purposes:** | |
|---|---|
| On first BBD 150,000 | 0 |
| On amounts between BBD 150,000 and BBD 400,000 | 0.10% of the improved value |
| On amounts between BBD 400,000 and BBD 1,000,000 | 0.45% of the improved value |
| On amounts exceeding BBD 1,000,000 | 0.75% of the improved value |
| On the improved value of each parcel of land on which there is a building other than a residence | 0.65% of the improved value |
| On the site value of each parcel of unimproved land | 0.60% of the site value |

The following concessions have been granted for land taxes:

- For villas, as defined by the Tourism Development Act, land tax is calculated and payable on only 75% of the improved value of the property.
- For hotels, as defined by the Tourism Development Act, land tax is calculated and payable on only 50% of the improved value of the property.

- For pensioners occupying their own homes, land tax is calculated and payable on only 50% of the improved value of the property in excess of BBD 150,000 (effective from 1 April 2008).
- For land used for agricultural purposes, a rebate of 50% of the land tax paid is granted.

A 10% discount is granted if the land tax is paid within 30 days from the date of the tax demand notice or 5% if paid within 60 days.

### *Customs duties / import tariffs*
Customs duty is levied on a wide range of imported goods at rates specified in Part 1 of the First Schedule of the Customs Act. Barbados' Customs Tariff is based on the Common External Tariff of the Caribbean Common Market (CARICOM) with special derogations for certain items, e.g. spirituous beverages. Customs duty is calculated on either an *ad valorem* basis or at specific quantitative rates. The ad valorem rates for most items vary between 0% and 20%, but certain goods regarded as luxury items are subject to higher rates (e.g. jewellery 60%). In addition, a select group of items that are produced within Barbados and CARICOM (including some agricultural products) are subject to a duty rate of 60% when imported from outside the region.

Manufacturers and agriculturists, including persons involved in fishing and horticulture, are exempt from the payment of duty on inputs (including packaging materials, machinery, equipment, and spares) imported for use in their businesses.

The various departments and institutions, international bodies and organisations listed in Part II-B of the Customs Tariff are exempt from the payment of customs duty. Specific goods (e.g. computers), also mentioned in Part II-B, are exempt from customs duty.

### *Excise taxes*
Excise taxes existed in Barbados prior to the introduction of VAT in 1997, but these were confined to products of the rum industry. As of 1 January 1997, four categories of goods (both locally manufactured, as well as imported) became subject to excise taxes. These are motor vehicles, spirituous beverages, tobacco products, and petroleum products. Most excisable goods are subject to the tax at a specific rate, with the exception of motor vehicles, which are subject to *ad valorem* rates.

A few persons and goods are exempt from excise taxes. These include motor vehicles imported by the diplomatic corps, and other organisations exempt from customs duty under Part II-B of the Customs Tariff, goods imported for temporary use or for a temporary purpose that will be re-exported within 3 months, and goods (other than spirits) intended to be used as raw materials for the manufacture or production in Barbados of other taxable goods.

### *Property transfer taxes*
Property transfer taxes are levied as set out in the following table:

| | |
|---|---|
| Shares of companies listed on the Barbados Stock Exchange | Exempt |
| Shares of private companies* | 2.5% of value or amount of gross consideration above BBD 50,000 |
| Land with a building | 2.5% of value or amount of gross consideration above BBD 150,000 |
| Land with no building | 2.5% of value or amount of gross consideration |

| | |
|---|---|
| Leases of 25 years or more or short-term leases that are continuously renewed for a period equal to 25 years or more | 2.5% of value or amount of gross consideration |

*Any transfer of shares to a person who is resident outside of Barbados, whether or not the transferor is resident in Barbados, where the assets of the company concerned consists of foreign assets and its income is derived solely from sources outside Barbados, will not be subject to transfer taxes in Barbados.

### *Land development duty*
Where a person disposes of property situated in a specially designated development area within 15 years of the date specified by statute, duty may be charged. This may be at rates of up to 50% on the excess of the value of the consideration over the improved value at the specified base date, plus certain other expenses and an amount representing capital appreciation of the property.

### *Stamp duty*
Barbados imposes a stamp duty tax on various instruments, including written documents. The rates imposed vary depending on the document. Stamp duty applicable to documents for the transfer of shares, real estate and for mortgages are set out below:

| | |
|---|---|
| On sale of shares of companies listed on the Barbados Stock Exchange | 0 |
| On sale of real estate, leases, and shares in public companies* | BBD 10 per BBD 1,000 or part thereof |
| On mortgages | BBD 3 on each BBD 500 or part thereof |

*Any transfer of shares to a person who is resident outside of Barbados, whether or not the transferor is resident in Barbados, where the assets of the company concerned consists of foreign assets and its income is derived solely from sources outside Barbados, will not be subject to transfer taxes in Barbados.

### *Life insurance premium tax*
In addition to the CIT computed on the gross investment income of life insurance companies, a life insurance premium tax is levied on gross direct premium income earned by resident and foreign life insurance companies as set out in the following table:

| | Resident life insurance companies | Foreign life insurance companies |
|---|---|---|
| New business written for the income year | 6% | 6% |
| Renewal business | 3% | 5% |

### *General insurance premium tax*
In addition to the CIT computed on the gross investment income of general insurance companies, a general insurance premium tax is levied on gross direct premium income at a rate of 4.75% in respect of property insurance business and 4% for other general insurance business.

### *Environmental levy*
The environmental levy was abolished effective 1 December 2010.

Prior to that date, an environmental levy was in force in Barbados, and its main purpose was to defray the cost of the disposal of refuse generated by the use of goods imported into Barbados. The general rates were either 2% or 3% of the CIF (cost, insurance, and freight) of all goods, both imported and local, but some items were subject to specific rates, e.g. motor vehicles BBD 1,500 per vehicle and BBD 300 for other vehicles. Certain persons were exempt from the payment of this levy, including those organisations listed in Part II-B of the Customs Tariff, the international financial services sector, manufacturers, and the diplomatic corps.

## Branch income

Branches are taxed on the same basis as corporations. In addition, a 10% tax is assessed on the transfer or deemed transfer of the after-tax profits to the head office that are not reinvested in Barbados, unless a double taxation agreement overrides this.

## Income determination

### Inventory valuation

Inventory is generally stated at the lower of cost and net realizable value. First in first out (FIFO) or average values are generally used for book and tax purposes. Last in first out (LIFO) is not acceptable for tax purposes. The Inland Revenue will normally accept a method of valuation that conforms to standard accounting practice in the trade. Conformity between book and tax values is expected.

### Capital gains

Capital gains are not taxed in Barbados.

### Interest income

Amounts received on account of, in lieu of, or in satisfaction of interest are included in the calculation of assessable income. In certain instances (to the extent specified by regulation) certain types of interest may be exempt from inclusion into the calculation of assessable income, including interest on bonds, debentures, or stock of the Government of Barbados that is beneficially owned by a non-resident; interest on tax reserve and tax refund certificates; and interest on holdings (within certain limits) of National Development Bonds, National Housing Bonds, Savings Bonds, and Sugar Industry Bonds classified as non-taxable bonds, as well as interest income from some CARICOM countries.

### Partnership income

Amounts received from a partnership or syndicate for the income year, regardless of whether or not these amounts were withdrawn during the income year, are included in the calculation of assessable income.

### Foreign income

A Barbados corporation is taxed on foreign branch income as earned. Double taxation is avoided by means of foreign tax credits or an exemption where double taxation treaties exist.

## Deductions

Business expenses that are reasonable and incurred for the purpose of producing assessable income are deductible for tax purposes unless disallowed by a specific provision of the Income Tax Act. Deduction of capital expenditures is specifically prohibited, but special provisions may allow tax depreciation of these expenditures.

## *Depreciation*
Depreciation for tax purposes is computed on a straight-line basis at prescribed rates. The process is accelerated by additional initial allowances in the year of acquisition. Conformity between book and tax depreciation is not required. Gains on sales of depreciable assets are taxable as ordinary income up to the amount of tax depreciation recaptured, and losses on sales below depreciated value are deductible.

### Capital allowances

| Initial allowance | Rate |
|---|---|
| Plant and machinery | 20% |
| Industrial buildings | 40% |

| Annual allowance | Rate |
|---|---|
| Plant and machinery | Various rates |
| Industrial buildings | 4% |
| Intellectual property | 10% of 50% of the amount expended |

| Investment allowance (an incentive allowance limited by statute to entities operating in certain industries) | Rate |
|---|---|
| Basic industry* | 20% |
| Businesses or persons entitled to export allowance for exports outside of CARICOM countries | 40% |
| Business engaged in the manufacture and refining of sugar | 40% |
| Business engaged in the manufacture of clay and limestone products | 40% |

Notes

*As prescribed by the regulations to the Barbados Income Tax Act.

This allowance is not deducted from the cost of the asset in calculating tax written down value.

### Manufacturing allowance
Capital allowances are more complex for companies involved in the manufacturing sector, who are granted an additional 50% of the annual allowance claimed in an income year. Such companies are also often able to claim investment allowances. Please note that any company that is able to claim an investment allowance cannot also claim an initial allowance.

### Commercial building allowance
A deduction is available in respect of a commercial building. For each income year, the available allowance is calculated as 1% of the land tax improved value, or 10% of the land tax improved value if the building is registered with the National Trust.

## *Depletion*
For oil and gas companies, depending on certain circumstances, a depletion allowance of 20% or 10% is given in addition to annual depreciation on prescribed types of capital expenditure.

## *Bad debt*
Amounts representing debts owed that have been established as bad debts during the income year and have been previously included in calculating assessable income for that income year or a previous income year are deductible in calculating assessable income.

### Pension expenses
Contributions made by companies under pension schemes that are approved by the Commissioner are deductible in calculating assessable income.

### Taxes
Taxes on income are not deductible.

### Net operating losses
No carryback is allowed for CIT losses. Losses can generally be carried forward for nine years after the income year in which they are incurred and may be applied in full against future taxable profits. Notwithstanding this, a tax loss incurred by a person in respect of residential property can only be deducted against assessable income earned by that person in respect of residential property.

Losses of general insurance companies can only be carried forward for five years, and losses of life insurance companies cannot be carried forward at all.

### Payments to foreign affiliates
A Barbados corporation can claim a deduction for royalties, management fees, and interest charges paid to foreign affiliates, provided that payments are no greater than what it would pay to an unrelated party.

## Group taxation

Trading losses (i.e. the tax loss for the year, excluding capital allowances) incurred during an income year of a surrendering company may be set off wholly or partially against the profits of a claimant company, where both are members of the same group (defined as where one company is a 75% subsidiary of another, or both companies are 75% subsidiaries of a third company).

Group relief is not available to companies operating in the international business and financial services sector or any other company which is operating under concessionary legislation.

### Transfer pricing regime
Although Barbados has no specific transfer pricing legislation or regulations in place, the Income Tax Act does contain a section dealing with artificial transactions. This enables the revenue authorities to amend the assessable income of a person where they believe the main purpose of a non-arm's-length transaction is to artificially reduce that person's assessable income.

In such circumstances, the transaction is disregarded or modified to achieve the effect that it no longer results in the artificial reduction of that person's assessable income.

### Treatment of inter-company items
Dividends between two companies resident in Barbados are not taxed in the hands of the recipient. Dividends received by a resident Barbados company from a non-resident entity where the equity interest owned is at least 10% of the non-resident company and the shareholding is not held solely for the purpose of portfolio investments are not subject to tax. Dividends paid to a non-resident company are subject to 15% withholding tax (WHT) unless a double taxation agreement (DTA) overrides or reduces this WHT, or the dividends are paid out of income earned from sources outside of Barbados, or exemption is granted under specific legislation.

### Thin capitalisation rules
Barbados does not have tax provisions relevant to thin capitalisation.

### Controlled foreign company (CFC) regime
Barbados does not have tax provisions relevant to CFCs.

## Tax credits and incentives

### Foreign tax credit
Barbados allows a credit for foreign taxes (taxes paid in jurisdictions outside Barbados). The credit should not exceed the Barbados tax attributable to the income derived outside Barbados.

### Agricultural cash rebate
The following rebate may be claimed on agricultural or agro-processing machinery or plant that is new or imported into the island for the first time:

- Sugar cane harvesters: 10% or 15%.
- Other: 18%.

### Export allowance
There is a rebate of tax under the Income Tax Act in respect of income from export sales outside CARICOM. The maximum tax credit on eligible sales is 93%, which is available where eligible sales exceed 81% of total sales.

### Exempt Insurance Act
The Exempt Insurance Act is applicable to companies in Barbados that insure risks and earn premiums outside the island and for companies that manage the former. Under the Act, both types of companies are exempt from exchange control regulations. In lieu of standard CIT rates, exempt insurance companies are subject to tax at the rate of 0% for the first 15 years; thereafter, the rate is 8% on the first BBD 250,000 of taxable income and 0% on taxable income in excess of BBD 250,000. No WHT is levied on remittances of dividends or interest.

Exempt insurance companies are subject to an annual license fee of BBD 20,000.

### Fiscal Incentives Act
The Fiscal Incentives Act provides to manufacturers of an ‘approved product’ a full exemption from taxes and duties for varying periods, up to a maximum of 15 years.

### Foreign currency earnings credit
Persons carrying on business in Barbados may claim a tax credit of up to 93% of CIT on net profits from foreign currency earnings derived from construction projects or professional services undertaken outside of CARICOM or international insurance business.

### Housing Incentives Act
The Housing Incentives Act provides CIT, import duty, WHT, and other concessions to developers who implement low income housing projects. Approved developers are subject to CIT at a rate of 15%.

### *International Business Companies (IBCs) Act*

International business companies resident in Barbados but deriving income solely from sources outside Barbados are taxed at the following rates:

| Taxable income | Rate (%) |
|---|---|
| Up to BBD 10,000,000 | 2.5 |
| BBD 10,000,000 - BBD 20,000,000 | 2 |
| BBD 20,000,000 - BBD 30,000,000 | 1.5 |
| In excess of BBD 30,000,000 | 1 |

Freedom from exchange controls is granted to IBCs, as well as duty-free concessions on certain imports. No WHT is levied on remittances of dividends, royalties, interest, management fees, fees, or other income paid by IBCs to persons outside Barbados. IBCs may also claim a credit for taxes paid outside Barbados, provided that this does not reduce the company's rate of CIT in Barbados to less than 1%.

IBCs are subject to an annual license fee of BBD 850.

### *International Financial Services Act (IFSA)*

The IFSA provides for the establishment of international banking, trust administration, and other related or ancillary services by eligible companies incorporated in Barbados or branches of qualified foreign banks. An annual licence fee of BBD 100,000 is payable by IFSA licensees that take third party deposits, while IFSA licensees who take only related party deposits are required to pay BBD 50,000.

International financial service entities are exempt from exchange controls and are granted duty-free concessions on certain imports. Profits and gains are taxed at the same rates as for IBCs. No WHTs are levied on remittances of dividends, interest, or fees. International financial service entities may also claim a credit for taxes paid outside Barbados, provided that this does not reduce the entity's rate of CIT in Barbados to less than 1%.

### *International Trust Act*

The International Trust Act is aimed at facilitating the use of Barbados trusts for purposes previously made possible in many tax free financial centres. An international trust is taxed in Barbados as an individual that is resident but not domiciled in Barbados. This allows the trust to take advantage of a network of tax treaties while not subjecting its foreign earnings to Barbados tax unless they are remitted there. The Act exempts trusts from exchange control and WHT requirements. No registration is required.

### *Market development allowance for export sales or the tourist industry*

150% of certain expenditure on research and development for export sales outside of CARICOM or on tourism development is deductible.

### *Shipping (Incentives) Act*

The Shipping (Incentives) Act was enacted to encourage the development of Barbados' shipping activities by granting CIT, import duty, WHT and other concessions to approved shipping companies for a period of ten years.

### *Small Business Development Areas Act*

Companies incorporated under the Companies Act with at least 75% of their shares owned locally and having share capital of not more than BBD 1 million, annual sales not in excess of BBD 2 million, and not more than 25 employees may obtain approval as a small business. Such companies pay CIT at a reduced rate of 15% and are exempt from the payment of import duties on equipment imported for use in the business and from stamp duty on all documents related to the business that must be registered. In addition, 120% of certain expenditures directly related to the development of the business are deductible for tax purposes. Investors in such businesses are exempt from WHT on interest and dividends earned on their investment.

### *Societies with Restricted Liability (SRL) Act*

An SRL is a hybrid entity that can be recognized as a corporation or partnership in certain jurisdictions depending on the nature of its organizational documents. The entity has limited liability, and membership units are known as quotas. Societies qualifying under this Act may apply for a license to operate as international SRLs and as such are taxed at the same rates as IBCs. No WHT is levied on any distributions, interest, or other income paid by an international SRL to non-residents. International SRLs are granted duty-free concessions on certain imports, and no exchange control requirements are applicable. Entity mobility is also a prominent feature of this legislation. Qualifying societies organized overseas can continued into Barbados under the Act.

### *Special Development Areas Act*

The Special Development Areas Act provides relief for approved developers carrying out work in certain defined locations in Barbados and to persons financing such work (other than a commercial bank). Persons financing such work are exempt from income tax on interest received. Approved developers are exempt from import duties and value-added tax on inputs for the construction or renovation of buildings, WHTs on repatriation of interest (for a period of 15 years), land tax, and property transfer tax payable by vendors. An approved developer pays CIT at the rate of 15% and is granted initial and annual allowances on industrial buildings of 40% and 6%, respectively, and on commercial buildings of 20% and 4%, respectively.

### *Qualifying insurance companies*

Companies registered under the Insurance Act that derive at least 90% of their premiums from sources outside of CARICOM and at least 90% of whose risks originates outside of CARICOM may obtain a certificate of qualification. Such companies are entitled to the same exemptions from WHTs and exchange controls as exempt insurance companies. They are also entitled to the foreign currency earnings credit, which may reduce their CIT rate from 25% to 1.75% for general insurance business. The rate of tax on gross investment income applicable to life insurers may fall from 5% to 0.035%.

### *Tourism Development Act*

The Tourism Development Act provides that a qualifying owner of a tourism project or of a completed tourism product may offset expenditures on construction or the provision of certain amenities against its profits.

A tourism project includes the following:

- The construction of a new hotel.
- The alteration or renovation of an existing hotel.
- The conversion of an existing building or buildings into a hotel by reconstruction, extension, alteration, renovation, or remodelling.

- The furnishing and equipping of a building to be utilised as a hotel.
- The provision of tourist recreational facilities and tourism related services.
- The construction and equipping of a new restaurant.
- The alteration or renovation of an existing restaurant.
- The construction of a new attraction or the alteration or renovation of an existing attraction.
- The restoration, preservation, and conservation of natural sites.
- The establishment, restoration, preservation, and conservation of monuments, museums, and other historical structures and sites.
- The construction and furnishing of villas.
- The construction and furnishing of timeshare properties.
- The addition to a tourism product of any facilities or services intended to increase or improve the amenities that the tourism product provides.

Concessions extend to the following:

- The importation of building materials and supplies without payment of customs duty and an exemption from the payment of customs duties on specified supplies to be used for equipping that project.
- A refund of customs duty (including VAT) where the holder of a permit can satisfy the Comptroller of Customs that the building materials and supplies purchased for a tourism product have been purchased in Barbados, or in the case of importation that the customs duty was paid by the holder of the permit.
- Income tax concessions with respect to the write-off of interest, accelerated deduction of expenditure, interest rate subsidy, equity financing, training, and marketing.
- The set off of approved capital expenditures against revenues for a period of 15 years where the owner of a qualifying tourism project (except restaurants), which has a project with a value of up to BBD 200 million. Hotels with capital expenditure over BBD 200 million are allowed one additional year to write off expenditure for each additional BBD 20 million, up to a maximum of 20 years.

## *Withholding taxes*

### *Dividends, interest, royalties, and management fees*

WHTs are levied as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Management fees (%) |
|---|---|---|---|---|
| Barbados residents: corporations and individuals | 0/12.5 (25) | 12.5 (26) | 0 | 0 |
| Non-treaty countries | 15 | 15 | 15 | 15 |
| Austria | 5/15 (1) | 0 (3) | 0 (3) | 0 |
| Botswana | 5/12 (2) | 10 | 10 | 0 |
| Canada | 15 | 15 (4) | 10 (5) | 5 |
| CARICOM | 0 | 15 | 15 | 15 |
| China P.R. | 5/10 (6) | 10 | 10 | 0 |
| Cuba | 5/15 (7) | 10 | 5 | 0 |
| Finland | 5/15 (1) | 5 | 5 | 5 |
| Ghana* | 5/15 (1) | 0 (8) | 0 (9) | 0 |
| Luxembourg* | 0/15 (10) | 0 (3) | 0 (3) | 0 |

# Barbados

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Management fees (%) |
|---|---|---|---|---|
| Malta | 5/15 (11) | 5 | 5 | 0 |
| Mauritius | 5 | 5 | 5 | 0 |
| Mexico | 5/10 (12) | 10 | 10 | 0 |
| Netherlands* | 0/15 (13) | 5 | 5 | 0 |
| Norway | 5/15 (1) | 5 | 5 | 5 |
| Panama* | 5 (14) | 5/7.5 (15) | 7.5 | 0 |
| Portugal* | 5/15 (16) | 10 | 5 | 0 |
| Seychelles | 5 | 5 | 5 | 0 |
| Spain | 0/5 (17) | 0 (3) | 0 (3) | 0 |
| Sweden | 5/15 (1) | 5 | 5 | 5 |
| Switzerland | 0 (18) | 0 (18) | 0 (18) | 0 |
| United Kingdom | 0 (19) | 15 (20) | 15 (21) | 0 |
| United States | 5/15 (22) | 5 | 5 | 0 |
| Venezuela | 5/10 (23) | 5/15 (24) | 10 | 0 |

*Treaty/protocol not yet in force; awaiting ratification.

Notes

1. The rate is 15% for portfolio dividends and 5% for holdings of at least 10%.
2. The rate is 12% for portfolio dividends and 5% for holdings of at least 25%.
3. Dividends and interest are only taxable in the territory in which the beneficial owner of the dividends or interest is resident.
4. This rate applies provided that the interest is subject to tax in the other territory.
5. This rate applies provided that the royalties are subject to tax in the other territory.
6. The rate is 10% for portfolio dividends and 5% for holdings of at least 25%.
7. The rate is 15% for portfolio dividends and 5% for holdings of at least 25%.
8. Interest is only taxable in the territory in which the beneficial owner of the interest is resident.
9. Royalties are only taxable in the territory in which the beneficial owner is resident.
10. The rate is 15% for portfolio dividends and 0% for holdings of at least 10%, held for at least 12 uninterrupted months prior to dividend distribution.
11. The rate is 15% for portfolio dividends and 5% for holdings of at least 5%.
12. The rate is 10% for portfolio dividends and 5% for holdings of at least 10%.
13. The rate is 15% for portfolio dividends and 0% for holdings of at least 10%.
14. The rate is 75% of the statutory nominal rate at the time of distribution; 5% for companies with holdings of at least 25%.
15. The rate is 7.5% of the gross amount; 5% if beneficial owner is a bank.
16. The rate is 15% for portfolio dividends and 5% for holdings of at least 25%.
17. The rate is 5% for portfolio dividends and 0% for holdings of at least 25%.
18. Agreement extended to Barbados by virtue of the agreement between Switzerland and the United Kingdom, on payments to non-residents from Barbados.
19. Dividends are exempt from WHT if they are subject to tax in the other territory.
20. This rate applies provided that the interest is subject to tax in the other territory.
21. WHT applies only to royalties in respect of cinematographic or television films. All other royalties are exempt from WHT, provided that they are subject to tax in the other territory.
22. The rate is 15% for portfolio dividends, 5% for holdings of at least 10%. Dividends paid by a regulated investment company will bear WHT at a rate of 15%, regardless of the percentage of shares held by the recipient. Dividends paid by a real estate investment trust (REIT) will qualify for the 5% WHT rate only if the beneficial owner is an individual holding less than 10% of the shares in the REIT, otherwise, a 30% WHT rate will apply.
23. The rate is 10% for portfolio dividends, 5% for holdings of at least 5%.
24. The rate is 5% if the recipient is a bank, 15% in all other cases.
25. Dividends paid to corporations are not subject to WHT, except for dividends paid on preference shares issued before January 1, 1975, which are subject to WHT at 25%. Dividends paid to individuals out of pre-July 1992 retained earnings are grossed up by 15% and included in taxable income. A 15% dividend tax credit is permitted on this income. Those paid from profits earned after July 1992 are subject to a final tax of 12.5%. There is no WHT on dividends paid out of exempt profits under the Fiscal Incentives Act.
26. Interest paid to pensioners over the age of 60 is exempt from WHT.

## *Tax administration*

### *Returns*

CIT returns are prepared on a fiscal year basis. Companies with fiscal years ending between 1 January and 30 September (both dates inclusive) are required to file a CIT return on or before 15 March in the year following the end of the fiscal period. Companies with fiscal years ending any time between 1 October and 31 December (both dates inclusive) are required to file a CIT return on or before 15 June in the year following the end of the fiscal period.

The Department of Inland Revenue has instituted an online filing system, which is still optional.

### *Payment of tax*

Companies with fiscal years ending between 1 January and 30 September (both dates inclusive) are required to make an instalment of CIT for the income year in which the fiscal period ends on or before 15 September of that year. The instalment is 50% of the net CIT payable for the preceding income year. The remainder of CIT due (if any) must be paid on filing of the CIT return by 15 March of the following year.

Companies with fiscal years ending between 1 October and 31 December (both dates inclusive) are required to make two instalments of CIT for the income year in which the fiscal period ends on or before 15 December of that year and 15 March of the following year. The instalments are each 50% of the net CIT payable for the preceding income year. The remainder of CIT due (if any) must be paid on filing of the CIT return by 15 June of the following year.

It is possible to apply for a reduction or waiver in the instalments if lower profits are anticipated in the current year when compared with those of the preceding year.

### *Penalties*

The penalties and interest for failing to file a return on time and pay the CIT due are as follows:

- Penalty for failing to file a CIT return by the due date is BBD 100 (USD 50) plus 5% of the tax assessed at the due date.
- Penalty for failing to pay CIT by the due date is 5% of the tax assessed and unpaid at the due date.
- Interest charge of 1% per month on the tax and penalties calculated for each month during which any amount of tax and penalties remain unpaid on the largest amount of tax and penalties that were due and unpaid at any time during that month.

The penalty for failing to make a prepayment of CIT by the due date is 10% of the CIT prepayment due, plus interest at 0.5% per month on the CIT prepayment and penalty outstanding.

# Belarus

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## Significant developments

Changes to the Tax Code, effective 1 January 2011, have abolished the following taxes:

- 3% area development tax (local).
- 5% service tax (local).

The following two separate taxes were transferred into taxable objects of ecological (environmental) tax and state dues accordingly:

- Charge for issuance of the permission for transit of motor vehicles registered with Belarus within the territories of foreign countries.
- Duty for importation of ozone depleter to Belarus.

According to amendments to the Tax Code, effective 1 January 2011, ecological tax is abolished on the following objects:

- Production and/or import of plastic, glass containers, container-based paper, paperboard, and other products that could generate waste or do harm to the environment after the loss of their consumer characteristics.
- Manufacture and/or import of goods containing 50% or more of volatile organic compounds (paints and lacquer including enamel, polish, distemper paint, and products from related materials; patching material, assembly compounds, and other mastics; joint filler; and polygraphic paint).
- Import of goods packed in plastic, glass bottles, and containers from paper and paperboard, with certain exceptions.
- Oil refining, oil transportation via trunk pipelines, and oil products in transit.

In 2011, taxpayers may qualify for value-added tax (VAT) filing and payment on a quarterly basis regardless of the amount of sales revenue.

In 2011, sales of fixed and intangible assets below the book value, as well as further sales of goods acquired from third parties below acquisition costs, represent the value for VAT purposes.

Significant changes in corporate income tax (CIT) filing and payments procedures have been introduced. In 2011, a company will have to file a CIT return on an annual basis, whereas the tax should be paid by equal current instalments on a quarterly basis, based on two methods allowable for CIT base calculation.

A reduced 12% CIT is levied on dividends derived from local or foreign sources and on capital gains from disposal of shares or stocks in a Belarusian entity.

A company is entitled to deduct for CIT any business related costs if supported by proper documents, except for certain costs specifically restricted by the Tax Code.



In 2011, taxpayers are allowed to deduct representation expenses in full amount for CIT purposes, as well as interests on loans spent for acquisition of fixed, intangible, and other long-term assets.

## *Taxes on corporate income*

The standard CIT, also known as profits tax, rate is 24%.

Corporate income tax is charged on taxable income (net profits). Taxable income is generally determined as revenues from sales of goods, works, and services, excluding VAT, less production and business related costs, less other deductible expenses, plus net results of non-operating income and expenses.

Resident companies are taxed on their worldwide income.

### *Local taxes*
There are no local taxes due on net profits. The 3% local area development tax on net profits has been repealed as of 1 January 2011.

## *Corporate residence*

A company is resident in Belarus if it is incorporated in Belarus.

### *Permanent establishment (PE)*
According to local legislation, a non-resident company is deemed to have a permanent establishment (PE) in Belarus in cases where:

- it permanently carries out commercial activities in Belarus in whole or in part
- it carries out its activities through a dependent agent
- it uses a building site or construction, assembly, or equipment objects, or
- it provides services or performs works within a period of 90 days continuously or in the aggregate during a calendar year.

Double taxation treaties (DTT) may establish different rules of PE recognition. According to domestic law, where there is a DTT, the provisions of the treaty shall prevail.

Notwithstanding the activities which create a PE in Belarus, a non-resident company must be registered with the local tax authorities controlling the territory where activities are carried out, before starting a business in Belarus.

Any profits derived by a non-resident company via a PE in Belarus are subject to 24% CIT. Expenses incurred by a non-resident company either in Belarus or abroad that relate to a PE can be deducted, subject to local deductibility restrictions.

## Other taxes

### Value-added tax (VAT)
The standard VAT rate is 20%, whereas the preferential rate is 10%.

The 10% preferential rate applies on:

- local supplies of crop products (excluding floriculture, cultivation of ornamental plants), beekeeping, livestock (except for fur production), and fisheries locally produced and
- import and/or local supplies of certain food products and goods for children.

In general, local supplies of goods, works, and services made by a taxpayer performing its economic activities in Belarus, as well as the importation of goods, are subject to VAT.

Place of supply rules established by the Tax Code of Belarus should be followed to determine whether goods, works, and services are supplied locally, and therefore, subject to tax in Belarus.

When a non-resident company, which does not have a PE registered in Belarus, sells goods or provides works and services that are considered local supplies according to the place of supply rules, the VAT due on such supplies is paid by the purchaser registered with the local tax authorities from its own funds. This VAT could be deducted against output VAT, if any, or refunded from the budget in the established order.

Some exceptions apply to provision of construction and other similar works.

Exemptions with credit (zero-rated) include, but are not limited to, the following:

- Supply of goods exported outside of Belarus.
- Provision of works and services involving maintenance, loading, reloading, and any other similar works and services related to supply of exported goods.
- Transportation and any directly linked ancillary services related to the export or import of goods, including transit forwarding, as well as exported works for goods processing.
- Works and services related to repair (modernisation, conversion) of aircrafts (including engines and railway vehicles) and provided to non-resident companies or individuals.

In order to apply zero-rated VAT on goods carried out from Belarus, VAT payers must hold supporting documents as evidence that these goods were actually exported from Belarus to another country. Application of zero-rated VAT on respective works and services must be supported by the appropriate documents, which have to be provided to the local tax authorities where the taxpayer is registered for tax purposes.

Exemptions without credit include, but are not limited to, the following:

- Disposal of shares in resident legal entities.
- Supply of material rights for industrial property objects (e.g. inventions, utility models, industrial designs, breeding achievements, integrated circuits, know-how, trade names, trademarks, and service marks).
- Supply of securities, derivatives, and other similar financial instruments, certain limitations apply.

- Fiduciary management services related to funds and assets owned by an individual or an entity.
- Provision of all types of insurance and re-insurance (co-insurance) services rendered by insurance and re-insurance agents.
- Supply of medicines, medical equipment, instruments, medical products, as well as drugs, devices, equipment, veterinary products, under certain conditions.
- Personal or public health care services, under certain conditions.
- Social services supplied by institutions for children and young people care, nursing homes for the elderly and/or by care/guardianship institutions for disabled or by other non-profit entities.
- Supply of services in the field of culture and art, under certain conditions.
- Public services (services of barbers, baths, and showers; laundry and dry cleaning services; watch repairing; manufacturing and repair of clothing and footwear; repair and maintenance of household appliances; repair of personal and household goods).
- Services provided by religious organisations, if these services correspond to the purposes set out in their canons, statutes, and other documents.
- Funeral services, maintenance of the graves, tombstones, fences, and other objects associated with burial, as well as works on their production, under certain conditions.
- Supply of postage stamps, postcards, and envelopes marked, excise and control (identification) stamps for marking of goods at their nominal value, stamps which can be used as a confirmation of fees and charges payable in accordance with the legislation.
- Supplies of jewels as well as related services, under certain conditions.
- Retail trade of goods in duty-free shops, under certain conditions.
- Communication services rendered to individuals.
- Legal services supplied by certified lawyers.
- Research and development, design, and technological works and services, under certain conditions.
- Education and training services.
- Lotteries and gambling, under certain conditions.
- Financial services supplied by the banks, under certain conditions.
- Goods and equipment imported into Belarus, under certain conditions.

In order to apply exemptions, taxpayers should ensure that the services and goods supplied meet the appropriate VAT exemption requirements.

VAT returns shall be submitted on either a monthly or quarterly basis, by the 20th day of the month following the reporting period. VAT shall be paid on either a monthly or quarterly basis, no later than the 22nd day of the month following the reporting period.

### *State dues*

State dues are payable by legal entities that apply to the state institutions for the issuance of documents having legal force or other deeds, bring the cases before the courts for consideration, use bills of exchange in their activities, etc.

State dues include the following payments and duties:

- State fees (payable on suits, applications, appeals, and other documents that are submitted to or claimed from the courts or prosecution authorities, payable on applications for state registration of a legal entity, notary public services, real estate registration services, etc.).
- Patent fees (payable for registration and use of intellectual property).
- Stamp fees (payable on activities with bills of exchange).

- Consular fees (payable on the activities of state consular and diplomatic departments performed under the request of any applicant).

### *Offshore charge*
An offshore charge is levied upon the following activities of domestic entities:

- Any transfer of funds to an entity registered in an 'offshore jurisdiction', to a third party who is a creditor of that entity, or to the bank account of an offshore jurisdiction.
- In kind performance of obligation to an offshore entity, with some exceptions.
- Any transfer of material rights and obligations as a result of changes in commitment (cession or transfer of debt) between a domestic entity and an offshore entity.

According to Belarusian laws, an offshore jurisdiction is a territory which is included in the list of offshore territories established by the President, has a preferential tax treatment, and/or does not disclose the information related to financial transactions made by resident entities.

A list of 52 offshore territories has been published. With certain exceptions specified in the law, all payments to offshore companies or their branches for any kind of work or services, commodities, interest on loans, insurance premiums, guarantees, etc. are subject to an offshore charge, which is deductible for CIT purposes.

Tax relief is granted to: i) repayment of loans including interests on them, borrowed from entities located in offshore territories, ii) payments due under international marine cargoes and forwarding services, and iii) payments for bank operations under certain conditions.

An offshore charge is paid at a 15% rate and is deductible for CIT purposes.

The tax is reported and paid on a monthly basis, no later than the 20th day of the month following the reporting period.

### *Land tax*
Belarusian and foreign entities are subject to land tax collected by the local tax authorities with respect to land that they own or use in Belarus.

The tax base depends on plot location and purpose and is normally determined pursuant to cadastral value of a land plot.

Land for public roads and railways, as well as forest land, is exempt.

The tax is payable on an annual basis at the rates established by the Appendixes to the Tax Code of Belarus. Tax rates for agricultural plots vary from 97 Belarusian rubles (BYR) to BYR 264,354 per hectare. Tax rates on the land plots located in towns and rural areas range from 0.25% – 3% payable on the cadastral value.

Land tax is deductible, with some exceptions, for CIT purposes.

Land tax is reported annually, no later than 20 February of the next reporting year. Generally, the tax is paid quarterly by equal parts, before the 22nd of the second month of each quarter. Concerning payment terms for land tax due on agricultural plots, some exceptions can be applied.

### *Real estate tax (immovable property tax)*
Real estate tax is levied at the annual rate of 1% on the residual value of buildings, including separated premises, and constructions, late construction in progress (if construction works take longer than the deadline established in technical documentation), owned by legal entities.

The tax base of buildings and constructions located in the territory of Belarus and leased by individuals to legal entities will be the contract value of the leased real estate not less than its value established by the evaluation. Evaluation is conducted in the manner approved by the President of Belarus.

When the real estate subject to taxation is located in Belarus and leased by a resident company to a lessee, the lessee is considered a real estate taxpayer provided that the leased real estate is accounted for in its balance sheet. The lessee is also obliged to pay the tax due on real estate leased from foreign companies that are not considered as having a PE in Belarus.

The amount of tax, except the tax due on late construction in progress (if construction works take longer than the deadline established in technical documentation), is deductible for CIT purposes.

The tax reporting obligation must be fulfilled by a taxpayer before 20 January of the reporting year. The tax is paid on a quarterly basis by equal parts, no later than the 22nd day of the first month of each quarter.

### *Excise taxes*
Excise taxes are imposed on the following goods produced and sold in or imported to Belarus:

- Rectified ethyl alcohol and alcoholic drinks, including beer and wine.
- Alcohol-containing food products in the form of solutions, emulsions, suspensions, produced with the use of ethanol from all types of raw materials, other alcohol-containing products.
- Tobacco (excluding raw tobacco), including cigarettes, cigars, cigarillos, and smoking tobacco.
- Energetic products, including petrol, kerosene, diesel, and bio diesel, gasoline, fuel, marine fuel, oils for diesel engines, and engines with a carburettor and an injector.
- Liquefied hydro carbonated gas and compressed natural gas used as motor fuel.
- Vans and passenger cars, including those converted to cargo.

The tax rate depends on the type and quantity of goods. Rates of excise taxes are stipulated by the Appendixes to the Tax Code of Belarus. Compared to the rates applicable in 2010, rates of excise taxes effective in 2011 have increased to between 7% and 8%. Almost 240% growth of excise taxes on bio diesel and diesel fuel, corresponding STB 1658-2006 (EN 590:2004) appeared in 2011.

Excise taxes paid on the purchasing/importation of excisable goods to be used in manufacturing of goods or provision of works and services in Belarus are considered as deductible for CIT purposes, with certain exceptions.

The tax is reported and paid on a monthly basis, no later than the 20th day of the month following the reporting period.

### Customs payments

The Customs Union between Russia, Kazakhstan, and Belarus, with its unified trade regulations (effective as of 1 January 2010) and customs code (effective as of 6 July 2010), has significantly affected administering, customs clearance, and payment procedures to be followed by Belarus in 2011 in regards to exports and imports.

Indirect taxation issues within the Customs Union shall be administered in compliance with the International Agreement on Indirect Taxation and two Protocols signed by the Customs Union Member States.

The following charges are considered customs payments:

- Import duties.
- Export duties.
- Special anti-dumping and countervailing duties.
- VAT and excise taxes due upon importation of goods.
- Fees for customs processing/services.

Rates of import duties as well as description of goods subject to them are established by the Single Nomenclature of Goods of the Customs Union (HS Nomenclature) and Single Customs Tariff of the Customs Union.

However, for certain goods specified in Appendix 5 of HS Nomenclature, Belarus is allowed to apply specific rates of import duties different from the rates set in HS Nomenclature.

Export duties are not levied on exported goods, with the following exceptions: certain soft oil; light distillates; fuels and gasoline; wasted petroleum products; propane, butane, ethylene, propylene, and other liquefied gases; petroleum coke; petroleum bitumen, benzol, toluene, xylenes; etc. According to the Customs Union regulations, rates of export duties in regards to mentioned goods shall be established by Belarusian Government and shall be equal to the rates applied in Russia.

Import and export duties are calculated on the customs value of the goods, which is defined pursuant to the price of transaction method established by the Customs Union regulations. Generally, the following components are considered when calculating the customs value of imported goods:

- Contract price of the goods.
- Rebates and discounts provided by a supplier, under certain conditions.
- Transportation related expenses to the border of the Customs Union (i.e. Belarusian border).
- Insurance premiums.
- Cost of containers and other packaging.
- Part of direct or indirect income to be derived by the seller from future resale, transfer, or other use of imported goods.

Special, anti-dumping, and countervailing duties could be imposed as a measure to protect economic interests of Belarus.

Tax base for VAT calculation due on imported goods includes the total amount of customs value, import duty, and excise tax paid, if any.

Generally, the taxpayer is required to pay customs duties before the customs clearance of the appropriate goods; however, under certain conditions, a taxpayer may be provided with an extension of payment deadlines or allowed to pay only part of customs duties. It is also possible to pay customs duties in advance.

In 2011, electronic customs filing has been introduced. Electronic customs declaration is currently available for customs clearance of the goods declared in customs regime of temporary export, re-export (exports) as well as free circulation (imports).

### *Ecological (environmental) tax*

Ecological (environmental) tax is imposed on pollutants discharged into the environment, storage and disposal of industrial wastes, wastewater discharges, and on importation of ozone-depleting substances, including those contained in the products.

The following are excluded from taxation, including but not limited to:

- Pollutants discharged into the air by mobile sources (e.g. cars, vehicles).
- Transit of ozone-depleting substances, including those contained in the products through the territory of Belarus.

The tax base of environmental tax is the actual quantity of respective pollutants used/discharged. Tax rates of environmental tax are stipulated by the Tax Code of Belarus.

Environmental tax paid, with certain exceptions, is treated as deductible for CIT purposes.

The tax is reported and paid on a quarterly basis. Certain exemptions are provided to legal entities effecting tax payments on the basis of established annual limits. These taxpayers will have to file an annual tax return and provide it to a tax authority no later than 20 April of the calendar year.

### *Tax on natural resources*

A tax on natural resources is payable on the actual value of extracted natural resources. It depends on the kind and quantity of extracted resources.

Tax rates are established by the Tax Code of Belarus and are applied on natural resources that have been extracted by a taxpayer within established limits. Natural resources extracted over established limits are taxed by a standard tax rate multiplied by ten.

Tax paid on resources extracted within established limits, or if the limits are not established (for certain type of resources), is treated as deductible for CIT purposes.

The tax is reported and paid on a quarterly basis. Those taxpayers who calculate the tax on the basis of annual limits for extraction fulfil tax reporting and payment liability on an annual basis.

### *Local tax on providers (suppliers)*

The local tax on providers is levied on legal entities engaged in gathering/purchasing of wild plants (or parts thereof), mushrooms, and technical and medical raw materials of floral origin for their further industrial processing or resale.

Tax base is the cost of gathered items defined on the basis of procurement (purchasing) prices.

Tax rates do not exceed 5%. Tax on providers is treated as deductible for CIT purposes.

The tax is reported and paid on a quarterly basis.

## *Branch income*

Non-resident legal entities pay tax on profits attributable to a PE. A PE is broadly defined as “a branch, division, office, bureau, agency, or any other place through which a foreign legal entity regularly carries out its business activities in Belarus”. Belarus’s various DTTs may define a PE differently, which could in some cases result in tax relief. Conducting business through an agent may also create a taxable PE in Belarus.

### *Taxation of a PE*

A PE’s profits are computed on substantially the same basis as Belarusian legal entities, including the composition of tax deductible expenses. The Tax Code provides for the deductibility of expenses incurred abroad by a head office with respect to its PE in Belarus (including a reasonable allocation of administration costs).

To calculate a PE’s taxable income, a non-resident company is required to provide a tax authority with financial documents (i.e. accounting records, income statement, general ledger accounts, invoices, statements of services/works fulfilment, etc.) supporting the amount of revenue earned and expenses incurred. Generally, a PE’s taxable income is defined on a revenue less costs basis. Documentary support of each revenue and/or costs item is required.

When it is not possible to calculate a profit attributable to a PE, this profit can be calculated by the tax authority using one of the following methods:

- A profit sharing method (i.e. gross foreign profit is allocated to PE by using one of the following coefficients related to a PE: working time costs, expenses incurred, services/works performed).
- Benchmarking method (tax authority performs benchmarking study by collecting the respective ratios/indexes of other entities engaged in similar activities).

Head office expenses related to a PE are considered for calculation of taxable income in Belarus and require confirmation of an independent foreign auditor. Splitting of expenses is highly recommended in the audited financial statements of the parent company (head office).

If a non-resident company is deemed to have a PE in Belarus, it will have to register with a local tax authority and declare related profit. Profit related to a PE will be taxed by CIT at a rate of 24%.

Non-resident legal entities operating in Belarus through a PE are required to follow the filing and payment schedules established for Belarusian legal entities, although they shall submit CIT returns on a quarterly basis within established reporting deadlines and an annual tax report by 15 April of the following year.

### *Representative office*

Non-resident legal entities are also allowed to operate in Belarus via a representative office or to set up a resident legal entity.

A representative office of a non-resident company is defined as the structural subunit registered with the ministry of foreign affairs, which is entitled either to engage in commercial activities in Belarus or not, conclude contracts, and undertake obligations according to the power of attorney issued to the management official of the branch by its head company (founder).

The representative office is not considered a legal person.

A representative office conducting commercial activities is taxed in the same manner as a PE or as a local resident company, with some exceptions.

A non-commercial representative office pays taxes due on its primary and auxiliary activities, such as real estate tax (with some exceptions), customs duties, input VAT, personal income tax, social security contributions due on employment of individuals, etc.

## *Income determination*

### *Exemptions from taxable income*

The following types of income are exempt from CIT:

- 'Target financing' received from the state or municipal budget. The taxpayer is required to hold separate accounting records of income and expenses derived and incurred within 'target financing'.
- Amounts payable to a shareholder, whether in cash or in kind, not in excess of its contribution to the statutory capital of a legal entity in case of:
  - its liquidation
  - a shareholder's withdrawal from a legal entity, or
  - if the shares are purchased by a legal entity from its shareholder.
- Payments to a shareholder in the value of its shares or as a result of an increase in their nominal value made by the legal entity's sources, as long as such payments do not change the percentage of participation of either shareholder.
- Goods (works, services), material rights, and monetary means granted:
  - to the successors by a legal entity in case of its restructuring
  - as an inter-company transfer pursuant to corporate decision
  - to taxpayers engaged in crop production, animal husbandry, fish farming, and beekeeping, provided that this income is spent for the appropriate activities, or
  - as a foreign gratuitous help on conditions stipulated by the President.
- Monetary means or assets received by a taxpayer from its shareholders as their contributions to the statutory capital, not in excess of amounts provided by the statutory documents.
- Dividends received by venture companies.

### *Inventory valuation*

Under domestic accounting legislation, stock used in the production and included in the cost of produced goods may be generally valued by the following methods:

- Cost of each unit.
- Average cost.
- Weighted-average cost.
- Last in first out (LIFO).
- First in first out (FIFO).

The inventory valuation method used for CIT purposes must be the same method established by the taxpayer's accounting policy.

### *Capital gains*

Capital gains from disposal of shares/stocks in a Belarusian entity are taxed as part of the taxpayer's profits and are subject to 12% CIT. No tax exemptions are provided by the Tax Code for the capital gains taxation.

### *Dividend income*

Dividends distributed by a resident company to another resident company are subject to 12% CIT, which is withheld by a paying company.

The Tax Code provides no exemptions for taxation of inter-company dividends.

Dividends distributed by a foreign entity represent non-operating income of a receiving Belarus entity and are subject to 12% CIT payable by the receiving entity in Belarus, irrespective of the fact that the foreign entity has paid the withholding tax (WHT) on dividends distributed.

### *Foreign income*

Foreign income of Belarusian resident legal entities is taxed, except for dividends, as ordinary business income at a standard 24% CIT rate.

## *Deductions*

Deductible expenses include all the usual costs that an entity actually incurs for the purpose of earning income or receiving economic benefit, unless the Tax Code of Belarus or presidential regulations provide otherwise.

Limited deductible expenses include the following:

- Depreciation of fixed assets. For tax purposes, assets cannot be depreciated faster than indicated in the relevant tax and accounting legislation *(see below)*.
- Modernisation and reconstruction of fixed assets. The value of modernisation or reconstruction is included in the acquisition costs.
- Business trips.
- Representation.
- Management fees payable to outsourcing companies, with restrictions.
- Natural losses, with certain exceptions.
- Cost of fuel and energy resources, with restrictions established for certain entities.
- Environmental tax and tax on natural resources, with restrictions.
- Bad debts, only if proved and specific criteria are met.
- Social insurance contributions and expenses for the benefit of employees, with restrictions.
- Membership fees, contributions, and premiums, with restrictions.
- Premiums on certain types of voluntary insurance, with restrictions.

Non-deductible expenses include the following:

- Expenses on provision or acquisition of works and services not related to the taxpayer's business activities.
- Construction, maintenance, and other works, including all types of repair of assets that are not used for the purpose of earning income or receiving economic benefit.

- Default interest (forfeit), fines, and other sanctions paid to the budget.
- Certification related expenses (i.e. testing (analysis) of samples of goods subject to mandatory certification), if the results are negative.
- Dividends paid and similar type of payments.
- Contributions made to the authorised share capital.
- Expenses incurred on purchase and/or creation of depreciable assets.
- Depreciation for tangible and intangible assets not used in business, as well as for tangible assets that are not in operation.
- Cost of assets or material rights transferred as advance or a pledge to a third party.
- Expenses covered by reserves for future expenses created by a taxpayer in the prescribed manner.
- Interest on overdue loans, as well as on loans related to the acquisition of tangible and intangible assets, other long-term assets.
- Other expenses not related to the deriving of income and not attributed to operating activities of the entity as well as expenses that are not considered as allowable deductions under the Tax Code of Belarus.

### *Depreciation*

Assets may be depreciated using the directly proportional (straight-line) depreciation method, indirect disproportionate depreciation method, production depreciation method, or a declining-balance depreciation method. Depreciation may not exceed maximum rates established by the law.

Almost all types of fixed assets (buildings, premises, equipment, vehicles) are depreciated for tax purposes in accordance with the established procedures. Land plots are not depreciated. There are many different depreciation rates established for different types of fixed assets. Generally, fixed assets may be divided into five basic groups as follows:

| Group of assets | Description of the assets | Annual depreciation rate (%) |
|---|---|---|
| 1 | Buildings and constructions, premises | 1 and 2 |
| 2 | Vehicles and equipment | 10 |
| 3 | Cars and vehicles | 12.5 |
| 4 | Inventories (furniture, tools, etc.) | 10 |
| 5 | Computers and other related devices | 20 |

Fixed assets are obligatorily re-valued one time per year because of BYR inflation.

### *Goodwill*

Goodwill and personnel experience cannot be recognized as intangible assets for CIT purposes.

### *Charitable contributions*

Amounts not exceeding 5% of an entity's gross profit granted to the health, education, social welfare, culture, sports state institutions, or spent for acquisition of goods, works, or services for the benefit of the named institutions, are deductible.

### *Taxes*
Generally, the following taxes, dues, and other compulsory charges to the budget are deductible for CIT purposes:

- Excise taxes paid at purchasing/importation of excisable goods to be used in manufacturing of goods or provision of works and services in Belarus, with some exceptions.
- Environmental tax, with certain exceptions.
- Real estate tax, except the tax due on late construction in progress.
- Land tax, with some exceptions.
- Tax on natural resources, with some exceptions.
- State dues.
- Offshore charge.
- Tax on providers.
- Payments for social and other mandatory security.

The following taxes shall not be deducted for CIT purposes:

- VAT paid, with certain exceptions *(see below)*.
- CIT.

VAT can be treated as deductible for CIT purposes only if acquired goods, works, or services are used for production or sale of goods, works, or services that are VAT exempt.

### *Net operating losses*
Pursuant to local tax rules, net operating losses shall not be carried forward nor carried back. They must be fully recognised in the year incurred.

### *Payments to foreign affiliates*
Payments to foreign affiliates of a Belarusian resident legal entity in amounts of financing aimed to cover ongoing costs thereof are deductible for CIT purposes in Belarus.

## *Group taxation*

Currently, group taxation legislation and regimes are not available in Belarus. Each Belarusian entity is regarded as a separate taxpayer and may not deduct tax losses of any other group entity. Belarus Tax Code does not allow the deduction of foreign losses from domestic taxable income, or domestic losses from foreign taxable income.

### *Transfer pricing*
No transfer pricing rules exist in Belarus.

However, there is a mechanism to control transfer pricing provided by the DTTs applicable for Belarus. When interests under the loan agreement between related parties exceeds the arm's-length rate/basis (the amount which will be agreed upon between independent parties under normal business circumstances), a 5% rate of WHT (provided by the treaty) will be charged on the arm's length interest charge. Excess amounts, if any, will be taxed by WHT at a 10% rate.

### *Thin capitalisation*
No thin capitalisation rules exist in Belarus.

## Tax credits and incentives

### Special tax treatments

The Belarusian Tax Code provides a more favourable tax environment for particular resident legal entities. Special tax treatments are available for certain taxpayers depending on their location, amount of revenue, number of individuals employed, types of business, etc. Special tax treatments include, but are not limited to, the following:

- Simplified taxation.
- Tax on farmers and other producers of agricultural products.
- Tax on gambling business.
- Tax on lotteries.
- Tax on electronic interactive games.
- Free economic zones.

In cases where activities fulfil the criteria of a special tax treatment, the taxpayer is not permitted to use the general taxation regime with regard to income deriving from those activities, with certain exceptions. Concerning simplified taxation and tax on farmers, the taxpayer is entitled to determine whether to apply such treatment or not.

### Incentive for employing disabled persons

Entities employing disabled persons, if their number exceeds 50% of the average number of employees for the reporting period, are exempt from CIT due on taxable profit derived from production activity.

### Exemption of CIT on profits derived from various activities

- Profit of entities engaged in baby food production is exempt from CIT.
- Profit derived by insurance companies from investments of insurance reserves under the contracts of voluntary life insurance is exempt from CIT.
- Entities engaged in manufacturing of prosthetic and orthopaedic devices (including dental prostheses), provision of rehabilitation, and disability services are exempt from CIT due on profit derived from sales of these items.
- Entities deriving profit from sales of plants (except for flowers, ornamental plants), livestock (except for farming), fish farming, and beekeeping, provided the entities raise them, are exempt from CIT.

### Tax holidays

Profit from the services provided by hotels located at tourist sites established by the President of Belarus is exempt from CIT for three years starting from the commencement of its activities, with certain exceptions.

Profit derived by motels, hotels, campgrounds, maintenance stations, objects of trade and catering, cleaning, located on the roadsides of national highways is exempt from CIT for five years starting from the day when the permission for such activities was received.

### Capital investment tax incentive

Profit is excluded from CIT if it is spent for financing of capital investments for production purposes as well as for the repayment of bank loans received and used for this purpose. Capital investments are defined as any purchase of fixed assets or construction in progress, any capital construction in the form of new construction or creation of fixed assets, or any reconstruction and modernisation of fixed assets or construction in progress. This tax relief is provided if a taxpayer meets certain established requirements.

### *Scientific and Technological Association incentive*

Entities that are members of the Scientific and Technological Association established by Belarusian State University, in accordance with legislation, are entitled to apply a 5% CIT rate on their profit derived from sales of information technology and provision of information technology development services.

### *Incentives for the production of high-technology and laser-optical equipment*

High-technology producers included in the special list approved by the President of Belarus are taxed at 12% CIT with regard to the profit derived from sales of their own high-tech goods, works, and services, under certain conditions.

Entities engaged in production of laser-optical equipment, accounting for at least 50% of the entity's total production, can benefit from a reduced CIT rate of 10% under certain conditions.

### *Free economic zones*

Entities which are registered in Belarusian Free Economic Zones are exempt from CIT in relation to goods, works, and services of their own production for five years starting from the date when the profits were declared. After expiration of this term, the CIT rate is 12%.

Moreover, residents of Free Economic Zones are granted, under certain conditions, a partial VAT relief and a relief for real estate tax on buildings and constructions located in Free Economic Zone.

### *Foreign tax credit*

If a Belarusian legal entity derives income subject to taxation abroad, the tax paid abroad may be deducted from the calculated CIT.

In accordance with the Tax Code, the amount deducted from CIT may not exceed that part of the tax calculated in Belarus that is attributed to the income received in a foreign jurisdiction. If there is a valid DTT with the country in question, the provisions of the treaty regarding avoidance of double taxation shall apply.

## *Withholding taxes*

### *Domestic legislation*

The following income of a non-resident entity in Belarus that is not derived through a PE is deemed to be Belarusian-source income and is subject to WHT at the rates provided:

| Income | WHT (%) |
|---|---|
| Freight charges, (including demurrage) and freight-forwarding services (excluding freight charges for marine transportation and forwarding services) | 6 |
| Interest on any type of debt obligations including securities | 10 |
| Royalties | 15 |
| Dividends and other similar income | 12 |
| Penalties, fines, and other sanctions received for breach of contractual liabilities | 15 |
| Income derived from sports, entertainment activities, or performers' activities | 15 |

| Income | WHT (%) |
|---|---|
| Income derived from innovative, design, research and development activities, design of technological documentation engineering design, and other similar works and services | 15 |
| Income from provision of guarantees | 15 |
| Income from provision of disk space and/or communication channel for placing information on the server and services for its maintenance | 15 |
| Proceeds from the sale, transfer (with title), or lease of immovable property located in Belarus | 15 |
| Income derived by a foreign entity from the sale of an enterprise as a complex of assets located in Belarus | 15 |
| Capital gains (income from the sale of shares/stocks) in local companies | 12 |
| Income from the sale of securities (except shares) | 15 |
| Income derived from provision of works and services | 15 |

In calculation of WHT due on certain types of income, a taxpayer is permitted to deduct related expenses following the rules specified by the Tax Code.

Generally, the tax is withheld and paid to the budget by a local entity, an individual entrepreneur, a branch, or a PE of a foreign company. When certain types of Belarusian-source income is received (e.g. capital gains, sale, transfer of title of ownership or lease of immovable property, provision of licenses for software, and other copyright objects), a WHT shall be paid directly by a foreign entity.

Currently, Belarus has approximately 60 DTTs with foreign countries. Where a treaty for the avoidance of double taxation with the country in question contradicts the local tax regulations, the treaty provisions prevail.

Reduction of or an exemption from WHT under a DTT may be obtained if a special residence certificate is completed and provided to the tax authorities before the payment is made.

If the payment that is covered by the DTT has already been made and WHT at the local rate was withheld, it is possible to obtain an appropriate refund (reduction) by completing a special claim for a refund. The claim for a refund must be filed with additional documents, such as a residence certificate, copies of the contract, and other documents related to the payment.

## Tax administration

### Returns

A CIT return shall be submitted on an annual basis, whether a company has taxable income or not, by the 20th day of March following the reporting year.

The above CIT reporting rule is also applicable on PEs of foreign companies as well as non-commercial representative offices. Since 2011, an annual CIT return filed by non-commercial representative offices does not have to be audited by a Belarusian certified auditor.

CIT withheld on inter-company dividends must be reported by a tax withholding entity no later than the 20th day of the month following the month in which the dividends were accrued.

A tax-withholding entity must submit a WHT return to the tax authorities no later than the 20th day of the month following the month when the payment was made.

### *Payment of tax*

CIT must be paid via equal installments, on a quarterly basis, within the following deadlines:

- In 2011: before 22 March, 22 June, 22 September, and 22 December.
- Starting from 2012: before 22 April, 22 July, 22 October, and 22 January.

Remaining CIT, if any, shall be paid not later than 22 March following the expired tax period. The above deadlines shall also be followed by PEs of foreign entities.

CIT on inter-company dividends shall be paid no later than the 22nd day of the month following the month when dividends were paid.

WHT is to be calculated, withheld, and paid by a Belarusian company or a PE of a non-resident company no later than the 22nd day of the month following the month when the payment was made.

# Belgium

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## Significant developments

### Dividends-received deduction (DRD): Revised conditions

As of 1 January 2010, Belgian tax-resident companies (or Belgian branches) must have, at the moment of distribution, a participation of at least 10% or an acquisition value of at least 2,500,000 euros (EUR) in the distributing company in order to deduct 95% of dividends received from qualifying holdings from their net taxable income. Prior to 1 January 2010, the minimum acquisition value was EUR 1,200,000.

In addition, the exemption from these conditions that was provided for credit institutions, insurance companies, and broker-dealers companies has been abolished as of 1 January 2010.

Finally, due to European Court of Justice (ECJ) jurisprudence, it is no longer required that the participations are booked as financial fixed assets in order for the dividend income they generate to benefit the DRD.

### Payments made to tax havens

As of 1 January 2010, Belgian companies (and Belgian branches) that make direct or indirect payments to recipients established in tax havens are obliged to declare them if they are equal to or exceed EUR 100,000 during the tax year. The reporting has to be made on a special form to be attached to the CIT return.

In the event of non-reporting, the payments will be disallowed expenses for CIT purposes. Where the payments have been reported duly and timely, their tax deductibility will be subject to the ability of the taxpayer to prove that (i) said payments were made as part of genuine, proper transactions and (ii) they were not made to an entity under an artificial construction.

*For more information about tax havens, see Payments to foreign affiliates in the Deductions section.*

### Notional interest deduction (NID)

Belgian companies (and Belgian branches) can claim tax relief for their cost of capital by deducting notional (deemed) interest, which is calculated on their adjusted accounting net equity. The NID rate for a given tax year is based on the ten-year government bond interest rate of the calendar year, two years prior to the tax year (e.g. for tax year 2012, reference is made to 2010 government bonds).

For budgetary reasons, the NID rate for tax year 2011 (i.e. financial years ending between 31 December 2010 inclusive and 30 December 2011 inclusive) has been capped at 3.8% (4.3% for small and medium-sized enterprises (SMEs), *see the Tax* *incentives section for definition*). For tax year 2012 (i.e. financial years ending between 31 December 2011 inclusive and 30 December 2012 inclusive), the NID rate is 3.425% (3.925% for SMEs).

### *Automobile costs*

As of 1 January 2010, rules related to the tax deductibility of automobile costs in the hands of Belgian companies (and Belgian branches) have been changed to introduce a system where the deductibility rate varies in a range between 50% and 120% of the automobile costs, depending on the CO2 emission of the automobile. Prior to 1 January 2010, the deductibility ranged from 60% to 90%.

Moreover, the deduction for fuel costs has been limited to 75% as of 1 January 2010.

Finally, the rules for determining the benefit in-kind arising from the private use of company automobiles have been amended. As of 1 January 2010, the benefit in-kind is calculated on the basis of a coefficient related to the CO2 emission of the automobile. Prior to 1 January 2010, this was determined on the basis of a fixed number of privately-driven kilometres (in principle 5,000 or 7,500) multiplied by a coefficient related to the fiscal horsepower of the automobile.

## *Taxes on corporate income*

### *Corporate income tax (CIT) rate*

In general, the tax base for CIT purposes is determined on an accrual basis and consists of worldwide income less allowed deductions. It is assumed that all income received by a company is, in principle, business income. The income tax base is based on the Belgian GAAP financial statements of the company.

#### General rate

CIT is levied at a rate of 33% plus a 3% crisis tax, which is a surtax, implying an effective rate of 33.99%. This rate applies to both Belgian companies (subject to Belgian CIT) and Belgian branches of foreign companies (subject to Belgian non-resident income tax).

#### Reduced rates

A progressive scale of reduced rates applies to taxpayers with lower amounts of taxable income. If the taxable income is lower than EUR 322,500, the following rates apply (including the 3% crisis tax):

| Taxable income (EUR) | Rate (%) |
|---|---|
| 0 to 25,000 | 24.98 |
| 25,001 to 90,000 | 31.93 |
| 90,001 to 322,500 | 35.54 |

Even if their taxable income does not exceed the aforesaid ceilings, certain companies are excluded from the reduced rate and always subject to the normal CIT rate. These companies include:

- Finance companies, which are defined as companies that own participations whose investment value exceeds, at the closure date of the annual accounts, 50% of the paid-up capital, possibly revalued, or 50% of the paid-up capital plus taxable

reserves and recorded (taxable or tax free) capital gains of the companies that want to benefit from the reduced rates. Participations that exceed 75% of the paid-up capital of the companies held are not taken into account for the purpose of this computation.
- Companies that are owned 50% or more by one single company.
- Companies that distribute dividends exceeding 13% of their paid-up capital at the beginning of the taxable period.
- Companies that, per taxable period, do not attribute a tax deductible remuneration of at least EUR 36,000 to at least one key individual (known as dirigeant d'entreprise/bedrijfsleider).
- Collective investment companies (e.g. BEVEK (Beleggingsvennootschap met veranderlijk kapitaal)/SICAV (Société d'investissment à capital variable), BEVAK (Beleggingsvennootschap met vast kapitaal)/SICAF (Société d'investissmenet à capital fixe), VBS (Vennootschap voor belegging in schuldvorderingen)/SIC (Société d'investissment en créances)), organisations for financing pensions, and recognised coordination centres.

### *Surcharge*

A surcharge is due on the final CIT amount upon assessment (including the crisis surtax). The surcharge can be avoided if sufficient advance tax payments are made *(see Payment of tax in the Tax administration section for more information)*. For tax year 2012 (i.e. financial years ending between 31 December 2011 inclusive and 30 December 2012 inclusive), the surcharge is 2.25%.

### *Secret commissions tax*

A special assessment of 309% (300% plus 3% crisis tax) is applicable to so called 'secret commissions', which are any expense of which the beneficiary is not identified properly by means of proper forms timely filed with the Belgian tax authorities. These expenses consist of:

- Commission, brokerage, trade, or other rebates, occasional or non-occasional fees, bonuses, or benefits in-kind forming professional income for the beneficiaries.
- Remuneration or similar indemnities paid to personnel members or former personnel members of the paying company.
- Lump-sum allowances granted to personnel members in order to cover costs proper to the paying company.

The secret commissions tax is not applicable if the payer demonstrates that the payments have been reported in the beneficiary's Belgian tax return. The 309% rate is also applicable to hidden profits that are not part of the property of the company, with the exception of certain specific hidden reserves. The special assessment of 309% and the expenses themselves are, however, fully deductible for CIT purposes.

## *Corporate residence*

A company is considered to be a resident of Belgium for tax purposes if it has its registered office, its principal place of business, or its seat of management in Belgium. The seat of management has been defined by Belgian case law as the place from where directing impulsions emanate or the place where the company's effective management and central administration abide, meaning the place where the corporate decision-making process actually takes place.

## Other taxes

### Value added tax (VAT)

**Scope of VAT**

The following transactions are subject to VAT in Belgium:

- The supply of goods effected for consideration by a taxable person acting as such.
- The supply of services effected for consideration by a taxable person acting as such.
- The importation of goods.
- Intra-Community acquisition of goods for consideration by a taxable person acting as such or by a non-taxable legal person.

**Intra-community supply and intra-community acquisitions**

An intra-community supply of goods is a supply of goods whereby the goods are moving from one EU member state to another EU member state. In the member state of departure of the goods, the goods can be, under certain conditions, VAT exempt. As a result, the intra-community acquisition of the goods (i.e. the arrival of the goods in the other member state) will be taxable.

**Standard and other VAT rates**

The standard VAT rate is 21%. This rate applies to all goods and services not qualifying for one of the reduced VAT rates.

The following supplies of goods and services have a 12% VAT rate:

- Restaurant and catering services, excluding beverages.
- Phytopharmaceutical products.
- Pay television.
- (Inner) tubes.
- Certain combustible material.

The following supplies of goods and services have a 6% VAT rate:

- Works on immovable property (limited in time and with strict conditions).
- Basic necessities, such as food and pharmaceuticals.
- Some printed materials.
- Transport services of persons.
- Hotels and camping.
- Admission to cultural, sporting, and entertainment venues.

The following supplies of goods and services are VAT exempt with credit ('zero-rated'):

- Exports and certain related services.
- Intra-community supplies of goods.
- Certain transactions on goods placed in a customs or VAT warehouse.
- Cross-border passenger transportation by ship or aircraft.
- Supplies to diplomats and international organisations.
- Certain supplies of goods and services to certain vessels and aircrafts mainly involved in international passenger transport.

The following supplies of goods and services are VAT exempt without credit:

- Healthcare services.
- Social services.

- Education services.
- Sport services.
- Cultural services.
- Services of lawyers and notaries.
- Banking services.
- Interest charges.
- Financial services.
- Insurance services.
- Land and real estate sales.
- Property leasing and letting.

It should be noted that specific conditions may apply to the above two categories.

**VAT grouping**

VAT grouping came into effect in Belgium on 1 April 2007. Under a VAT group, independent legal persons are treated as one single taxable person for VAT purposes if they are closely linked financially, economically, and organisationally. Hence, for VAT purposes, all supplies of goods and services to or by the group members are deemed to be made to or by the group itself.

The application of a VAT group has, amongst other, the following consequences:

- No issuance of 'inter-company' invoices between companies in the VAT group.
- No charging of VAT between companies in the VAT group.
- Filing of one VAT return for all companies in the VAT group.
- No risks of incorrect VAT treatment of transactions between companies in the VAT group.
- No cascade of the limitation of the right to deduct VAT when on charging costs to companies in the VAT group.

### *Registration duties*

Purchases and transfers of real estate located in Belgium, including buildings (except new buildings, which are subject to VAT as described above), are subject to registration duty at the rate of 12.5% of the higher of transfer price or fair market value (except in the Flemish Region, where the applicable rate is 10%).

No registration duty is due upon a capital contribution; only a fixed fee of EUR 25 is due.

### *Stamp duties*

Stamp duties are due on transactions relating to public funds that are concluded or executed in Belgium, irrespective of their (Belgian or foreign) origin, to the extent that a professional intermediary intervenes in these transactions. Exemptions for non-residents and others are available.

## *Branch income*

Branch profits are subject to the normal tax rate for Belgian corporations of 33.99% plus the possible surcharge for absence/insufficiency of advance payments *(see the Taxes on corporate income section).* Transfers of branch profits to the head office abroad do not give rise to further taxation in Belgium. Branches can benefit from the reduced CIT rates under specific conditions *(see the Taxes on corporate income section).* The specifications for the applicable conditions include:

- To determine whether the EUR 322,500 ceiling of taxable income is exceeded and whether the 'EUR 36,000 remuneration' requirement is satisfied, reference needs to be made to the branch's results only.
- All other conditions must be satisfied at the level of the foreign company, taken as a whole.

Capital gains realised on real estate located in Belgium by non-resident companies are subject to a professional withholding tax (WHT) at the normal CIT rate of 33.99%. The professional WHT is in fact an advance payment of the final Belgian non-resident CIT and can be offset against it. Any balance is refundable.

In general, taxable basis is the difference between the profits actually realised and the tax deductible costs actually incurred in the hands of the Belgian branch as determined from the separate set of accounts of the Belgian branch. Please note, however, that no legal requirement exists to keep a separate set of accounts in the hands of the permanent establishment (PE), in case no legal branch is deemed to exist in Belgium.

Should no separate set of accounts be kept, the taxable basis in the hands of the Belgian branch, in principle, will be determined on the basis of article 182, §1, 3°, a) of the Royal Decree implementing the Belgian Income Tax Code. As a result, the yearly taxable basis will be determined on 10% of the gross turnover realised in Belgium with a minimum of EUR 7,000 per employee and an absolute minimum of EUR 19,000. Note that the European Court of Justice has ruled that this 'minimum taxable basis' is in violation with the freedom of establishment. It is still applied in practice, though. Note that such determination of the taxable basis is often formalised in a written agreement with the local Belgian tax inspector without, however, deviating from the tax law criteria as mentioned.

## *Income determination*

### *Inventory valuation*

Belgian accounting law provides for the following four methods of inventory valuation: the method based on the individualisation of the price of each item, the method of the weighted average prices, the last in first out (LIFO) method, and the first in first out (FIFO) method. All of these methods are accepted for tax purposes.

### *Capital gains*

Capital gains are subject to the normal CIT rate. For tax purposes, a capital gain is defined as the positive difference between the sale price less the costs related to the disposal of the asset and the original cost of the acquisition or investment less the depreciations and write-offs which have been deducted for tax purposes.

Capital gains realised on tangible fixed assets and intangible assets can be subject to a deferred and spread taxation regime, provided that the following conditions are cumulatively met:

- The assets realised have been held by the company for more than five years, and depreciations have been claimed on them for tax purposes.
- The proceeds of the transfer are reinvested fully in tangible or intangible assets subject to depreciation in Belgium within three years (or five years in the case of reinvestments in buildings, vessels, or aircrafts).

If the above conditions are met, the taxation of the net capital gain is spread over the depreciation period allowed for tax purposes of the asset that is acquired to fulfil the reinvestment obligation. Deferred and spread taxation occurs at the normal CIT rate.

Net capital gains realised on shares are 100% tax exempt if dividends from such shares would meet the 'taxation conditions' under the dividends-received deduction regime (*see the Deductions section for more information*). The 'minimum participation condition' provided under that regime needs not be satisfied for capital gain exemption.

### *Dividend income*

Dividends received by a Belgian company are first included in its taxable basis on a gross basis when the dividends are received from a Belgian company or on a net basis (i.e. after deduction of the foreign WHT) when they are received from a foreign company.

Provided certain conditions are met, 95% of the dividend income can be offset by a dividends-received deduction (DRD). *See the Deductions section for more information.*

### *Bonus shares – stock dividends*

Distribution of bonus shares to shareholders in compensation for an increase of the share capital by incorporation of existing reserves is, in principle, tax free. The situation may be different if the shareholder has the choice between a cash or stock dividend.

### *Foreign income*

A Belgian resident company is subject to CIT on its worldwide income, and foreign source profits not exempt from taxation by virtue of a double tax treaty *(see the treaty list in the Withholding taxes section)* are taxable at the normal CIT rate in Belgium (i.e. 33.99%).

A foreign tax credit may be available for foreign royalty income and foreign interest income. *See the Tax credits and incentives section for more information.*

Undistributed income of subsidiaries, whether or not they are foreign, is not subject to any Belgian income tax (i.e. no controlled foreign company (CFC) rules).

## *Deductions*

As a general rule, expenses are tax deductible in Belgium provided that they are incurred in order to maintain or to increase taxable income, they relate to the taxpayer's business activity, they are incurred or have accrued during the taxable period concerned, and that evidence of the reality and the amount of such expenses is provided by the taxpayer.

### *Provisions and bad debt reserves*

Provisions and bad debt reserves are tax deductible provided that:

- they are set up to cover clearly identified losses and charges (i.e. not to cover 'general' risks that have been rendered probable by events) which took place during the taxable period concerned
- they are booked at the end of the financial year in one or more separate accounts on the balance sheet
- they are reported on a specific form enclosed with the tax return, and
- they relate to losses and charges that are deductible for Belgian tax purposes.

### *Interest expenses*

Interest paid is not tax deductible to the extent that it exceeds an amount corresponding to the market rate, taking into account factual circumstances proper to the appraisal of the risk linked to the operation and particularly the financial situation of the debtor and the duration of the loan. The latter test, however, is not applied with respect to interest paid to a Belgian-based financial institution.

### *Dividends-received deduction (DRD)*

A DRD of 95% of dividend income can be applied under certain conditions *(see below)*. Any unused portion of the DRD from dividends received from a European Economic Area (EEA) subsidiary or a subsidiary from a country with which Belgium has concluded a double tax treaty with a non-discrimination clause on dividends can be carried forward to future tax years. The possibility of carrying forward the unused portion of DRD from qualifying non-EEA dividends has not been codified, but should continue to apply based on an October 2009 practice note. The same also applies for dividends from Belgian subsidiaries.

The DRD is subject to a (i) minimum participation condition and (ii) a taxation condition.

#### Minimum participation condition

According to the minimum participation condition, the recipient company must have, at the moment of attribution, a participation of at least 10% or an acquisition value of at least EUR 2,500,000 in the distributing company. However, that condition neither applies to dividends received or attributed by investment companies nor to dividends attributed by intra-municipal organisations. The beneficiary of the dividend must have been holding the full legal ownership of the underlying shares for at least one year prior to the dividend distribution or commit to hold it for a minimum of one year.

#### Taxation condition

The taxation condition, in summary, means that the dividend income received must have been subject to tax at the level of the distributing company and its subsidiaries if the former redistributes dividends received.

The taxation condition is based on five 'exclusion' rules and certain exceptions to these rules. Basically, the exclusion rules apply to the following:

- Tax haven companies, which are companies that are not subject to Belgian CIT (or to a similar foreign tax) or that are established in a country where the common taxation system is notably more advantageous than in Belgium. Countries in which the minimum level of (nominal or effective) taxation is below 15% qualify as tax havens for the application of the regime (a list of tainted countries has been published). The common tax regimes applicable to companies residing in the European Union are, however, deemed not to be notably more advantageous than in Belgium.
- Finance, treasury, or investment companies that, although are subject in their country of tax residency to a taxation system similar to that of Belgium as mentioned in the item above, nevertheless benefit from a taxation system that deviates from the one commonly applicable.
- Offshore companies, which are companies receiving income (other than dividend income) that originates outside their country of tax residency and in these countries such income is subject to a separate taxation system that deviates substantially from the common taxation system.

- Companies having branches that benefit globally from a taxation system notably more advantageous than the Belgian non-resident corporate taxation system. This exclusion is deemed not applicable to EU companies with an EU branch.
- Intermediary holding companies, which are companies (with the exception of investment companies) that redistribute dividend-received income, which on the basis of regulations mentioned under the items above would not qualify for the DRD for at least 90% of its amount in case of direct holding.

While this is a summary of the major exceptions, numerous exceptions to these exclusion rules exist and need to be analysed on a case-by-case basis.

### *Depreciation and amortisation*

Depreciation of an asset is tax deductible to the extent that it results from a devaluation of the asset, and the devaluation effectively occurred during the taxable period concerned. The depreciation methods that are accepted by Belgian tax law are the straight-line method (linear method) and the double-declining balance method. In the latter case, the annual depreciation may not exceed 40% of the acquisition value. The double-declining method may not be used for intangible fixed assets, automobiles, minibuses and automobiles used for mixed purposes, and for assets, the use of which has been transferred to a third party (e.g. in the case of operational leasing).

Depreciation rates are based on the estimated lifetime of the assets concerned, which are normally agreed upon by the taxpayer with the tax authorities. However, for certain assets, rates are set by administrative instructions as follows:

| Assets | Depreciation rate (%) |
|---|---|
| Commercial buildings | 3 |
| Industrial buildings | 5 |
| Machinery and equipment (depending on the type) | 20 or 33 |
| Rolling stock | 20 |

Intangible fixed assets have to be amortised over a period of at least five years for tax purposes (except R&D expenses, for which the minimum amortisation period is three years).

For the year of acquisition of an asset, only the proportionate share of an annual depreciation calculation can be accepted as depreciation for income tax purposes (in principle to be computed on a daily basis). This provision, however, applies only to companies that cannot be considered as SMEs *(see the Tax credits and incentives section for definition).* In contrast, SMEs can deduct a full year of depreciation in the year of acquisition.

According to the position of the central tax administration, no depreciation can be accepted for the year in which the asset is disposed of.

Ancillary expenses incurred at the time of acquisition must be depreciated in the same way as the asset to which they relate (i.e. no full deduction in the year of acquisition, except for SMEs). Alternatively, ancillary expenses relating to the acquisition of land can be written down and such write-downs, if they are justified, may constitute a deductible expense.

### *Goodwill*

Belgian accounting and tax laws allow amortisation of goodwill arising at the occasion of an asset deal. For Belgian tax purposes, the amortisation period, which depends on the elements included in the goodwill, is a minimum of five years, and the straight-line method must be applied. According to the Minister of Finance, 'clientele' (client lists) should be amortised over a period of 10 to 12 years. The aforesaid accounting and tax amortisation for goodwill is not available in the case of mergers or de-mergers that occur tax free (i.e. they, among other things, follow the continuity principle from an accounting perspective).

### *Start-up expenses*

Incorporation costs, at the election of the taxpayer, may be deducted fully in the year of incorporation or can be depreciated over a maximum period of five years.

### *Net operating losses*

#### Principle: carryforward without limitation in time

Tax losses can, in principle, be carried forward without any limitation in time.

#### Change of control

In case of change in control of a Belgian company (e.g. if the shares of the company are transferred and along with them the majority of the voting rights), the amount of tax losses carried forward available in that company (before the change of control) can no longer be offset against future profits unless the change can be justified by legitimate needs of a financial or economic nature in the hands of the loss realising company (i.e. evidence must be brought that the change is not purely tax driven).

The condition of legitimate needs of a financial or economic nature is considered to be fulfilled when the employees and activities of the company are maintained by the new shareholder or when the company's control is acquired by a company belonging to the same consolidated group of companies as the former controlling company.

A ruling can be obtained from the Belgian tax authorities to obtain upfront certainty on the Belgian tax treatment of the contemplated operation, so as to ensure the losses are not forfeited as a result of a change of control.

#### Tax-free merger or (partial) de-merger

In the case of a tax-free merger or (partial) de-merger, Belgian tax law provides for a partial transfer/maintenance of the rollover tax losses of the absorbed/absorbing company. The carried forward tax losses of the companies involved are then reduced based on the proportionate net fiscal value of the company (before the restructuring) compared to the sum of the net fiscal values of both the merging entities (before the restructuring).

#### No carryback

There is no tax loss carryback provision under Belgian tax law.

### *Payments to foreign affiliates*

A Belgian corporation can claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates, provided such amounts are at arm's length. However, when such payments are made, either directly or indirectly, to a foreign person, entity, or branch which is not subject to tax or is subject to a tax regime that is notably more advantageous than the Belgian tax regime on such income, there is a reversal of the burden of proof. Such charges will be disallowed unless the Belgian enterprise can prove that the payments are reasonable and that they correspond to genuine and real transactions.

Fees, commissions, etc. paid to beneficiaries located in foreign countries, which are not properly reported on Form 281.50 and Summary Form 325.50, will, in principle, be subject to the secret commissions tax (of 309%), unless the taxpayer can prove that the beneficiaries have declared this income in their Belgian tax return.

**Payments to tax havens**

As of 1 January 2010, companies subject to Belgian CIT or Belgian non-resident CIT that make direct or indirect payments to recipients established in tax havens are obliged to declare them if they are equal to or exceed EUR 100,000 during the tax year. The reporting has to be made on a special form to be attached to the (non-resident) CIT return.

In the event of non-reporting, the payments will be disallowed expenses for CIT purposes. Where the payments have been reported duly and timely, their tax deductibility will be subject to the ability of the taxpayer to prove that (i) said payments were made as part of genuine, proper transactions and (ii) they were not made to an entity under an artificial construction.

A tax haven is defined as: (i) a jurisdiction regarded by the Organisation for Economic Co-operation and Development (OECD) as not being cooperative concerning transparency and international exchange of information or (ii) a jurisdiction where the nominal corporate tax rate is less than 10%. A royal decree containing the list of countries where the nominal corporate tax rate is lower than 10% is published. The countries which are mentioned in the royal decree are the following:

| | | |
|---|---|---|
| Abu Dhabi | Fujairah | Nauru |
| Ajman | Guernsey | Palau |
| Andorra | Jersey | Ras el Khaimah |
| Anguilla | Jethou | Saint-Barthelemy |
| the Bahamas | Maldives Islands | Sark |
| Bahrain | Isle of Man | Sharjah |
| Bermuda | Micronesia (Federation of) | Turks and Caicos Islands |
| British Virgin Islands | Moldavia | Umm al Qaiwain |
| Cayman Islands | Monaco | Vanuatu |
| Dubai | Montenegro | Wallis-and-Futuna |

### *Taxes, fines, and penalties*

Belgian resident and non-resident CIT, including advance tax payments, any surcharge imposed in case of insufficient advance tax payments, any interest for late payment of the CIT, and any Belgian movable WHT, is not tax deductible in Belgium. Immovable WHT (i.e. real estate tax), secret commissions tax and foreign taxes, however, are considered as tax deductible.

Regional taxes and contributions, including penalties, increases, ancillary expenses, and interest for late payment, are not tax deductible in Belgium (certain exceptions apply).

Any administrative and judicial fines or penalties (except for VAT proportionate fines) are not tax deductible in Belgium.

### Automobile costs

As of 1 January 2010, rules related to the tax deductibility of automobile costs in the hands of Belgian companies (and Belgian branches) have been changed to introduce a system where the deductibility rate varies in a range between 50% and 120% of the automobile costs, depending on the CO2 emission of the automobile. Prior to 1 January 2010, the deductibility ranged from 60% to 90%.

Moreover, the deduction for fuel costs has been limited to 75% as of 1 January 2010.

Finally, the rules for determining the benefit in-kind arising from the private use of company automobiles have been amended. As of 1 January 2010, the benefit in-kind is calculated on the basis of a coefficient related to the CO2 emission of the automobile. Prior to 1 January 2010, this was determined on the basis of a fixed number of privately-driven kilometres (in principle 5,000 or 7,500) multiplied by a coefficient related to the fiscal horsepower of the automobile.

### Disallowed expenses

The following expenses are not tax deductible in Belgium (this list is not exhaustive):

- 31% of restaurant expenses.
- 50% of representation expenses and business gifts (there are exceptions).
- Advantages granted to employees for social reasons with certain exceptions (e.g. hospitalisation insurance premiums, gifts of a small value).
- Capital losses on shares (except in the case of liquidation, up to the amount of paid-up capital of the liquidated company).
- Brokerage, commissions, commercial discounts, or other payments allocated directly or indirectly to a person in the form of a Belgian public bribery.

## Group taxation

Belgium does not apply any tax consolidation mechanism with respect to corporate tax.

### Transfer pricing

The arm's-length principle is formally codified in multiple articles of the Belgian Income Tax Code, and Belgian tax law contains standard anti-abuse provisions dealing with artificial profit shifting (e.g. deductibility of costs, excessive expenses, granting and receiving of abnormal or benevolent benefits, deductibility of interest paid to a tax haven, deductibility of excessive interest).

If a Belgian tax resident company grants an abnormal or benevolent advantage (i.e. an advantage which has no arm's-length character), the advantage should be added back to taxable income as a disallowed expense unless the advantage is taken into account to determine the taxable basis of the beneficiary. Notwithstanding the above exception, the abnormal or benevolent advantage should be added back to taxable income when the advantage is being granted to a non-resident affiliated company. Such granted abnormal or benevolent advantages can be offset against any tax deductible items (e.g. tax losses carried forward, notional interest deduction).

If a Belgian tax resident company receives an abnormal or benevolent advantage, and to the extent that such benefit is received from a related company, the advantage received cannot be offset by the Belgian company against its current year or carryforward tax losses or other tax deductions (e.g. dividends-received deduction, patent income deduction, notional interest deduction, and investment deduction). According to a debatable position of the tax authorities, the taxable basis of a Belgian company must be at least equal to the amount of the advantage received.

No specific transfer pricing documentation requirements or rules on the selection of transfer pricing methods are foreseen in the Belgian tax legislation. Nevertheless, transfer pricing requirements have been developed, mainly by the tax authorities, which are in line with the OECD transfer pricing requirements and the EU Code of Conduct. Based on these requirements, it is advisable to proactively compile a coherent and consistent documentation set, although there is no legal obligation to do so.

### *Thin capitalisation rules*

While there are no general thin capitalisation rules in Belgium, there are two specific thin capitalisation rules.

The deduction of interest paid by a Belgian company or branch can be denied partially when the beneficial owner of such interest is not subject to tax or is subject, with respect to the interest received, to a tax regime that is significantly more advantageous than the ordinary Belgian income tax system. In that case, the interest charge is considered a disallowed expense to the extent that the outstanding total amount of tainted loans, other than fixed interest securities, from such beneficiary exceeds seven times the sum of taxable reserves (at the start of the financial year) and paid-up capital (at the end of the financial year) of the interest paying company (i.e. so-called 7/1 debt equity ratio).

Interest due on advances or loans (other than bonds) granted to a Belgian company (i) by shareholders (private individuals only) of that company, (ii) by any person (not being a Belgian tax resident company) acting as a director, manager (known as gérant/zaakvoerder), payments to liquidators or those exercising a similar function in the company, or (iii) by the spouse or minor children of such persons may be recharacterised as dividend income to the extent that the interest rate exceeds the applicable market rate or the amount of such advances or loans exceeds the sum of the paid-up capital (at year-end) and taxable reserves (at the start of the financial year) of the Belgian company.

### *Excess profit rulings*

While the Belgian tax authorities have long since had at their disposal instruments to make upward adjustments to a taxpayer's Belgian taxable basis in case of non-arm's-length dealings. A recent measure now allows multinational companies to achieve a unilateral downward tax adjustment. Belgium will refrain from taxing profits that a Belgian tax resident company would not have realised if it had not been party to related-party dealings.

As the cost structure (or the profit potential) of a member of a multinational group of companies will normally differ from that of a stand-alone entity, its profit will normally also be higher. Applying the arm's-length principle, this profit differential, which does not result from the functions performed and risks assumed by the respective entities, should not be allotted to the Belgian group member. As such, Belgian tax law allows for unilateral adjustments of the Belgian tax base similar to the corresponding adjustments in article 9 of the OECD Model Convention. The underlying assumption is that the 'excess profit' forms part of the profits of the foreign related party.

The part of profit that is deemed to derive from related-party dealings and that is exempted from taxation in Belgium and how the 'part-of-the profits-of-the-foreign-related-party' condition should be interpreted will need to be submitted to the Belgian Ruling Office to obtain a ruling in advance. Such rulings are granted for renewable periods of five years and are based on a detailed functional, economic analysis of the relevant Belgian activities with a view to determining a profit level commensurate with the company's functional and risk profile.

## *Tax credits and incentives*

### *Foreign tax credits (FTC)*

**Royalty income FTC**

Unless a more advantageous provision (e.g. a tax sparing provision) would apply based on a double tax treaty concluded by Belgium *(see the treaty list in the Withholding tax section)*, a FTC is granted under Belgian tax law with respect to foreign royalty income, provided that this income has effectively been subject to taxation in its source country. This FTC is equal to 15/85 of the net frontier amount (i.e. after deduction of foreign WHT) of the royalty. The FTC is included in the taxable basis of the recipient company and is only creditable against Belgian income tax to the extent that said foreign income is included in the taxable basis of the Belgian company. Excess FTC, if any, is not refundable.

**Interest income FTC**

Unless a more advantageous provision (e.g. a tax sparing provision) would apply based on a double tax treaty concluded by Belgium *(see the treaty list in the Withholding tax section)*, the Belgian beneficiary of foreign interest income is entitled to a FTC under Belgian tax law, provided that this income effectively has been subject to taxation in its source country. The computation of the FTC is based on the net frontier interest income (i.e. after deduction of foreign WHT) and adjusted with a ratio taking into account the financial cost. The FTC is included in the taxable base of the Belgian lender. It is creditable against the CIT due but is not refundable in case of excess.

### *Notional interest deduction (NID)*

Belgian corporate income taxpayers are allowed to claim a NID for tax purposes reflecting the economic cost of the use of capital, equal to the cost of long-term, risk-free financing. The NID rate is in principle based on the average rate on ten-year Belgian government bonds. The NID rate will be adjusted annually (with a maximum upwards or downwards variation of, in principle, 1%) again by making reference to the average interest rate on ten-year Belgian government bonds of the prior year, but capped at maximum 6.5% (7% for SMEs).

An SME is a company that does not exceed more than one of the following criteria during the two foregoing financial years when evaluated on a consolidated level: a yearly average number of employees of 50, a turnover of EUR 7.3 million (excluding VAT), or total asset value of EUR 3.65 million.

A company that employs more than 100 employees on the basis of an annual average workforce is automatically considered to be a 'large' company.

The NID rate for tax year 2011 (i.e. financial years ending between 31 December 2010 inclusive and 30 December 2011 inclusive) is capped at 3.8% (4.3% for SMEs). For tax year 2012 (i.e. financial years ending between 31 December 2011 inclusive and 30 December 2012 inclusive), the NID rate is 3.425% (3.925% for SMEs).

As for determining the basis on which this deduction is calculated, the company's share capital plus its retained earnings, as determined for Belgian generally accepted accounting principles purposes and as per the last year-end date, will have to be taken into account.

Certain adjustments to the equity should be made in order to avoid double use. The accounting equity as per the last year-end date has to be reduced by, amongst others, (i) the fiscal net value of financial fixed assets qualifying as participations and other shares, and (ii) in case of a company that has a foreign PE, located in a jurisdiction with which Belgium has concluded a tax treaty, the positive difference between the net book value of assets attributable to the foreign PE and the liabilities (other than equity).

In addition, various adjustments should be made in order to avoid abuse.

### *Investment deductions*

The investment deduction is a deduction from the tax base in addition to the normal tax depreciation on, amongst others, qualifying patents, environmentally friendly R&D investments, and security and energy-saving investments.

A company can benefit from a one-shot investment deduction of 13.5% (for tax year 2012, i.e. financial years ending between 31 December 2011 inclusive and 30 December 2012 inclusive) of the acquisition value of qualifying investments. With respect to environmentally friendly R&D investments, a company can also opt for a spread investment deduction of 20.5% (for tax year 2012) of the depreciation on qualifying environmentally friendly R&D investments.

In case of insufficiency or absence of taxable profits, the investment deduction can be carried forward without any limitation in time or in amount. Certain restrictions apply as to the maximum amount of investment deduction carried forward that is tax deductible in a given year.

Under certain conditions, the investment deduction carried forward can be lost after a change of ownership *(see Net operating losses in the Deductions section)*.

Note that the investment deduction for patents and R&D cannot be combined with the tax credit for patents and R&D.

### *Patents and R&D tax credit*

As an alternative for the above investment deduction for patents and R&D, a company may opt for a tax credit for which the advantage corresponds to the advantage of the investment deduction (i.e. 13.5% one-time and 20.5% for a spread investment deduction), multiplied by the normal CIT rate of 33.99%. The investment deduction implies a deduction of the taxable basis, while the tax credit is a reduction of the tax due. A key advantage of the tax credit for patents and R&D is that it is refundable if it has not been deducted for five subsequent tax years.

Note that the amount of the tax credit should be deducted from the basis of the notional interest deduction.

### *Reduced payroll tax for qualifying researchers*

75% of the payroll tax withheld from wages of qualifying researchers by a Belgian company or establishment does not need to be remitted to the Belgian Tax Revenue provided that the researchers are employed in research and development programmes and have a qualifying degree (such as a degree in (applied) sciences, veterinary medicines, bio-technology, etc.). For the employee's personal tax liability, the Belgian Tax Revenue considers that the payroll withholding tax amount entirely was withheld.

### *Patent income deduction (PID)*

The PID allows a taxpayer to deduct, as an extra tax deduction in the tax return, 80% of qualifying gross patent income. Therefore, only 20% of gross patent income will be taxable at the normal CIT rate (33.99%), resulting in a maximum effective tax rate of 6.8%.

Qualifying taxpayers are corporate taxpayers in Belgium that are involved in the development or further improvement of patents through an in-house R&D centre. They include both Belgian companies and Belgian PEs of foreign companies. The company must be the owner, licensee, or usufruct holder of the patents for which they claim the benefits of the PID.

To benefit from the PID, the R&D centre should qualify as a 'branch of activity' or 'line of business', which means that it should be a division of an entity that is capable of operating autonomously. The Belgian company or PE should have relevant substance to perform and supervise research and development activities, but may use subcontractors, related or unrelated, in its development of the patents or extended patent certificates. The law specifically provides that the R&D centre can be located outside Belgium but must belong to a Belgian legal entity.

Belgian companies or PE's acting as 'contract R&D' service providers on behalf of another company cannot qualify for PID because they are not the owners, holder of beneficial rights to, or licensee of the patent.

#### Qualifying patents

The PID applies where patents or supplementary protection certificates are owned by a Belgian company or establishment as a result of its own patent-development activities (partly or fully) in an R&D centre in Belgium or abroad. The PID also applies where patents or supplementary protection certificates are acquired by a Belgian company or establishment from a related or unrelated party, in full ownership, joint ownership, usufruct, or via license agreement, provided it has further improved the patented products or processes in the company's R&D centre in Belgium or abroad.

Other Intellectual Property (IP), such as copyrights, know-how, designs, trade or marketing intangibles, are as such not eligible for the Belgian PID.

The Belgian company or establishment can license the patents to other parties. Alternatively, it can use the patents, which are owned by it or licensed to it, to manufacture and supply patented products or services.

For patents licensed by the Belgian company or establishment to any party, whether related or unrelated, the tax deduction amounts to 80% of the relevant patent income to the extent the income does not exceed an arm's-length price.

For patents used by the Belgian company or establishment for the manufacture of patented products, manufactured by itself or by a contract manufacturer on its behalf, the tax deduction is 80% of the license fee (known as 'embedded royalties') that the Belgian company would have received had it licensed the patents used in the manufacturing process to an unrelated party.

The tax deduction for patent income is available to all corporate taxpayers in Belgium. This includes essentially all Belgian resident companies and Belgian permanent establishments of non-resident companies.

No advance ruling is required to benefit from this deduction since it is applicable generally and automatically. Only minor compliance formalities apply. The taxpayer should submit a special application form together with the CIT return.



## *Withholding taxes*

Domestic corporations and branches of foreign corporations paying dividends, interest, royalties, and/or certain rentals are required to withhold tax. The standard rates applicable under Belgian tax law are fixed at 25% for dividends and 15% for interest, royalties, and certain rentals. However, some WHT reductions/exemptions are foreseen under Belgian domestic tax law.

- A reduced Belgian WHT of 15% applies to dividend distributions relating to non-preference shares subscribed in cash, issued as of 1 January 1994 and which, upon issuance, are nominative or have been deposited with a financial institution in Belgium, on condition that the distributing company does not irrevocably renounce its right to benefit from the reduced rate of WHT.
- A reduced Belgian WHT of 15% is possible for dividend distributions relating to non-preference shares issued as of 1 January 1994 in the context of a public offering (i.e. shares quoted on the stock exchange) on condition that the distributing company does not irrevocably renounce its right to benefit from the reduced rate of WHT.
- Under certain conditions, a reduced WHT of 15% applies to dividend distributions made by companies quoted on a stock market or by companies whose capital has been (partly) contributed by a PRIVAK/PRICAF, which must also be quoted on a stock market. A PRIVAK/PRICAF is a company with the sole objective of collective investment in non-quoted companies and in growth companies.
- A WHT exemption on dividends is foreseen if both the receiving and distributing companies are subject to Belgian CIT, if the receiving company holds a minimum shareholding of at least 10% for at least one year in the capital of the subsidiary and if certain formalities are complied with. If the one year holding requirement is not fulfilled at the time of distribution, the distributing company provisionally should withhold the amount of WHT due (but it does not have to pay the tax authorities). Once the one year holding requirement is met, the provisionally withheld tax amount can be paid out to the parent company. If the one year holding requirement eventually is not complied with (e.g. because the Belgian participation is disposed of by the parent company before the one year holding requirement is met) then the Belgian company has to pay the amount provisionally withheld increased by interest for late payment (at an annual rate of 7%) to the competent services of the Belgian tax authorities.
- A WHT exemption is foreseen also for the distribution of profits made by a Belgian subsidiary to an EU parent company, if both the parent and subsidiary have a legal form that is mentioned in the Annex to the EU Parent-Subsidiary directive, if both are subject to CIT, and if the parent company holds during an uninterrupted period of at least one year a shareholding of at least 10% in the capital of the distributing company. The same procedure as that described above applies in case the one year holding requirement is not met at the moment of the dividend distribution.
- A 10% tax is applicable to profits that are attributed or made payable as a result of the full or partial liquidation of a company or the acquisition by a company of its own shares. However, the exemption of Belgian WHT is maintained for liquidation proceeds distributed by a BEVEK (Beleggingsvennootschap met veranderlijk kapitaal)/SICAV (Société d'investissment à capital variable), for dividends resulting from tax-free mergers, and for liquidation proceeds resulting from the redemption

of own shares by a company listed on a regulated stock exchange. If the conditions described above apply, an exemption is also available.
- The application of the Parent-Subsidiary directive to dividend payments has been extended towards non-EU resident companies. Dividends distributed towards a country that has concluded a tax treaty with Belgium containing a qualifying exchange of information clause can be exempt from WHT subject to the same conditions as laid down in the Parent-Subsidiary directive.
- There is a WHT exemption on interest on loans granted by professional investors to banks established in the EEA or in a country which has concluded a double tax treaty with Belgium. For example, banks situated in France, the United Kingdom, or the United States should be able to benefit from this exemption.
- No Belgium interest WHT arises where two related companies with tax residence outside Belgium are involved in a financial transaction with the intervention of a Belgium based intra-group financial enterprise. Under these circumstances, the Belgium intra-group financial enterprise is not required to retain Belgium interest WHT if the entity merely intervenes as 'paying agent intermediary'.
- Belgian domestic tax law also provides for a WHT exemption on the following movable income sourced in Belgium (this list is not exhaustive):
  - Income from deposits allocated or attributed to non-resident savers by Belgian banks.
  - Income from bonds, treasury bonds, or other similar instruments of which the beneficiaries are identified as financial institutions.
  - Income from receivables (this includes income from commercial receivables) or loans of which the beneficiaries are identified as financial institutions or professional investors. Professional investors are defined as any Belgian resident company or branch not being a financial institution or any equivalent. As a result, interest payments between two Belgian companies are exempt from WHT. The applicability of this exemption has been extended. As a result, on transactions with banks situated in a country with which Belgium has concluded a double tax treaty, no withholding will be due. In practice this means that on transactions with inter alia French, UK, and US banks no withholding will be due.
  - Income from bonds paid by a Belgian resident financial institution or by a Belgian resident company to non-resident savers, provided that such bonds are registered on a nominal basis with the debtor of the income during the entire period to which the interest relates and that the foreign beneficiaries of the interest are not located in a tax haven country or held by more than 50% by Belgian residents.
  - Income from bonds and loans granted by 'eligible quoted companies' and 'eligible intra muros financial companies' to non-residents (under certain conditions).
  - Interest payments between a Belgian company and an EU tax resident company in case of direct or indirect shareholding of at least 25% for an uninterrupted period of at least one year (i.e. transposition of EU Interest & Royalty directive in Belgian tax law).

With respect to payments made to non-resident corporations or individuals, WHT exemptions and/or reductions can also be found in the double taxation treaties concluded by Belgium.

| Recipient | Dividends (%) | Interest (%) (6) | Royalties, certain rentals (%) (6) |
|---|---|---|---|
| Non-resident corporations and individuals | | | |
| Non-treaty: | 25 | 15 | 15 |
| Treaty: | | | |

B

| Recipient | Dividends (%) | Interest (%) (6) | Royalties, certain rentals (%) (6) |
|---|---|---|---|
| Albania | 5/15 (4) | 5 | 5 |
| Algeria | 15 (4) | 15 | 5/15 |
| Argentina | 10/15 (4) | 12 | 3/5/10/15 |
| Armenia | 5/15 (4) | 10 | 8 |
| Australia | 15 (4) | 10 | 10 |
| Austria | 15 (4) | 15 | 10 |
| Azerbaijan | 5/10/15 (4) | 10 | 5/10 |
| Bangladesh | 15 (4) | 15 | 10 |
| Belarus | 5/15 (4) | 10 | 5 |
| Brazil | 10/15 (4) | 10/15 | 10/15/20 (7) |
| Bosnia-Herzegovina (1) | 10/15 (4) | 15 | 10 |
| Bulgaria | 10 (4) | 10 | 5 |
| Canada | 5/15 (4) | 10 | 0/10 |
| Chile | 0/15 (4) | 5/15 | 5/10 |
| China, P.R. (2) | 10 (4) | 10 | 10 |
| Croatia | 5/15 (4) | 10 | 0 |
| Cyprus | 10/15 (4) | 10 | 0 |
| Czech Republic | 5/15 (4) | 10 | 5/10 |
| Denmark | 15 (4) | 10 | 0 |
| Ecuador | 15 (4) | 10 | 10 |
| Egypt | 15/20 (4) | 15 | 15/25 (7) |
| Estonia | 5/15 (4) | 10 | 5/10 |
| Finland | 5/15 (4) | 10 | 5 |
| France | 10/15 (4) | 15 | 0 |
| Gabon | 15 (4) | 15 | 10 |
| Georgia | 5/15 (4) | 10 | 5/10 |
| Germany | 15/25 (4) | 0/15 | 0 |
| Ghana | 5/15 (4) | 10 | 10 |
| Greece | 5/15 (4) | 5/10 | 5 |
| Hong Kong | 0/5/15 (4) | 10 | 5 |
| Hungary | 10 (4) | 15 | 0 |
| Iceland | 5/15 (4) | 10 | 0 |
| India | 15 (4) | 10/15 | 20 (7) |
| Indonesia | 10/15 (4) | 10 | 10 |
| Ireland, Rep. of | 15 (4) | 15 | 0 |
| Israel | 15 (4) | 15 | 10 |
| Italy | 15 (4) | 15 | 5 |
| Ivory Coast | 15 (4) | 16 (4, 7) | 10 |
| Japan | 5/15 (4) | 10 | 10 |
| Kazakhstan | 5/15 (4) | 10 | 10 |
| Korea, Rep. of | 15 (4) | 10 | 10 |
| Kuwait | 0/10 (4) | 0 | 10 |
| Kyrgyzstan (3) | 15 | 15 | 0 |
| Latvia | 5/15 (4) | 10 | 5/10 |
| Lithuania | 5/15 (4) | 10 | 5/10 |

| Recipient | Dividends (%) | Interest (%) (6) | Royalties, certain rentals (%) (6) |
|---|---|---|---|
| Luxembourg | 10/15 (4) | 0/15 | 0 |
| Macedonia (1) | 10/15 (4) | 15 | 10 |
| Malaysia | 0/15 (4) | 10 | 10 |
| Malta | 15 (4) | 10 | 0/10 |
| Mauritius | 5/10 (4) | 10 | 0 |
| Mexico | 5/15 (4) | 10/15 | 10 |
| Moldova (3) | 15 | 15 | 0 |
| Mongolia | 5/15 (4) | 10 | 5 |
| Montenegro (1) | 10/15 (4) | 15 | 10 |
| Morocco | 6.5/10 (4) | 10 | 10 |
| Netherlands | 5/15 (4) | 0/10 | 0 |
| New Zealand | 15 (4) | 10 | 10 |
| Nigeria | 12.5/15 (4) | 12.5 | 12.5 |
| Norway | 5/15 (4) | 15 | 0 |
| Pakistan | 10/15 (4) | 15 | 15/20 (7) |
| Philippines | 10/15 (4) | 10 | 15 |
| Poland | 5/15 (4) | 5 | 5 |
| Portugal | 15 (4) | 15 | 10 |
| Romania | 5/15 (4) | 10 | 5 |
| Russia | 10 (4) | 10 | 0 |
| San Marino | 0/5/15 (4) | 10 | 5 |
| Senegal | 15/16 (4) | 15/16 | 10 |
| Serbia (1) | 10/15 (4) | 15 | 10 |
| Singapore | 0/5/15 (4) | 5 | 5 |
| Slovakia | 5/15 (4) | 10 | 5 |
| Slovenia | 5/15 (4) | 10 | 5 |
| South Africa | 5/15 (4) | 10 | 0 |
| Spain | 15 (4) | 10 | 5 |
| Sri Lanka | 15 (4) | 10 | 10 |
| Sweden | 5/15 (4) | 10 | 0 |
| Switzerland | 10/15 (5) | 10 (5) | 0 |
| Taiwan | 10 (4) | 10 | 10 |
| Tajikistan (3) | 15 | 15 | 10 |
| Thailand | 15/20 (4) | 10/25 | 5/15 |
| Tunisia | 5/15 (4) | 5/10 | 11 |
| Turkey | 15/20 (4) | 15 | 10 |
| Turkmenistan (3) | 15 | 15 | 0 |
| Ukraine | 5/15 (4) | 2/10 | 0/10 |
| United Arab Emirates | 5/10 (4) | 5 | 0/5 |
| United Kingdom | 5/10 (4) | 15 | 0 |
| United States | 0/5/15 (4) | 0/15 | 0 |
| Uzbekistan | 5/15 (4) | 10 | 5 |
| Venezuela | 5/15 (4) | 0/10 | 5 |
| Vietnam | 5/10/15 (4) | 10 | 5/10/15 |

Notes

1. The treaty concluded with ex-Yugoslavia is still applicable to Bosnia-Herzegovina, Macedonia, Serbia, and Montenegro.
2. Not applicable to Hong Kong. Note that a new treaty with China has been signed (but not yet into force). The rates under the new treaty are 5% and 10% for dividends, 10% for interest, and 7% for royalties.
3. The treaty concluded with the former USSR is still applicable to Kyrgyzstan, Moldova, Tajikistan, and Turkmenistan.
4. It concerns an EU country or the treaty contains a qualifying exchange of information clause. Hence, the rate of 0% is applicable subject to the same conditions as invoked by the Parent-Subsidiary directive *(see above)*.
5. Under the Bilateral II agreement concluded between Belgium and Switzerland, a rate of 0% is applicable under certain conditions.
6. With respect to EU countries, a WHT exemption is applicable provided that the conditions laid down in the Interest & Royalty directive are met *(see above)*.
7. Since the Belgian domestic rate for interest and royalties is maximum 15%, the higher treaty rate will in principle not be applicable on interest and royalties arising from Belgium.

The treaties which are currently in force are listed above. The following tax treaties are signed, modified, or under renegotiation but have not yet entered into force (including some for the exchange of information clause): Armenia, Azerbaijan, Australia, Bahrain, China, Congo, Croatia, Denmark, Isle of Man, Finland, France, Germany, Iceland, Italy, Japan, Luxembourg, Macao, Malaysia, Malta, Moldova, the Netherlands, New Zealand, Norway, Qatar, Rwanda, San Marino, Seychelles, Singapore, Spain, Tajikistan, Uganda, and the United Kingdom.

## Tax administration

### Tax returns

As a general rule, the annual resident or non-resident CIT return cannot be filed less than one month from the date when the annual accounts have been approved and not later than six months after the end of the period to which the tax return refers. For instance, assuming that the accounting year has been closed on 31 December 2010, the corporate tax return needs to be filed, in principle, by 30 June 2011 at the latest (this deadline is often postponed).

### Payment of tax

CIT is payable within two months following the issue of the tax assessment. Interest for late payment is charted at the (non-cumulative) rate of 7% per year.

The advance tax payments needed to avoid the CIT surcharge *(see the Taxes on corporate income section)* can be made in quarterly instalments. In the situation where the company's financial year ends on 31 December 2011, the due dates for the advance tax payments are 11 April 2011, 12 July 2011, 10 October 2011, and 20 December 2011. Advance tax payments give rise to a tax credit. The tax credit amounts to 3%, 2.25%, 2%, or 1.5% of the advance tax payment made, depending on whether such payment has been made respectively in the first, second, third, or fourth quarter (percentages applicable for tax year 2012). If the total amount of credits exceeds the surcharge, no surcharge is due, but the excess is not further taken into account for the final tax computation. The taxpayer can choose to either have the excess reimbursed by the tax authorities as the excess can be used as an advance tax payment for the next year.

### Belgian ruling practice

Belgium has a long tradition of providing formal and informal rulings. Currently, a taxpayer may request an advance tax ruling on a wide range of subjects including but not limited to: CIT, individual tax, non-resident income tax, legal entity income tax, VAT, customs, and registration duties. The request should cover a 'specific and concrete' operation, which effectively is envisaged to be realised in a foreseeable future. The ruling should be filed before the transaction takes place. In practice, the ruling decision should be granted prior to the filing of the CIT return of the year of the transaction. A ruling is binding upon the Belgian tax authorities for a renewable period of five years. Delivery of a requested ruling takes, on average, three months.

The Ruling Office is autonomous from the Belgian tax authorities and has the legal authority to issue decisions, which are binding upon the Belgian tax authorities. The Ruling Office increasingly has adopted a constructive approach towards the taxpayer and is seen in the Belgian tax practice as a powerful insurance instrument ascertaining the Belgian tax treatment of contemplated operations.

# Bermuda

B

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## Significant developments

The Bermuda Government has recently extended the tax exemption granted to Bermuda companies under the Exempt Undertakings Act of 1976 from 28 March 2016 until 2035. The extended Undertaking provides protection to companies from any newly enacted taxes on income or capital gains until 2035. Existing companies are required to apply for the tax exemption extension.

Further, the Bermuda government has recently agreed to Tax Information Exchange Agreements (TIEAs) with a number of key trading partners, including The People's Republic of China, Canada, and Italy. 24 TIEAs have now been agreed to/signed (including all of the G7 countries). The follow list of countries have agreed to/signed TIEAs with Bermuda: Aruba, Australia, Canada, China, Denmark, Faroe Islands, Finland, Germany, France, Greenland, Iceland, India, Ireland, Italy, Japan, Mexico, Netherlands, Netherlands Antilles, New Zealand, Norway, Portugal, Sweden, the United Kingdom, and the United States.

Bermuda also has a Double Taxation Agreement with the Kingdom of Bahrain and a Limited Tax Treaty with the United States which only applies to 'enterprises of insurance'.

Under certain circumstances, the United States-Bermuda Tax Treaty provides for relief from taxation of insurance business profits. The business profits of a Bermudian insurance company will not be taxed in the United States unless a company has a permanent establishment (PE) in the United States. The United States-Bermuda Tax Treaty also provides for mutual assistance on tax matters. The purpose of a mutual assistance provision is to prevent or decrease tax avoidance. The United States also believed that having a tax treaty with Bermuda would be beneficial for the United States-Bermuda diplomatic relations.

Bermuda's double taxation agreement with the Kingdom of Bahrain includes a provision for the full exchange of information on criminal and civil tax matters, consistent with the internationally agreed standard for transparency and the exchange of information for tax purposes set by the Organisation for Economic Co-operation and Development (OECD).

## Taxes on corporate income

Income tax and taxes on capital gains are not imposed on corporations in Bermuda.

# Bermuda

## Corporate residence

Entities that are incorporated in Bermuda are considered to be resident in the country.

## Other taxes

### Value-added tax (VAT)
There is no VAT or sales tax in Bermuda.

### Customs duties/import tariffs
Customs duties are imposed on almost all goods arriving on the island at varying rates.

### Excise taxes
There are no excise taxes imposed in Bermuda.

### Property taxes
A land tax is imposed on all developed land throughout Bermuda, with certain exceptions. The tax is assessed on the annual rental value of each valuation unit, depending on whether such unit is a private dwelling or any other dwelling. The owner of the valuation unit is liable for the land tax.

Private dwellings are taxed on a progressive scale of tax rates that ranges between 0.6% and 19% based on the annual rental value of the unit, while commercial properties are taxed on a single rate of tax of 4.4%.

### Transfer taxes
There is no transfer tax imposed in Bermuda.

### Stamp taxes
Bermuda does impose a stamp duty on certain types of legal instruments; however, exempt companies are not subject to stamp duty.

### Social insurance
If an employer has employees in Bermuda for 26 or more weeks in a calendar year, the employer will have to register and obtain an account number from the Department of Social Insurance (DSI) (unless previously registered) and pay social insurance tax for its employees. At the same time, the employer must also apply for and obtain from the DSI a social insurance number for each employee, which is required to pay social insurance. Once the employer has registered for a social insurance account number and the employees have obtained social insurance numbers, the DSI will automatically send an electronic print-out to the employer with an itemised list of employees as well as the amount of social insurance tax due for the month. Under certain facts and circumstances, the employer may also file an Employee Amendment Form, which shows any change in status (i.e. termination or unpaid leave) of employees that could affect the amount of social insurance tax due.

The amount of social insurance tax due is calculated as 60.80 Bermudian dollars (BMD) per employee per week (effective 1 April 2010), with the employer and employee each paying half of the liability (or BMD 30.40). The employer must pay and remit monthly (for all employees), to the DSI, the total social insurance tax due per employee. The amount of social insurance tax due per month is based on the number of Mondays in the month and must be paid by the end of the following month. Employed persons over the age of 65 are not required to pay their half (BMD 30.40). The employer continues to pay their half (BMD 30.40).



### *Payroll tax*

Under Section 3 of the Payroll Taxes Act 1995, an employer (viewed as the entity that has control over an individual's remuneration) is required to remit payroll taxes (currently 14% on all remuneration paid or given up to a maximum compensation of BMD 750,000) for each of its employees whose employment in Bermuda exceeds four consecutive weeks in a calendar year (whether or not with one or more employers). If an employee's stay in Bermuda is for a period of less than four consecutive weeks, the employer is not obligated to remit the payroll taxes.

Once an employee's service period in Bermuda has exceeded four consecutive weeks, the employer must register the employee with the Office of the Tax Commissioner (OTC). The employer must obtain a payroll tax account number by filing an application with the OTC, if no previous account exists for such employee. The application must be filed within seven days after the end of the quarterly tax period (the four quarters end on 1 January, 1 April, 1 July, and 1 October) in which the employee's stay exceeded four consecutive weeks. A payroll tax return and remittance of tax must be filed with the OTC 15 days after the end of each quarterly period (i.e. 15 January, 15 April, 15 July, and 15 October). A return is due only when an employee's stay exceeds four consecutive weeks in a tax period. The employer may recover from the employee a maximum of 5.25% of the 14% payroll tax, and the employer is allowed an exemption of BMD 600 (of remuneration paid) per employee for each quarterly tax period. Penalties for tax returns filed late are 5% of the payroll tax due for each month (or part thereof) that the tax return is late (with a maximum of 30%).

Compensation subject to the payroll tax under the Payroll Taxes Act includes all remuneration paid or given to the employee. Remuneration includes:

- wages, salary, leave pay, commission, gratuity, fee, bonus, perquisite, or allowance
- money paid under a profit-sharing scheme
- money or anything of value paid or given to an employee or ex-employee in connection with the permanent termination of employment
- any amount paid with respect to a retirement or provident fund, scheme, or society, or under a hospital or health insurance scheme
- the value of meals, boarding, lodging, or other benefit of any kind, whether provided in cash or otherwise
- the rental value of any place of residence provided rent-free, or the difference between the rent paid and the rental value if the rent paid is lower than the rental value, and
- any gain on the exercise or right to acquire company stock based on services rendered.

All employers or self-employed persons are required to report remunerations up to a maximum of BMD 750,000 per annum per employee, deemed employee, or self-employed person. There is no payroll tax on remunerations above BMD 750,000.

Please note that the Payroll Taxes Act is extremely broad in its definition of remuneration. Therefore, a Bermuda employer should take caution when calculating the amount of remuneration paid to an employee.

### *Annual company fee*
Every exempted company shall, in the month of January, forward to the Registrar of Companies a declaration, signed on behalf of the company, as to the company's principal business and its assessable capital together with the appropriate fee payable. For the purposes of the Companies Act 1981, an exempted company means a local company which does not comply with the requirements of the Companies Act 1981. Exempt companies are generally owned by non-Bermudans.

| Assessable capital of the exempted company (BMD) | Annual company fee (BMD) |
|---|---|
| 0 to 12,000 | 1,870 |
| 12,001 to 120,000 | 3,820 |
| 120,001 to 1,200,000 | 5,890 |
| 1,200,001 to 12,000,000 | 7,850 |
| 12,000,001 to 100,000,000 | 9,815 |
| 100,000,001 to 500,000,000 | 17,530 |
| 500,000,001 or more | 29,220 |

### *Corporate services tax*
A 4% corporate service tax is imposed on a provider of corporate services in respect of gross earned revenue derived from an exempted undertaking for taxable corporate services provided during a tax period. Corporate services include corporate administrative services, corporate management services, corporate secretarial services, the provision of a registered office, the performance of functions in the capacity of director or resident representative, and the provision of accounting and/or financial services.

### *Hotel occupancy tax*
A 7.25% tax is imposed on revenue received from hotels and other forms of accommodation.

### *Betting duty*
There is a betting duty charge of 20% imposed on all bets made, received, or negotiated by a person licensed under the Betting Act of 1975.

## *Branch income*

Branches are treated the same as other corporations doing business in Bermuda.

## *Income determination*

Since income taxes are not imposed on corporations in Bermuda, income determination is not relevant in the context of Bermuda taxation.

## *Deductions*

Since income taxes are not imposed on corporations in Bermuda, deductions from income are not relevant in the context of Bermuda taxation.

## Group taxation

Since income taxes are not imposed on corporations in Bermuda, group taxation is not relevant in the context of Bermuda taxation.

## Tax credits and incentives

Bermuda offers no specific tax incentives.

## Withholding taxes

There are no withholding taxes in Bermuda.

## Tax administration

Since income taxes are not imposed on corporations in Bermuda, tax returns are not required to be completed for corporate income tax compliance purposes. *For information regarding tax returns, due dates, and the payment of tax for non-income taxes imposed in Bermuda (e.g. Social insurance and Payroll tax), please see the Other taxes section.*

## Other issues

### Foreign exchange controls

Exempt companies and permit partnerships are considered as non-residents for exchange control purposes. This allows these entities to make dividend payments, distribute capital, open and maintain foreign bank accounts, maintain bank accounts in any currency, and purchase securities.

There is a Foreign Currency Purchase Tax imposed at the rate of 1% on foreign currency purchased by a resident from a local bank.

### Tax treaties

There are no tax treaties between Bermuda and other nations due to the fact that Bermuda does not impose direct taxes. However, Bermuda has a Double Taxation Agreement with the Kingdom of Bahrain and a Limited Tax Treaty with the United States which only applies to 'enterprises of insurance'. Bermuda also has Tax Information Exchange Agreements with the following 24 countries: Aruba, Australia, Canada, China, Denmark, Faroe Islands, Finland, Germany, France, Greenland, Iceland, India, Ireland, Italy, Japan, Mexico, Netherlands, Netherlands Antilles, New Zealand, Norway, Portugal, Sweden, the United Kingdom, and the United States.

# Bolivia

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## Significant developments

A specific tax on lottery and gambling games came into force in late December 2010. The tax is also applicable to business promotions that involve a raffle or random activities in providing awards in order to increase sales or attract clients. The tax rate for lottery and gambling games is 30%, whereas the tax rate for business promotions is 10%.

The Bolivian government approved a new Pension Law in December 2010, which establishes additional employer social contribution obligations. Social tax charges for employers are now equal to 16.71% (previously was 13.71%) of gross salary in general and 18.71% (previously was 13.71%) for the mining sector.

In late 2010, changes to the Bolivian Tax Code established minimum amounts for which taxpayers must document their economic transactions (i.e. payment of acquisition of goods and services) through 'reliable means of payment', which consist of documents of payments recognised by the Bolivian financial system and regulated by the Autoridad de Supervisión del Sistema Financiero (ASFI) (i.e. the bank regulator).

The above changes were subsequently regulated in late May 2011, establishing the minimum amount of 50,000 bolivianos (BOB) for each economic transaction and the obligation to document such economic transactions with 'reliable means of payments'. Non-compliance with these new requirements implies the lack of the possibility to compute input VAT and to deduct the associated expenses for corporate income tax (CIT) purposes.

## Taxes on corporate income

All companies in Bolivia are subject to CIT at a rate of 25%. The taxable base is the profit arising from financial statements prepared in accordance with Bolivian generally accepted accounting principles (GAAP), adjusted for tax purposes (i.e. by non-deductible and non-taxable items) as per the requirements established in the tax law and regulations.

Bolivia taxes the income generated by corporations following the 'income source' principle (i.e. on a territorial basis). Therefore, income arising from goods and assets located or utilised economically within Bolivian territory and from any activity carried out within the country is considered Bolivian income source. Hence, such income is subject to CIT, regardless of the nationality/residence of the parties involved in generating such income or the place where the contracts were subscribed.

### *Surtax on extractive activities*

There is an additional CIT at a rate of 25%, which affects only extractive activities of non-renewable natural resources (mining and oil/gas). This additional tax is calculated on the same basis as the normal CIT, except that two additional deductions are allowed: (i) up to 33% of the accumulated investment as from 1991; and (ii) 45% of the gross revenue of each extractive operation (e.g. a field or a mining site) with a threshold of BOB 250 million for each extractive operation.

### *Special taxes on mining companies*

In addition to the general CIT of 25% and the 25% surtax on extractive activities, all mining companies are also subject to an additional tax, calculated on the taxable net profits, at the following rates:

- 12.5%, if the mining company carries out exploitation activities.
- 7.5%, if the mining company carries out manufacturing activities with raw minerals that add value.

Mining companies are also subject to mining royalties at a rate of between 1% and 7% (depending on the kind of mineral), calculated on the total sales price. Note that there is a 60% discount on the rates of mining royalties if minerals are sold within the Bolivian market. Mining royalties can be offset against CIT if official mineral prices are lower than the prices established by the tax law; however, in this case, mining royalties paid will not be deductible for CIT purposes. On the contrary, if official mineral prices are higher than the prices established by the tax law, then mining royalties will be considered a deductible expense for CIT purposes.

### *Tax on gross income*

The tax on gross income (also known as transaction tax) generally taxes gross income arising from the performance of any economic or commercial activity (including non-profitable activities) at a rate of 3% on a monthly basis. However, exceptions exist for the sale of investments (as defined by the Stock Exchange Law) and the sale of minerals, oil and gas within the local market, as long as such sales will ultimately be exported.

Corporations pay either CIT or transaction tax, whichever is higher. From an administrative perspective, CIT is due and paid at the end of each tax year and is considered an advanced payment of transaction tax, while transaction tax is due monthly. If during the year the cumulative monthly transaction tax due exceeds the CIT prepayment, the taxpayer will be subject to transaction tax on a monthly basis until the end of the tax year. For example, a corporation pays CIT for the 2009 fiscal year in April 2010. This payment is considered a prepayment for the transaction tax due between May 2010 and April 2011.

## *Corporate residence*

A corporation is considered resident in Bolivia if it has been incorporated in Bolivia.

Note that Bolivian commercial laws allow foreign corporations to carry out isolated commercial acts in Bolivia without the obligation to constitute a permanent representation in Bolivia; however, such corporations cannot carry out habitual commercial acts without fulfilling the requirements established to constitute a company in Bolivia (e.g. through either a subsidiary or a branch). Unfortunately, Bolivian legislation does not include provisions to regulate situations that could trigger permanent establishment (PE) nor does it define what should be understood by 'carrying out habitual commercial acts'.

## Other taxes

### Value-added tax (VAT)

VAT is levied on the sale of movable goods and provision of services carried out within Bolivian territory at a rate of 13%, including definitive importations. Since this tax is included in the final price, the effective tax rate amounts to 14.94% (13% / 87%).

### Customs duties

Definitive importations are also subject to customs duties at a rate of 10% and 5% for consumption goods and capital assets, respectively. Customs duties are calculated over the 'transaction value' of the merchandise valued as per Bolivian customs legislation, plus transportation and insurance costs.

### Property tax on real estate and vehicles

Real estate and vehicles are subject to a property tax calculated at different rates based on a scale value determined by the municipal government as follows:

| Property value (BOB) | | Property tax liability | | |
|---|---|---|---|---|
| From | Up to | BOB | Plus (%) | over excess of (BOB) |
| 0 | 200,000 | 0 | 0.35 | 0 |
| 200,001 | 400,000 | 700 | 0.50 | 200,000 |
| 400,001 | 600,000 | 1,700 | 1.00 | 400,000 |
| 600,001 | Onwards | 3,700 | 1.50 | 600,000 |

| Vehicle value (BOB) | | Vehicle tax liability | | |
|---|---|---|---|---|
| From | Up to | BOB | Plus (%) | over excess of (BOB) |
| 0 | 24,606 | 0 | 1.50 | 0 |
| 24,607 | 73,817 | 492 | 2.00 | 24,607 |
| 73,818 | 147,634 | 1,722 | 3.00 | 73,818 |
| 147,635 | 295,268 | 4,306 | 4.00 | 147,635 |
| 295,269 | Onwards | 10,949 | 5.00 | 295,269 |

### Taxes on specific goods for consumption (excise tax)

Specific goods are taxed at the following rates:

| Product | Tax rate (%) |
|---|---|
| Cigarettes and tobacco for pipes | 50 to 55 |
| Vehicles (except those of high capacity and weight, which will pay a 10% rate of excise tax) | 18 |

Other specific products taxed by specific measure:

| Product | Tax rate (BOB) |
|---|---|
| Soft drinks (except natural water and fruit juices) | 0.30/litre |
| Energising drinks | 3.50/litre |

| Product | Tax rate (BOB) |
|---|---|
| Maize liquor | 0.62/litre |
| Alcohol | 1.18/litre |
| Beers with 0.5% or more volumetric degrees | 2.60/litre + 1% |
| Wines | 2.40/litre + 5% |
| Ciders and sparkling wines (except maize liquor) | 2.40/litre + 5% |
| Liquors and creams in general | 2.40/litre + 5% |
| Rum and vodka | 2.40/litre + 10% |
| Other brandies/liquors | 2.40/litre + 10% |
| Whiskey | 10.01/litre + 10% |

### *Special tax on hydrocarbons and derived products*
A tax is charged on the commercialisation of the following products within the local market, regardless of whether they are produced in Bolivia or imported:

| Product | Tax rate (BOB) |
|---|---|
| Gasoline | 1.23/litre |
| Premium gasoline | 2.18/litre |
| Aviation gasoline | 1.85/litre |
| Kerosene | 0.29/litre |
| National jet fuel | 0.32/litre |
| International jet fuel | 4.28/litre |
| National diesel oil | 0.00/litre |
| Agro fuel | 0.00/litre |
| Fuel oil | 1.25/litre |

### *Direct tax on hydrocarbons*
A direct tax on hydrocarbons (IDH) is applied on the production of hydrocarbons, measured at the wellhead point, at a rate of 32%. To determine the taxable base for this tax, production of hydrocarbons must be valued taking into account the average sales price and considering the market (internal/external) where such hydrocarbons were sold.

### *Financial transaction tax*
A financial transaction tax is levied on bank transactions (deposit or transfer of funds), carried out within the domestic financial system, at a rate of 0.15%.

### *Special tax on lottery and gambling games*
A specific tax on lottery and gambling games came into force in late December 2010. The tax is also applicable to business promotions that involve a raffle or random activities in providing awards in order to increase sales or attract clients. The tax rate for lottery and gambling games is 30%, whereas the tax rate for business promotions is 10%.

### *Social contributions*
The Bolivian government approved a new Pension Law in December 2010, which establishes additional employer social contribution obligations. Social tax charges for employers are now equal to 16.71% (previously was 13.71%) of gross salary in general and 18.71% (previously was 13.71%) for the mining sector.

### Stamp taxes

There are no stamp taxes in Bolivia.

## Branch income

Branch income is subject to the same tax applicable to other types of Bolivian corporations (i.e. CIT of 25%). However, note that net profits of Bolivian branches are deemed to be distributed to the head office at the annual filing due date for CIT (i.e. 120 days after the fiscal year end); hence, a Bolivian branch must withhold 12.5% on such deemed distributed profits. Note that this can be avoided as long as the head office decides to reinvest Bolivian branch's net profits.

## Income determination

Taxable income is determined based on the financial statements prepared under Bolivian GAAP; then the income is adjusted for tax purposes in accordance with guidelines provided with respect to non-deductible and non-taxable items.

### Inventory valuation

Inventories must be valued at replacement cost or market value for tax purposes, whichever is lower. Replacement cost is defined as the necessary costs incurred in acquiring or producing the assets as of the year-end, whereas market value is defined as the net value that the company would have obtained for the sale of assets in normal conditions as of the year-end, less commercialisation direct expenses.

### Capital gains

Bolivian legislation does not include specific regulations for capital gains. Capital gains must be included in annual CIT if they are considered Bolivian-source income and hence will be taxed at a rate of 25%.

### Dividend income

Dividend income obtained from domestic corporations subject to CIT must be excluded from the net taxable profits of the investor. Dividend income obtained from foreign corporations is not subject to CIT due to the fact that is not considered Bolivian-source income.

### Interest income

Interest income is subject to annual CIT if loans have been economically utilised within Bolivian territory and hence associated interest is considered Bolivian-source income.

### Rent/royalty income

Rent/royalty income is subject to annual CIT as long as the income comes from an asset situated or economically utilised in Bolivian territory.

### Foreign income

Bolivian corporations are taxed only on income generated within Bolivian territory.

## Deductions

As a general principle, expenses may be deducted for CIT purposes as long as they are necessary to generate Bolivian-sourced income and are properly documented.

### *Depreciation*
Depreciation of fixed assets is permitted for CIT purposes if fixed assets contribute to generate taxable income. Depreciation must be calculated based on a straight-line method and considering useful lives included in tax law. Fixed assets which are not included in the tax law must be depreciated under a straight-line method in accordance with their useful lives, and this need to be communicated before the tax authorities within ten working days following the incorporation of the affected fixed assets.

### *Interest expense*
Interest paid to owners or shareholders is not deductible to the extent the interest rate exceeds the London Interbank Offered Rate (LIBOR) plus 3% in the case of foreign owners/shareholders and to the extent the interest rate exceeds the official interest rate on loans published by the Central Bank of Bolivia for national owners/shareholders. Interest deductible on shareholder loans may not exceed 30% of the total interest paid to third parties.

### *Bad debt*
Allowances for bad debt provisions are permitted if determined as required by law, which establishes an average method based on uncollectable receivables of the last three years. Uncollectable receivables are defined by current legislation as those which come from trade receivables and either: (i) remain unpaid for more than one year and have been sued without obtaining a seizure or (ii) when the receivables do not justify being sued due to the quantity of the receivables, remain unpaid for more than three years.

### *Compensation expenses*
Salaries, as well as associated compensations, paid to employees without the application of withholding taxes (i.e. RC-IVA) are not deductible. Employees are subject to RC-IVA at a rate of 13%, which is calculated on the gross salary (including any other compensation in kind/cash) less social contributions and four minimum national salaries (approx. BOB 48,950). RC-IVA must be withheld and paid to the tax authorities by the employer on a monthly basis.

Provisions for employees' severance payments are deductible. Provisions of other bonuses (e.g. holiday, productivity bonuses) accrued on behalf of employees are tax deductible as long as they are paid prior to the annual CIT filing due date and the company demonstrates it has withheld taxes (if applicable).

### *Charitable contributions*
Donations are not deductible unless made to non-profit organisations that are not subject to CIT. These donations are deductible up to a maximum of 10% of the donor's net taxable profit.

### *Taxes*
Taxes effectively paid by the corporation as a direct taxpayer, other than CIT, are deductible for tax purposes. Any transaction tax (tax on gross income) that has been offset against CIT paid is not deductible for CIT purposes.

Taxes paid in the acquisition of fixed assets are not deductible. These taxes must be included in the cost of the asset and depreciated accordingly.

### *Other significant items*
In broad terms, the following additional items are not deductible for tax purposes, according to current legislation:

- Owners' or shareholders' personal withdrawals and living expenses.
- Fees paid to individuals (i.e. acquisition of goods and services) for which no WHT have been withheld.
- Amortisation of trademarks and other intangible assets, unless a price has been paid to acquire them.
- Provisions that are not specifically authorised by the tax law and regulations.
- Depreciation of fixed assets that include a revaluation reserve.
- Losses arising from illegal acts.

### *Net operating losses*
Tax losses can be carried forward with no time limit. Bolivian legislation does not envisage carryback provisions for tax losses.

### *Payments to foreign affiliates*
Payments to foreign affiliates are subject to a 12.5% WHT with no restriction if the Bolivian company is remitting Bolivian-sourced income (e.g. interest on loans, provision of any kind of services, royalties).

## *Group taxation*

Bolivia does not include group taxation rules within its legislation.

### *Transfer pricing*
Bolivian legislation does not include provisions for transfer pricing; however, transactions carried out between related companies must be performed at market value or as they were carried between third parties (i.e. sort of arm's-length principle) and any excess must be considered non-deductible for tax purposes. Note that there are not further regulations as regards to how taxpayers must demonstrate that transactions carried out between related parties were carried out at market value.

### *Thin capitalisation*
Bolivian legislation does not include provisions for thin capitalisation apart from establishing restrictions on deductibility of interest when funding is provided by shareholders *(see Interest expense in the Deductions section)*.

## *Tax credits and incentives*

### *Investment incentives*
No incentives are granted in Bolivia for domestic or foreign investment.

### *Export incentives*
Export activities benefit from reimbursement of VAT and customs duties paid in the process of producing goods to be exported (with some limitations for oil/gas companies).

### *Other incentives*
Foreign exchange transactions are legal in Bolivia, and a system of free-floating exchange rates exists.

Tourist and lodging services by hotels to foreign tourists without a residence or address in the country are exempt from VAT.

### Regional manufacturing tax incentives
New investments in manufacturing in the states of Oruro and Potosi are entitled to the following tax exemptions:

| Exemption | Conditions of exemption |
|---|---|
| Import tariffs and VAT on imported machinery | Machinery imported exclusively for the new industry until start-up of operations. |
| Import tariffs on imported inputs | They do not replace domestic inputs of the same kind and are destined to a transformation process. The exemption is granted for the first ten years of operation. |
| Transaction tax | For ten years from the start-up of operations. |
| CIT | For ten years from the start-up of operations if the amount exempt is reinvested in fixed assets in the following fiscal year. |

## Withholding taxes

### Payments made to Bolivian residents
Dividends paid to Bolivian residents, either individuals or corporations, are not taxable.

Payments made by corporations to individuals with respect to the acquisition of goods or provision of services that are not supported with an invoice or fiscal receipt are subject to a WHT of 8% on goods and 15.5% on services.

### Payments to non-residents
Dividend payments, distributions of profits to the head office by Bolivian branches, interest payments, royalty payments, and fees paid for any type of services made to non-residents are subject to a WHT of 12.5%.

### Tax treaties
Bolivia currently has in force double tax treaties (DTT) with the Andean Community (i.e. Colombia, Ecuador, and Peru), Argentina, France, Germany, Spain, Sweden, and the United Kingdom.

Beneficial WHT rates on dividend distributions are provided by DTT with Spain and Sweden at 10% and 0%, respectively, provided the Spanish or Swedish holding company demonstrates it is the ultimate beneficial owner and holds more than a 25% interest in the Bolivian company.

## Tax administration

### Returns
CIT is assessed on a self-assessment basis every fiscal year, and the due date for submission and payment is 120 days after the fiscal year-end. Tax returns must be accompanied by audited financial statements (if applicable) and ancillary tax information as requested by the tax authorities.

The fiscal year varies according to the activity of the corporation. Banks and commercial and other service activities have a fiscal year end as of 31 December; industrial, oil, and gas companies as of 31 March; agribusiness and forestry companies as of 30 June; and mining companies as of 30 September.

### *Payment of tax*
CIT is payable in one annual payment, except for mining companies which are obliged to make advance payments on a monthly basis with respect to the additional tax (i.e. 12.5% and 7.5% for exploitation and manufacturing mining companies, respectively).

# Bosnia and Herzegovina

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## Significant developments

### New law on corporate income in Brčko District

The new Corporate Income Tax Law of Brčko District is applicable as of 1 January 2011. The new law is now in the line with corporate income tax regulations of the Federation of Bosnia and Herzegovina and Republika Srpska. However, significant differences still exist.

### Transfer pricing increasingly in the focus of the local tax authorities

The transfer pricing provisions were included in the Corporate Income Tax Laws of all three administrative entities of Bosnia and Herzegovina a few years ago. However, transfer pricing has never been of interested to the tax authorities until recently when the tax authorities included a transfer pricing review in several tax audits. Transfer pricing audits might increase due to the requirement of the government to increase tax revenue.

## Taxes on corporate income

Bosnia and Herzegovina consists of two entities: Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS), with a third region, the Brčko District (BD), being administered by both. Direct taxes are imposed on entities at the district level, while indirect tax regulations are imposed at the state level. Corporate income tax (CIT) systems in Bosnia and Herzegovina have been partially harmonised in the past few years, but significant differences remain.

The Federation of Bosnia and Herzegovina, Republika Srpska, and the Brčko District tax resident corporations on a worldwide basis. Non-residents are taxed on income realized in the FBiH, RS, and BD territories.

### FBiH CIT

A CIT payer in the Federation of Bosnia and Herzegovina is a resident business association or other legal entity performing independent and permanent business activity through the sales of products and providing services on the market for the purpose of generating profit.

A CIT payer in the Federation of Bosnia and Herzegovina is also a non-resident who generates profits through business activity from a business unit in the territory of the Federation of Bosnia and Herzegovina.

A non-resident whose registered seat or management is not in the Federation of Bosnia and Herzegovina and who does not have a business unit in the Federation of Bosnia and Herzegovina is subject to withholding tax (WHT) for income generated in the Federation of Bosnia and Herzegovina.

The CIT rate in the Federation of Bosnia and Herzegovina is 10%.

***RS CIT***
A CIT payer in Republika Srpska is:

- A legal entity from Republika Srpska that generates income from any source in Republika Srpska or abroad.
- A business unit of a legal entity that generates income in the territory of Republika Srpska.
- A non-resident legal entity that conducts business activity and has a permanent establishment (PE) in Republika Srpska, for income that is related to that PE.
- A non-resident legal entity that generates income from immovable property in Republika Srpska, for the income generated in Republika Srpska.
- A non-resident legal entity that generates income in Republika Srpska, not mentioned above, and is subject to WHT in accordance with the CIT law of Republika Srpska.

The CIT rate in RS is 10%.

***BD CIT***
A CIT payer in Brčko District is:

- A legal entity from Brčko District that generates income from any source in Bosnia and Herzegovina or abroad.
- A business unit of a legal entity with headquarters in the Federation of Bosnia and Herzegovina or Republika Srpska, for income generated in Brčko District.
- A non-resident legal entity that conducts business activity and has a PE in Brčko District, for income that is related to that PE.
- A non-resident legal entity that generates income from immovable property in Brčko District, for the income generated in Brčko District.
- A non-resident legal entity that generates income in Brčko District, not mentioned above, and is subject to WHT in accordance with the CIT law of Brčko District.

The CIT rate in Brčko District is 10%.

## *Corporate residence*

***FBiH residency***
Under FBiH CIT law, a resident is a legal entity whose headquarters (registration) is entered into a court registry or whose management and supervision over the business activities is located in the Federation of Bosnia and Herzegovina.

A PE of a non-resident is a permanent place of business through which the non-resident performs activity in whole or partially throughout the territory of the Federation of Bosnia and Herzegovina.

A PE under FBiH CIT law is considered to be one of the following:

- Management headquarters.
- Branch office.

- Business office.
- Factory.
- Workshop.
- Location of natural resources extraction.
- Construction site (construction or mounting project) when the work is performed during a period exceeding six months.
- Providing consulting or business services lasting for a period exceeding three months consecutively over a 12-month period.
- A representative acting independently on behalf of a non-resident related to the activities of signing a contract or keeping supplies of products delivered on behalf of a non-resident.

### *RS residency*
Under RS CIT law, a resident is a legal entity registered in Republika Srpska.

A PE is considered to be a place of business of a non-resident in Republika Srpska (i.e. construction works, installation and assembly works, infrastructure used for research or exploitation of natural resources or supervisory of the same). A PE shall also be considered to be a place of business where an individual or legal person has the authorisation to conclude contracts for a foreign legal entity.

### *BD residency*
The BD CIT law prescribes that a resident is a legal entity registered in Brčko District.

A PE of a non-resident in Brčko District is considered to be:

- construction works, installation and assembly works, infrastructure used for research or exploitation of natural resources, or supervisory of the same, or
- a place of business where an individual or legal person has the authorisation to conclude contracts for a foreign legal entity.

## *Other taxes*

### *Value-added tax (VAT)*
The standard VAT rate is 17%, and the VAT regime applies equally throughout the country of Bosnia and Herzegovina. There is no reduced VAT rate in Bosnia and Herzegovina.

Taxable persons are all individuals and legal entities registered, or required to be registered, for VAT. Any person making taxable supplies of goods and services that exceeds or is likely to exceed a threshold of 50,000 konvertibilna maraka (BAM) (EUR 25,000) is required to register as a VAT payer.

The export of goods is zero-rated.

Taxable transactions include the supply of goods and services in Bosnia and Herzegovina by a taxable person, as well as the importation of goods to Bosnia and Herzegovina by any person. The following transactions are also taxable:

- Transactions for no consideration or for a consideration less than the market value.
- The private use of taxable goods by a taxable person (self-supply).

The following services are exempt from VAT in Bosnia and Herzegovina:

- The leasing and subletting of residential houses, apartments, and residential premises for a period of longer than 60 days.
- The supply of immovable property, except for the first transfer of the ownership rights or the rights to dispose of newly constructed immovable property.
- Financial services.
- Insurance and reinsurance services.
- Educational services provided by private or public educational institutions.
- Postal services.

The VAT period is one calendar month.

Any tax credit that has not been used after a period of six months shall be refunded. Registered exporters are to be refunded within 30 days.

### *Excise duties*
There is a single excise regime throughout Bosnia and Herzegovina which levies excise tax on the following products: petroleum products, tobacco products, non-alcoholic drinks, alcohol and alcoholic drinks, beer and wine, and coffee (unroasted, roasted, and ground coffee and coffee extracts). The duties on petroleum products and drinks are set at a specific amount per litre, and the coffee excise is a specific amount per kilo.

### *Customs duties*
The customs policy law and the rates of customs tariffs to be applied exist and are largely based on European Union (EU) standards. Bosnia and Herzegovina has signed the Stabilisation and Association Agreement (SAA) and the Central European Free Trade Agreement (CEFTA).

### *Property taxes*
#### FBiH property taxes
FBiH property taxes are imposed on the cantonal level (ten cantons in total), and the rates as well as the taxpayers are different between the cantons.

#### RS property taxes
RS property taxes are imposed on the entity level. The annual tax rate is between o.05% and 0.5% of the market value of the property. The applicable tax rate is determined every year by the municipalities.

#### BD property taxes
BD property taxes are imposed by the BD assembly. The annual tax rate is between 0.05% and 1% of the market value of the property. The rate is adopted by the assembly for every year based on the proposed annual budget.

### *Tax on transfer of land and real estate*
#### FBiH transfer taxes
The FBIH tax on transfer of land and real estate is imposed at the cantonal level. The rate differs by canton; however, it cannot be higher than 5%.

#### RS and BD transfer taxes
There is no tax on transfer of land and real estate in Republika Srpska and Brčko District.

### *Other taxes*
There are several other taxes introduced at the entity, cantonal, and municapility level. The duties differentiate based on company location, business size, and type of business.

FBiH other taxes include the communal tax, fire prevention contribution, tourist community contribution, forestry contribution fee, Foreign Trade Chamber of Bosnia and Herzegovina duty, Chamber of Commerce FBiH duty, and administrative stamp duties.

RS other taxes include the special republic tax, communal tax, forestry contribution fee, fire prevention contribution, Foreign Trade Chamber of Bosnia and Herzegovina duty, Chamber of Commerce FBiH duty, and administrative stamp duties.

BD other taxes include the communal tax, fire prevention contribution, forestry contribution fee, Foreign Trade Chamber of Bosnia and Herzegovina duty, and administrative stamp duties.

## *Branch income*

Representative offices of foreign companies are permitted, although the concept of an international branch has not been recognized in Bosnia and Herzegovina.

## *Income determination*

Taxable profit is profit determined by adjusting the accounting profit as stated in the profit and loss statement and determined in accordance with International Financial Reporting Standards (IFRS) and accounting legislation, in accordance with the provisions of the CIT law.

### *FBiH income*
Income for assessment of taxable profit in the Federation of Bosnia and Herzegovina is income from the sales of products, services, goods, and materials, as well as financial, extraordinary and other income calculated in the profit and loss balance in accordance with accounting regulations and International Financial Reporting Standards/ International Accounting Standards (IFRS/IAS).

Income on the basis of collected written-off debt, in the event that it was included in income in a previous period and was not subject to tax allowable or recognised expenditure, shall not be included in the tax base.

There are no deferral or anti-deferral provisions in the Federation of Bosnia and Herzegovina.

#### Inventory valuation
Expenses of production in accordance with accounting regulations and IFRS/IAS shall be recognised in the value of stocks of unfinished production, semi products, and finished products for the calculation of taxable profit.

The inventory is valued by using the average price method.

### Capital gains
The taxable base shall include profit from liquidation and capital gain from the balance sheet.

### Dividend income
Dividends realised based on participation in the capital of other taxpayers shall not be included in the tax base. Shares in the profit of a business association will be considered dividends.

### *RS income*
Taxable revenue for the purpose of computing the tax base in Republika Srpska includes all revenue (domestic and foreign) from whatever source derived whether in cash or in kind or whether related or unrelated to the legal person's economic activity.

In the event of revenue received in the form of property (other than cash) or services, the amount of revenue is equal to the market price of the property or services received.

### Inventory valuation
Inventory includes goods used for resale, final goods produced by the taxpayer, semi-final goods used for further production, as well as main and auxiliary materials for production.

Purchase value of inventories at the beginning and end of a fiscal year has to be expressed using the same method for determination of purchase value of inventories.

The purchase value of inventories can be determined by using the first in first out (FIFO) method or the weighted average cost method.

### Capital gains
Capital gain is realised through the sale or other type of transfer of capital or investment assets and represents a difference between the sales price and adjusted base of an asset. The sales price is the contracted price (i.e. the market price established by the competent tax authority in case it finds the contracted price to be lower than the market price).

Capital gains or losses realised during the fiscal year can be offset, and the realised net gain or loss is added or subtracted from the taxable base, if they are not already included in the income or expense.

### Dividend income
Income from dividends is not included in the taxable base.

### *BD income*
Taxable income in Brčko District includes all income from any source (domestic or foreign), whether in cash or in kind, independently of the fact of whether the income is related to the business activity of the legal person.

### Inventory valuation
The purchase value of inventories can be determined by using the first in first out (FIFO) method or the average cost method.

### Capital gains
Capital gain is realized by sale or transfer of capital and investment goods and represents positive difference between the sales price and adjusted property base.

### Dividend income
Income from dividends is not included in the taxable base.

## *Deductions*

### *FBiH deductions*
Expenditures are deductible from revenue in computing the FBiH tax base if the expenditures directly relate to the realised revenue.

### Depreciation
Depreciation cost is deductible only if it relates to the property subject to depreciation and being used.

Depreciation of fixed assets is deductible up to the amount established by proportionate application of the highest annual depreciation rates using the linear method, prescribed by the FBiH government, as follows:

| Assets | Rate (%) |
|---|---|
| Buildings, except | 10 |
| Management, administration, office, and other buildings for providing service activities | 3 |
| Apartment houses, hotels, restaurants | 14.3 |
| Roads, communal objects, upper railway rails machine | 14.3 |
| Equipment, vehicles, mechanicals except | 20 |
| Equipment for water management, water-supply, and canalisation | 14.3 |
| Computers and equipment for environment protection | 33.3 |
| Crops | 14.4 |
| Livestock units | 40 |
| Intangible non-current assets | 20 |

Property being depreciated with a value of less than BAM 1,000 may be fully deducted in the purchase year, on condition that that the property was put in service.

The purchase value of computer hardware and software may be deducted fully in the year the purchase was made.

Depreciated assets, once depreciated, shall not be re-included in the depreciation calculation for the purposes of the tax balance.

Depreciation is allowed for increases in the value of fixed assets due to revalorisation in accordance with IFRS/IAS, up to the amount of calculated depreciation on the revalorisation base and by using the proportion method prescribed by law.

### Bad debt
The expenses occurring based on the write-off of doubtful debts are deductible. Debts are considered doubtful if one of the following is fulfilled:

- The debts have not been collected within 12 months from due date.
- The taxpayer has started court procedures in regard to the receivable or started the enforced collection procedure.
- The receivable is registered in the bankruptcy procedure.
- Agreement has been reached with the debtor in the bankruptcy or liquidation procedure.

### Tax reserves
Tax deductible expenditures include expenditures to set up reserves for the following:

- Severance pay paid up to the prescribed amount.
- Expenditures of natural resources renewal.
- Expenditures in guaranteed time frames.
- Initiated court procedures.
- Potential credit losses of banks and microcredit organisations.

### Charitable contributions
Costs of humanitarian, cultural, educational, scientific, and sports purposes (except professional sports) are deductible in the amount of up to 3% of total income.

### Other deductible expenses
Representation costs pertaining to business activity are deductible in the amount of 30% of representation costs.

Expenses of membership fees to the chambers are deductible in the amount not exceeding 0.1% of total income, with the exception of membership fees regulated by the law.

Expenses based on sponsorship are deductible in the amount of 2% of total income.

### Net operating losses
Tax losses may be offset against profits in a future tax period, not exceeding five years. Tax losses are utilised on a first in first out (FIFO) basis.

Tax losses cannot be carried back.

### Payments to foreign affiliates
Payments to foreign affiliates are generally allowed if they relate to realised revenue.

### *RS deductions*
Expenditures are deductible from revenue in computing the RS tax base if the expenditures directly relate to the realised revenue.

### Depreciation
Depreciation deductions are allowed only with respect to depreciable assets that are being used.

A depreciable asset is any tangible or intangible asset that is held for use in the production or supply of goods and services, for rental to others, or for administrative purposes. Land or any other asset that does not decrease in value through wear and tear or obsolescence is not considered a depreciable asset.

The assets are depreciated using the linear method of depreciation except for machines and equipment which can be depreciated with acceleration (first year at 40%, second year at 30%, and third year at 30%). The CIT Rulebook prescribes a wide range of accepted depreciation rates, depending on type of assets, ranging from 1% to 50% annually.

### Bad debts
A legal person using the accrual form of accounting is allowed a deduction with respect to bad debts and reserves.

Legal persons, other than banks, authorised credit institutions, or insurance companies, are entitled to a bad debt deduction that arose in connection with a sale of goods or services but only if the revenue from the sale was previously included in the tax base of the legal person.

A loan or trade receivable is considered to be a bad debt only if the receivable has not been collected within 12 months from the due date, and:

- the taxpayer has started court litigation for the receivables or if enforced collection procedure is initiated
- the receivables are registered in the bankruptcy procedure of the debtor, or
- an agreement has been reached with the debtor who is not a physical or related person in the bankruptcy or liquidation procedure.

In the case of a bank or other authorised credit institution, a deduction is allowed for increases in the reserve account for customary losses due to unpaid loans, and the amount may not exceed 20% of the tax base.

In the case of an insurance or reinsurance company, a deduction is allowed for increases in reserves as registered in accounting documents and as authorised according to applicable law. For insurance contracts pertaining to reinsurance, reserves are to be reduced so that they cover only part of the risk remaining with the insurer, and the amount may not exceed 20% of the tax base.

The tax savings resulting from a reduction or cancellation of any reserve that is collected later on will be included in taxable revenue at the moment of collection in accordance with this law.

### Charitable contributions

Contributions to public institutions and humanitarian, cultural, and educational organisations are deductible in an amount not exceeding 3% of the fiscal year's total revenue. Any excess contribution may be carried forward three years.

### Other deductible expenses

Expenditures that are recognised and deductible from revenue also include the following:

- 30% of the cost of entertainment, meals, and amusements related to the legal person's economic activity.
- Sponsorship expenses in an amount not exceeding 2% of the fiscal year's total revenue.
- Scholarships to students in an amount of up to 75% of average monthly net salary per employee in Republika Srpska in accordance with the latest published data from the body in charge of statistics.

### Net operating losses

Losses may be carried forward and offset against income in the following five years. Tax losses are utilised on a FIFO basis.

Tax losses cannot be carried back.

### Payments to foreign affiliates

Payments to foreign affiliates are generally allowed if they relate to realised revenue.

### *BD deductions*
Expenditures are deductible from revenue in computing the BD tax base if the expenditures directly relate to the realised revenue.

### Depreciation
Depreciation deductions are allowed only with respect to depreciable assets that are being used.

A depreciable asset is any tangible or intangible asset that is held for use in the production or supply of goods and services, for rental to others, or for administrative purposes. Land or any other asset that does not decrease in value through wear and tear or obsolescence is not considered a depreciable asset.

The assets are depreciated using the linear method of depreciation except for machines and equipment which can be depreciated with acceleration (first year at 40%, second year at 30%, and third year at 30%). The CIT Rulebook prescribes a wide range of accepted depreciation rates, depending on type of assets.

The calculation of depreciation for newly purchased property starts the following month on the day when it was put to use. The calculation of depreciation for newly constructed buildings starts from the first day of the following year in which it was put to use.

### Bad debts
Legal persons, other than banks, authorised credit institutions, or insurance companies, shall be entitled to a bad debt deduction that arose in connection with a sale of goods or services but only if the revenue from the sale was previously included in the tax base of the legal person. For this purpose, a credit or trade receivable is considered a bad debt only if one of the following is true:

- It is more than 12 months past the due date for payment of the invoiced receivable and the creditor has sued for the receivables or an enforced collection procedure is initiated due to receivables.
- The receivables are registered in the bankruptcy procedure of the debtor or an agreement has been reached with the debtor who is not a physical or related person in the bankruptcy or liquidation procedure.

In the case of a bank or other authorised credit institution, a deduction is allowed for increases in the reserve account for customary losses due to unpaid loans, and the amount may not exceed 20% of the tax base.

In the case of an insurance or reinsurance company, a deduction is allowed for increases in reserves as registered in accounting documents and as authorised according to applicable law. For insurance contracts pertaining to reinsurance, reserves are to be reduced so that they cover only part of the risk remaining with the insurer, and the amount may not exceed 20% of the tax base.

### Charitable contributions
Contributions to public institutions and humanitarian, cultural, and educational organisations are deductible in an amount not exceeding 3% of the fiscal year’s total revenue.

**Other deductible expenses**
Expenditures that are recognised and deductible from revenue also include the following:

- 30% of the cost of entertainment related to the legal person's economic activity.
- Awards to employees, up to the prescribed amount.
- Costs of business trips, meal allowance, transportation, and holiday allowance, up to the prescribed amount.
- Sponsorship expenses in an amount not exceeding 2% of the fiscal year's total revenue.
- Scholarships to students in an amount up to 75% of average monthly net salary in Brčko District.
- Committee membership fees, up to 0.2% of total revenue in the tax year.
- Expenses for research and development (R&D) in accordance with the Rulebook.

**Net operating losses**
Losses may be carried forward and offset against income in the following five years. Tax losses are utilised on a FIFO basis.

Tax losses cannot be carried back.

**Payments to foreign affiliates**
Payment to foreign affiliates is generally allowed if it relates to realised revenue.

## *Group taxation*

### *FBiH group taxation*
A business association has the right to request tax consolidation on the condition that all businesses in the group are residents of the Federation of Bosnia and Herzegovina.

A headquarters company and its branches may form a business association when there is direct or indirect control between them with no less than 90% share.

A request for tax consolidation must be filed to the authorised branch office of the tax authorities by a headquarters company.

Each group member is required to file its tax balance, and the headquarters of the business association may file a consolidated tax balance for the group.

The consolidated tax balance may offset losses of one or more businesses against the profit of other businesses in the association.

Individual group members are liable for the tax calculated on the consolidated balance proportionately to the profit from the individual tax balance, and the headquarters is the payer of the tax calculated on the consolidated balance.

Once approved, tax consolidation shall be applied for the consecutive period of no less than five years.

When one, several, or all the businesses in the association later opt for individual taxation, all group members shall be obliged to pay the difference proportionately on behalf of the tax privilege they have used.

***RS group taxation***
An affiliated group of legal persons located within Republika Srpska may elect to file a consolidated annual tax declaration.

An affiliated group of legal persons is a group of one or more legal entities from Republika Srpska that are connected through the ownership of stock with a common parent, provided that the common parent owns at least 80% of the stock in a legal person that is included in the affiliated group. If the common parent does not own at least 80% of the stock in a legal person that is included in the affiliated group, then the parent may file a consolidated tax declaration if one or more other legal persons in the affiliated group own at least 80% of the stock in such legal person.

***BD group taxation***
An affiliated group of legal persons located within Brčko District may elect to file a consolidated annual tax declaration.

An affiliated group of legal persons is a group of one or more legal entities from Brčko District that are connected through the ownership of stock with a common parent provided that the common parent owns at least 80% of the stock in a legal person that is included in the affiliated group.

***Transfer pricing***
Transfer pricing requirements are imposed at the entity level. The Federation of Bosnia and Herzegovina and Republika Srpska have different regulations in place, including different rules in regard to applicable methods, related parties, and documentation. The regulations in place do not differ if the transactions are within one entity, cross-border, or international. Basically, this means that all transactions can fall under the transfer pricing scope.

Brčko District has issued a new law on corporate income tax which states that the Rulebook will introduce provisions in regard to transfer pricing; however, the Rulebook has not been published yet.

With Bosnia and Herzegovina not being an EU or an OECD member, the local legislation does not have the same requirements with respect to transfer pricing documentation as in EU countries nor does the legislation refer to the OECD guidelines.

**Related parties**
As per the applicable RS legislation, related parties of a legal person are considered to be physical or legal persons if those persons possess more than 10% of active shares with voting rights.

A legal person can be a related party if it possesses more than 10% active shares in the other person indirectly or directly. Indirect ownership is considered to be:

- If a legal person possesses more than 10% of a dependant company, and that dependant company possesses more than 10% in the other legal person.
- If both legal persons have a common shareholder who possesses more than 10% active shares with voting rights in both legal persons.

In the Federation of Bosnia and Herzegovina, a related party is considered to be an individual or legal person who has the possibility of control or significant influence on the business decisions of the taxpayer. Owning more than half or individually the most stocks or shares in a company is considered to be enabled control.

Significant influence is considered to be mutually high sales turnover, technical dependence, or otherwise gained control over the management.

**Prescribed methods**
The RS regulation prescribes the following five methods that can be used in order to establish whether the prices are in accordance with the arm's-length principle:

- Comparable price method.
- Cost plus method.
- Resale price method
- Profit split method.
- Transactional net margin method.

### *Thin capitalisation*
There are no thin capitalisation rules in Bosnia and Herzegovina.

## *Tax credits and incentives*

### *FBiH tax incentives*
**Foreign tax credit**
When a taxpayer generates income or profit through business activities outside of the Federation of Bosnia and Herzegovina (directly or through a business unit) and pays the profit tax on such activities, the tax paid abroad shall be credited up to the amount of the profit tax that would have been paid for the income or profit generated by the same activities in the Federation of Bosnia and Herzegovina.

**Investment incentive**
A taxpayer who invested in production within the territory of the Federation of Bosnia and Herzegovina for five consecutive years for a minimum fee of BAM 20 million will be relieved from taxation for a period of five years, starting with the first year in which it has invested at least BAM 4 million.

**Special needs employment incentive**
A taxpayer who employs more than 50% of handicap or special needs individuals within its company for a period of time longer than one year is relieved from CIT for the year in which more than 50% of handicap or special needs individuals are employed within the company.

**Export incentive**
A taxpayer who realises more than 30% of annual income by export will be relieved from CIT for that year.

### *RS tax incentives*
**Foreign tax credit**
If a legal entity from Republika Srpska obtains revenue from a foreign state and the revenue is taxed both in Republika Srpska and in the foreign state, then the tax paid to the foreign state, whether paid directly or withheld and remitted by another person, is to be credited from RS CIT, unless such legal entity from Republika Srpska elects to treat the foreign tax as a deductible expenditure in determining the fiscal year tax base.

There are no other tax incentives available in Republika Srpska.

### *BD tax incentives*

#### Foreign tax credit

If a legal entity from Brčko District obtains revenue from a foreign state and the revenue is taxed both in Brčko District and in the foreign state, then the tax paid to the foreign state, whether paid directly or withheld and remitted by another person, is to be credited from the BD CIT, unless such legal entity from Brčko District elects to treat the foreign tax as a deductible expenditure in determining the fiscal year tax base.

#### Investment incentive

For a taxpayer who invests in machines and equipment for performing its own registered business activity on the territory of Brčko District, a deduction is allowed for the amount of the investment.

#### Employment incentive

For a taxpayer who employs new employees for an indefinite period of time during the tax period, a second deduction is allowed for the total amount of paid gross salaries for the new employees.

## *Withholding taxes*

### *FBiH WHT*

WHT in the Federation of Bosnia and Herzegovina is calculated on non-resident income generated throughout the territory of the Federation of Bosnia and Herzegovina.

The base for calculation of WHT is the gross amount paid by a resident of the Federation of Bosnia and Herzegovina to a non-resident for dividends, interest, royalties and other intellectual property rights, compensations for market research, tax consulting services, auditors' services, fun and sports events, premium insurance for insurance or reinsurance of risk in the Federation of Bosnia and Herzegovina, telecommunication services between the Federation of Bosnia and Herzegovina and other countries, as well as all other services performed on the territory of the Federation of Bosnia and Herzegovina.

WHT shall be paid at the rate of 5% on dividend payments and 10% for interest, royalties, and other, if not reduced under a tax treaty.

### *RS WHT*

Any legal or physical person from Republika Srpska, as well as any non-resident legal or physical person with PE in Republika Srpska, who pays revenue to a non-resident legal person is to withhold tax from the total payment of revenue and is to remit the withheld tax to the Public Revenues Account of Republika Srpska.

The WHT applies to the following revenue payments, regardless of whether the revenue is received in Republika Srpska or abroad:

- Payment of interest or its functional equivalent under financial instruments and arrangements from a resident.
- Payment for entertainment or sporting activities carried out in Republika Srpska, regardless of whether the revenue is received by the entertainer or sportsman or by another person.

- Payment for the performance of management, consulting, financial, technical, or administrative services, if the revenue is from a resident or if the revenue is paid by or included in the books and records of a PE in Republika Srpska or if such payment is deducted for the purpose of determining the tax base.
- Payment in the form of insurance premiums for the insuring or reinsuring of risks in Republika Srpska.
- Payment for telecommunication services between Republika Srpska and a foreign state.
- Payment of royalties.
- Payment of lease for movable property.
- Payment for the performance of other services in Republika Srpska.

WHT is not due on dividend payments. The WHT rate in Republika Srpska is 10%.

### *BD WHT*

Any legal or physical person from Brčko District, as well as any non-resident legal or physical person with PE in Brčko District, who pays revenue to a non-resident legal person is to withhold tax from the total payment of revenue and is to remit the withheld tax to the Public Revenues Account of Brčko District.

The WHT applies to the following revenue payments, regardless of whether the revenue is received in Brčko District or abroad:

- Payment of interest or its functional equivalent under financial instruments and arrangements from a resident.
- Payment for entertainment or sporting activities carried out in Brčko District, regardless of whether the revenue is received by the entertainer or sportsman or by another person.
- Payment for the performance of management, consulting, financial, technical, or administrative services, if the revenue is from a resident or if the revenue is paid by or included in the books and records of a PE in Brčko District or if such payment is deducted for the purpose of determining the tax base.
- Payment in the form of insurance premiums for the insuring or reinsuring of risks in Brčko District.
- Payment for telecommunication services between Brčko District and a foreign state.
- Payment of royalties.
- Payment of lease for movable property.
- Payment for the performance of other services in Brčko District.

WHT is not due on dividend payments. The WHT rate in Brčko District is 10%.

## *Tax administration*

### *FBiH tax administration*

#### Returns

An FBiH taxpayer is obliged to file correctly and accurately a completed tax return (declaration) with the tax balance to the authorised branch office of the tax administration by 31 March of the following year.

The deadline for submission of annual calculation of business results is 28 February of the following year.

#### Payment of tax
A taxpayer shall pay FBiH CIT pursuant to the final tax declaration. CIT prepayments are determined based on the tax return from the prior year and have to be paid monthly until the last day of the month for the previous month.

### *RS tax administration*
#### Returns
The RS tax declaration for a tax year shall be filed no later than 90 days upon the end of the tax year, and in case of a calendar year, no later than 31 March of the current year for the previous year.

#### Payment of tax
A taxpayer shall pay RS CIT pursuant to the final tax declaration. CIT prepayments are determined based on the tax return from the prior year and have to be paid monthly until the tenth day of the month for the previous month.

### *BD tax administration*
#### Returns
The BD tax declaration for a tax year shall be filed no later than 90 days upon the end of the tax year, and in case of a calendar year, no later than 31 March of the current year for the previous year.

#### Payment of tax
A taxpayer shall pay BD CIT pursuant to the final tax declaration. CIT prepayments are determined based on the tax return from the prior year and have to be paid monthly until the tenth day of the month for the previous month.

# Botswana



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## Significant developments

Botswana is effecting the following changes to its tax regime with effect as of 1 July 2011.

### Corporate income tax (CIT)

- The two tier CIT system will be replaced by a single CIT rate of 22% for resident companies.
- The CIT rate for non-resident companies (i.e. branch income) will increase to 30%.
- The tax rate for manufacturing companies and IFSC companies will remain at 15% in respect of approved activities for such businesses.
- Companies will cease to generate Additional Company Tax (ACT) for the tax year ending 30 June 2012 and subsequent tax years.
- Utilisation of accumulated ACT will end on 30 June 2011, after which date all unutilised ACT will fall away.
- Withholding tax will not be able to be offset against CIT.

### Withholding tax (WHT)

The WHT on dividends will be reduced to 7.5%.

### Capital gains

The exemption from tax on capital gains on the sale of certain shares, units, or debentures of a resident company will only apply if the shares, units, or debentures were held by the taxpayer for a period of at least one year prior to the date of disposal.

### Mines and minerals

The mining tax rate for non-diamond mining companies (derived in terms of the existing formula) will not be less than the CIT rate of 22%.

## Taxes on corporate income

Botswana has a source-based taxation system.

Currently, CIT is imposed at a rate of 15% for non-manufacturing companies and 5% for manufacturing companies. ACT is imposed at a rate of 10%, and the ACT amount could be carried forward up to five years to be offset against WHT payable on dividends paid.

As of 1 July 2011 (i.e. during the 2012 tax year), CIT will be charged at a single flat rate of 22% with no ACT component. Any accumulated ACT can be utilised before 30 June 2011, after which date all unutilised ACT will fall away.

### *Sample corporate tax calculation for a non-manufacturing company during the fiscal year ending 30 June 2011*

| | | BWP* |
|---|---|---|
| **Net income before taxation** | | **1,000,000** |
| **Add** | | |
| Depreciation | 50,000 | |
| Accounting loss on disposal of machinery and equipment | 5,000 | |
| Donations | 1,000 | |
| Balancing charge (Tax profit on disposal of machinery and equipment) | 35,000 | 91,000 |
| | | 1,091,000 |
| **Less** | | |
| Accounting profit on disposal of industrial buildings | 33,000 | |
| **Initial allowance:** | | |
| Industrial buildings at 25% on cost | 100,000 | |
| **Annual allowances:** | | |
| Commercial buildings at 2.5% on cost | 5,000 | |
| Industrial buildings at 2.5% on cost | 10,000 | |
| Plant and machinery at 15% on cost | 40,000 | |
| Office equipment at 10% on cost | 2,000 | |
| Computer equipment at 25% on cost | 10,000 | |
| Motor vehicles at 25% on cost (Subject to BWP 175,000 limit for motor cars) | 20,000 | |
| Approved training expenditure (Additional 100% of cost of 20,000) | 20,000 | 240,000 |
| | | 851,000 |
| Add – Taxable capital gain on disposal of property | | 49,000 |
| Taxable income | | 900,000 |
| Tax at 25%** | | 225,000 |

* Botswana pulas (BWP)
**CIT at a rate of 15% plus ACT at a rate of 10%.

### *International Financial Services Centre (IFSC) profits*

IFSC companies are currently taxed at a flat rate of 15% and will continue to be taxed at that rate going forward. Companies must apply for a certificate to be classified as IFSC companies, which deal only in specified services and only with non-residents.

### *Mining profits*

Mining profits, other than profits from diamond mining, shall be taxed according to the following formula:

Annual tax rate = 70 minus (1,500/x), where x is taxable income as a percentage of gross income.

The tax rate shall not be less than the combined CIT and ACT rate (25%) prior to 1 July 2011 and not less than the flat CIT rate (22%) as of 1 July 2011.

### *Diamond mining*

Diamond mining is usually taxed in terms of an agreement with the Government of Botswana.

## Corporate residence

If a company's registered office or place of incorporation is in Botswana or if the company is managed and controlled in Botswana, then the company is a considered a resident of Botswana.

The term permanent establishment (PE) has been defined in the Income Tax Act only in the limited context of interest, commercial royalty, and management or consultancy fee. However, the term PE is defined in all the Double Taxation Agreements (DTA) that Botswana has entered into with other contracting states. The definition of PE in the DTA follows the definition in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and Capital.

## Other taxes

### Value-added tax (VAT)

VAT is imposed on taxable supplies and the importation of goods into Botswana. The standard VAT rate of 12 % applies to all supplies that do not qualify for an exemption or are not zero-rated.

### Capital transfer tax (CTT)

CTT is levied on the donee upon the transfer (by way of inheritance or gratuitous disposal of property) of tangible or intangible, movable or immovable property, at 12.5%.

### Vocational training levy (VTL)

VTL is payable when submitting the VAT return, by every tax payer who is registered for VAT. It is calculated as a percentage of turnover ranging from 0.2% to 0.05% depending on the turnover of the company.

### Transfer duties on immovable property

Transfer duty is levied at 5% of the value of immovable freehold and leasehold property. The first BWP 200,000 of such value is exempt from transfer duty in case of transfer to a Botswana citizen.

In the case of agricultural property, transfer duty is levied at the rate of 30% for a non-citizen. This duty is 5% in the case of a Botswana citizen.

## Branch income

Currently, CIT is payable on branch profits at the rate of 25%. As of 1 July 2011, the rate will increase to 30%.

## Income determination

### Inventory valuation

Inventories are valued at cost less such amounts, if any, that the Commissioner General believes are reasonable as representing the amount by which the value of such stock has been diminished because of damage, deterioration, obsolescence, or other cause. Although not expressly excluded by legislation, last in first out (LIFO) has not been accepted in practice by the tax authorities.

### *Capital gains*
Gains from disposal of specified capital assets (immovable property and marketable securities, including shares in private companies) are included in taxable income in the hands of the corporate taxpayer. Acquisition costs of immovable property are subject to a 10% compound annual addition for inflation for the period from acquisition to 30 June 1982, and thereafter to an inflation addition based on the increase in the consumer price index to the date of sale. For other gains, no inflation allowances are granted, but the taxable gain is set at 75% of the total gain.

Currently, the sale of any shares, units, or debentures of a resident company is exempt from tax under any of the following circumstances:

- The resident company whose shares are being sold is a public company.
- The shares, units, or debentures are traded on the Botswana Stock Exchange.
- The company has released for trading 49% or more of its equity on the Botswana Stock Exchange.

As of 1 July 2011, this exemption shall only apply if the shares, units, or debentures were held by the tax payer for a period of at least one year prior to the date of disposal.

The aggregate amount of capital losses is offset against the aggregate amount of capital gains in the same tax year. Any excess of loss is deducted from aggregate gains over losses accruing in the succeeding tax year only. Capital losses cannot, in any circumstances, be deducted against other income.

### *Dividend income*
Dividend income is not subject to tax.

### *Interest income*
In case of a resident company, interest income is included in gross income and taxed at the CIT rate. In case of a non-resident company, interest income will be subject to WHT, which will constitute a final tax.

### *Royalty income*
Royalty income is included in gross income and taxed at the CIT rate. In case of a non-resident company, royalty income will be subject to WHT, which will constitute a final tax.

### *Partnership income*
Partnership income is taxed in the hands of the partners, in proportion to their share in the partnership.

### *Foreign income*
Resident corporations are not generally taxed on a worldwide income basis. However, interest and dividend income from a foreign source is taxed in the hands of the resident company on an accrual basis. Relief is currently given for any WHT imposed on such income. As of 1 July 2011, however, WHT will not be able to be offset against CIT.

## *Deductions*

### *Depreciation and depletion*
Annual and capital allowances available are as follows.

### Companies other than mining companies

Annual taxation allowances for expenditures incurred on machinery and equipment before 30 June 1982 can be claimed up to 100%. This allowance may be for any proportion of previously unclaimed expenditures. For expenditures incurred on machinery and equipment after 30 June 1982, annual allowances are granted, calculated on cost by the straight-line method on the basis of the expected useful lives of the individual assets. Guidelines are provided for expected useful lives of different categories of assets, which vary from four to ten years. Book depreciation is not required to conform to tax depreciation. The capital allowance claimable on a company motorcar is restricted to a maximum of BWP 175,000.

An initial allowance of 25% of cost is granted on certain industrial buildings. All industrial and commercial buildings (excluding residential properties) are granted a 2.5% annual allowance based on cost or, in the case of an industrial building on which an initial allowance has been claimed, the original cost less the initial allowance.

Balancing allowances and charges are brought to account on the disposal of assets on which allowances have been claimed. Where disposal value of an item of machinery or equipment exceeds the difference between expenditures incurred on the asset and allowances granted, the whole amount is taxable as corporate income or the balancing charge can be offset against further additions of new equipment, thus providing rollover relief. However, there is no rollover relief on motorcars except where the cars are used in a car rental or taxi service business.

### Mining companies

In ascertaining the business income for any tax year from a business of mining, there shall be deducted from business income an allowance, to be known as a mining capital allowance, computed in accordance with 100% of the mining capital expenditure made in the year in which such expenditure was incurred, with unlimited carryforward of losses.

### *Taxes*

Any taxes paid are specifically disallowed in computing a company's taxable income.

### *Other significant items*

An allowance is granted for dwelling houses erected for employees by a business other than a mining business. The amount of the allowance is the lower of cost or BWP 25,000 for each dwelling house constructed.

A deduction of 200% of the cost of an approved training expenditure is allowed.

Companies with shareholders having 5% or more of equity, either directly or indirectly, are classified as close companies, and there are additional tax regulations in respect of these shareholders.

Small companies, that is resident private companies whose gross income does not exceed BWP 300,000, may elect that the company be taxed as a partnership.

Expenses incurred by the company for having its shares listed on the Botswana Stock Exchange are deductible in determining the chargeable income of the company.

### Net operating losses
Losses may be carried forward for five years, with the exception of farming, mining, and prospecting operations, for which there is no time limit. There is no allowance for carrybacks.

### Payments to foreign affiliates
Royalties, interest, and service fees paid to foreign affiliates are generally deductible, provided such amounts are at arm's length and WHT is paid.

In the case of a mining company, head office expenses allowed as a deduction in ascertaining gross revenue from mineral licence shall be limited to 1.5% of gross income for the year of assessment, and any excess of such expense above the limit shall be treated and taxed as a dividend.

Where the interest rate on a loan made by a foreign-based mining company to an affiliate mining company resident in Botswana is considered by the commissioner to be in excess of the market rate, such excess will be disallowed as a deduction and taxed as a dividend.

## Group taxation

There are no concessions for group taxation, other than for wholly-owned subsidiary companies of the Botswana Development Corporation Limited (BDC).

BDC was established in 1970 to be the country's main agency for commercial and industrial development. The Government of Botswana owns 100 percent of the issued share capital of the Corporation.

Where in any tax year a wholly owned subsidiary of BDC has incurred any assessed loss, such member may, during the current tax year, by notice in writing to the Commissioner General, elect that the whole or part of such assessed loss shall be deducted in ascertaining the chargeable income of one or more of the other wholly owned subsidiaries.

### Transfer pricing
Botswana currently does not have any transfer pricing regulations, so transfer pricing is currently monitored through the anti-avoidance provisions contained in Section 36 of the Income Tax Act.

The arm's-length principle should always be followed in transactions between related parties. If such transactions have created rights or obligations that would not normally be created between independent persons dealing at arm's length, the Commissioner General may determine the liability in such manner as deemed appropriate. However, related party balances arising out of normal trading transactions (e.g. credit purchases with 30 days credit period) would not be subjected to these provisions.

Interest (at prime rate) should be charged/provided on loans from shareholders/ amounts due to related parties. If no interest has been charged/provided, in terms of the close company legislation, BURS may deem interest at the prime rate prevailing at the beginning of the tax year, as income in the hands of the lender without allowing the corresponding interest as a charge against the profits of the borrower. The borrower is obliged to deduct WHT at the prevailing rate on the deemed interest.

Amounts due from shareholders/directors may be deemed as dividend income and shall form part of the taxable income of the borrower, in which event these will be taxed at the prevailing dividend WHT rate in the hands of the borrower.

### *Thin capitalisation*

Thin capitalisation rules can be found in the Income Tax Act, but only in relation to mining companies and IFSC companies.

Where a foreign controlled resident mining company has a foreign debt-to-equity ratio in excess of 3:1 at any time during the year of assessment, the amount of interest paid by the resident company during that year on that part of the debt that exceeds the ratio shall be disallowed as a deduction, and the amount so disallowed shall be treated and taxed as a dividend.

In case of an IFSC company, where an amount of foreign debt interest is allowable as a deduction in a particular tax year and, at any time during that tax year, the total foreign debt exceeds the foreign equity product for that year, then the amount of foreign debt interest ascertained in accordance with the following formula will be disallowed:

I x (A/B) x (C/365)

A = amount of the excess of the total foreign debt over the foreign equity product.

B = the total foreign debt.

C = the number of days in that tax year during which the total foreign debt exceeded the foreign equity product by that amount.

I = the foreign debt interest.

## *Tax credits and incentives*

To encourage investment in Botswana, extra tax relief on revenue or capital accounts will be granted for specific business development projects if the government is satisfied that such projects are beneficial to Botswana.

## *Withholding taxes*

WHT at the following rates must be deducted from payments to residents and non-residents unless a double taxation agreement exists.

| **Residents** | **WHT rate (%)** |
|---|---|
| Interest | 10 |
| Dividends (7.5% as of 1 July 2011) | 15 |
| Payments due under certain construction contracts | 3 |
| **Non-residents** | **WHT rate (%)** |
| Interest | 15 |
| Dividends (7.5% as of 1 July 2011) | 15 |
| Payments due under certain construction contracts | 3 |
| Payments for royalties, management, or consultancy fees | 15 |

| | |
|---|---|
| Payments for entertainment fees | 10 |

Botswana has tax agreements with the following countries, which provide for WHT at the rates shown.

| Recipient | Dividends (%) (1) | Interest (%) | Royalties (%) | Management and consultancy fees (%) |
|---|---|---|---|---|
| Mauritius | 5/10 (2) | 12 | 12.5 | 15 |
| South Africa | 10/15 (3) | 10 | 10 | 10 |
| Sweden | 15 | 15 | 15 | 15 |
| United Kingdom | 5/12 (2) | 10 | 10 | 7.5 |
| France | 5/12 (2) | 10 | 10 | 7.5 |
| Russia | 5/10 (2) | 10 | 10 | 10 |
| Barbados | 5/12 (2) | 10 | 10 | 10 |
| Seychelles | 5/10 (2) | 7.5 | 10 | 10 |
| Namibia | 10 | 10 | 10 | 15 |
| Zimbabwe | 5/10 (2) | 10 | 10 | 10 |
| India | 7.5/10 (2) | 10 | 10 | 10 |

Notes

1. It is expected that the reduction in the dividends WHT rate to 7.5% on July 2011 will result in a change in the DTA negotiated rates for dividend WHT.
2. 5% or 7.5% rate of WHT is applicable if the beneficial shareholder is a company resident in the double taxation agreement country and holds at least 25% of the share capital in the company paying dividends. Otherwise, the other rate applies (10% or 12% as the case may be).
3. 10% rate of WHT is applicable if the beneficial shareholder is a company resident in the double taxation agreement country and holds at least 25% of the share capital in the company paying dividends.

## *Tax administration*

### *Returns*

Botswana has a fiscal year ending on 30 June. However, a business may select its own accounting year, which may end on a date other than 30 June. This accounting year is accepted for the computation of the company's taxable income.

Botswana requires self-assessment, which means that the return submitted constitutes the assessment. The system is one that requires all taxpayers to file tax returns in standard format (providing information relating to taxable income earned) within four months after the financial year end of the company.

### *Payment of tax*

Under the self-assessment tax procedures, if the tax payable for a tax year exceeds BWP 50,000, then estimated tax is required to be paid in equal quarterly instalments over the period of 12 months ending on the company's financial year-end date. Accordingly, the first quarterly payment should be made within three months of the beginning of the financial year and the balance quarterly payments at three monthly intervals thereafter. The final (balance) payment, if any, is to be made within four months from the end of the financial year, when submitting the return.

Where the tax is less than BWP 50,000, then the tax is payable within four months from the company's financial year-end date.

# Brazil



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## Significant developments

### New changes to the tax on financial transactions (IOF) rules

With the aim of stemming speculative short-term investment and the depreciation of the US dollar against the Brazilian real, the Brazilian government has adopted new fiscal measures. On 28 March 2011, the applicable IOF rate on foreign currency exchange transactions (on an inflow of funds into the country only) related to loans with an average payment term of up to 360 days and subject to registration at the Brazilian Central Bank was raised from 0% to 6%.

Only 8 days later (on 6 April ), the rules were amended so that the 6% rate now applies to foreign currency exchange transactions related to loans with an average payment term of up to 720 days (as opposed to 360 days).

Prior to these changes, only loan arrangements with an average payment term of up to 90 days were subject to the IOF tax at the rate of 5.38%.

### New regulation on Brazilian thin capitalisation rules

On 13 May 2011, the Brazilian Revenue Service issued Normative Instruction (NI) 1,154, with the aim of regulating the deductibility of interest and other general expenses paid or credited by a Brazilian source to individuals or legal entities considered related or resident/domiciled in a tax haven or in a jurisdiction under a privileged tax regime.

Especially in connection with the Brazilian thin capitalisation rules *(see the Group taxation section),* the NI details the concept of related party and the calculation procedures towards the debt/equity ratios and excess of interest expense to be added to the corporate income tax basis.

## Taxes on corporate income

Brazilian resident companies are taxed on worldwide income. Non-resident companies are generally taxed in Brazil through a registered subsidiary, branch, or permanent establishment (PE), based on income generated locally. Other than that, non-resident companies can be subject to withholding income tax on income derived from a Brazilian source.

Corporate income tax (Imposto de Renda de Pessoa Jurídica or IRPJ) is assessed at the fixed rate of 15% on annual taxable income, using either the 'actual profits' method or the 'presumed profits' method *(see the Income determination section)*.

### Surcharge

Corporate taxpayers are also subject to a surcharge of 10% on the annual taxable income in excess of 240,000 Brazilian real (BRL).

### Social contribution on net income

All legal entities are subject to a social contribution to the federal government (Contribuição Social sobre o Lucro Líquido or CSLL) at the rate of 9% (except for financial and insurance institutions, which are taxed at the rate of 15%), which is not deductible for IRPJ purposes. The tax basis is the profit before income tax, after some adjustments.

## Corporate residence

A corporation is considered resident in Brazil if it has been incorporated in Brazil, and its tax domicile is where its head office is located.

### Permanent establishment (PE)

Brazilian tax law has yet to develop rules similar to those existing in other countries, which treat a non-resident as having a PE under various factual circumstances.

Currently, there are few rules to determine whether a foreign business constitutes a taxable presence in Brazil and the concept of 'permanent establishment' only appears in Brazil's treaties.

In general, a non-resident company may be treated as having a taxable presence if it operates in Brazil either through: (i) a fixed place of business or (ii) an agent who has the power to enter into contracts in Brazil in the name of or on behalf of the non-resident.

## Other taxes

### Value-added tax (VAT)

VAT is payable on imports, sales, and transfers of goods and products in the form of (i) a federal excise tax (Imposto sobre Produtos Industrializados or IPI) at various rates in accordance with the nature of the product (normally around 10% to 15%, but in certain cases ranging to over 300%) and (ii) a state sales and service tax (Imposto sobre as operações relativas à Circulação de Mercadorias, e sobre a prestação de Serviços de transporte interestadual e intermunicipal e de comunicação or ICMS) with rates ranging from 7% to 25%.

Except for services related to freight and transportation, communications, and electric energy, which are subject to ICMS, income from services rendered is normally subject to a municipal service tax (Imposto Sobre Serviços de qualquer natureza or ISS), which is not a VAT, with rates ranging from 2% to 5%.

### Import tax

Import tax (Imposto de Importação or II) is levied on the cost, insurance, and freight (CIF) price of the imported good. The rates depend on the degree of necessity and are defined in accordance with the product's tariff code contained in the Mercosur Harmonised System (NCM/SH). The rates tend to be in the range of 10% to 20%, although there are many exceptions which are subject to higher or lower rates.

### *Social assistance contribution (Contribuição para o Financiamento da Seguridade social or COFINS)*

COFINS, a monthly federal social assistance contribution calculated as a percentage of revenue, is levied at the rate of 7.6%. A COFINS credit system is meant to ensure the tax is applied only once on the final value of each transaction. However, some taxpayers (such as financial institutions, telecommunication companies, cooperatives, and companies which opt to calculate IRPJ and CSLL using a 'presumed profits' method) are still subject to the previous COFINS system, which applies a rate of 3% with no credit system.

### *Federal social contribution (Programa de Integração Social or PIS)*

PIS, which is also a federal social contribution calculated as a percentage of revenue, is levied at the rate of 1.65%. A PIS credit system is meant to ensure the tax is applied only once on the final value of each transaction. However, some taxpayers (such as financial institutions, telecommunication companies, cooperatives, and companies which opt to calculate opt to calculate IRPJ and CSLL using a 'presumed profits' method) are still subject to the previous PIS system, which applies a rate of 0.65% with no credit system.

### *PIS and COFINS on imports*

Importation of goods and services are also subject to PIS and COFINS (in addition to all other taxes imposed on import transactions). PIS and COFINS are imposed on the Brazilian entity or individual (the importer of goods or services) and applied at the rates of 1.65% and 7.6%, respectively. The contributions paid upon import transactions may, in some instances, be creditable.

### *Tax on financial transaction (Imposto sobre operações de crédito, câmbio, seguro e sobre operações relativas a títulos e valores mobiliários or IOF)*

IOF is a tax levied primarily on certain financial transactions, such as loans, foreign exchange operations, insurance, and securities, as well as transactions with gold (as a financial asset) and foreign exchange instruments. The applicable rate will vary depending on the transaction. The IOF rate may be reduced to 0% in some cases, such as: (i) exchange transactions relating to the inflow of revenues in Brazil deriving from the export of goods and services; (ii) exchange transactions relating to the inflow and outflow of resources in and from Brazil, stemming from foreign loans with average term exceeding 720 days; and (iii) remittances of interest on net equity and dividends relating to investment in the stock market.

Foreign loans with average payment term of up to 720 days, contracted as of 7 April 2011, are subject to the IOF at a 6% rate on the foreign exchange transaction corresponding to the inflow of the resources.

### *Contribution for the intervention in the economic domain (Contribuição de Intervenção no Domínio Econômico or CIDE)*

CIDE is a contribution levied at the rate of 10% on remittances made by corporate taxpayers for royalties and for administrative and technical services provided by non-residents. CIDE is payable by the local entity, and therefore, not creditable to the non-resident. CIDE does not represent a liability to the foreign recipient. CIDE is not applied on the payments relating to the license to use, market, or sublicense software, provided that it does not involve transfer of technology.

### *Property taxes*

Imposto Predial e Territorial Urbano (IPTU) is a property levied annually based on the fair market value of property in urban areas at rates that generally vary according to the municipality and location of the property. In the municipality of São Paulo, the basic IPTU rate is 1% for residential properties or 1.5% for commercial properties (both rates may be increased or decreased according to the market value of the property).

Imposto de Transmissão de Bens Imóveis Inter Vivos (ITBI) is a property tax levied at the transfer of immovable property, with rates also varying based on the municipality were the property is located. The ITBI rate in the municipality of São Paulo is currently 2%, applied over the market value of the property.

Imposto sobre Transmissão Causa Mortis e Doações (ITCMD) is a state property transfer tax normally payable at rates varying from state to state on inheritances and donations of goods and rights. In the State of São Paulo, ITCMD is charged at the rate of 4%.

## *Branch income*

Profits of branches of foreign corporations are taxable at the normal rates applicable to Brazilian resident corporations.

## *Income determination*

Brazilian taxpayers have the option (subject to some restrictions) to calculate IRPJ and CSLL using an 'actual profits' method ('Lucro Real'), which is based on total taxable income (book results before taxes), adjusted by certain additions and deductions as determined in the legislation.

Brazilian taxpayers also have the option to calculate IRPJ and CSLL using a 'presumed profits' method ('Lucro Presumido'). Under the 'presumed profits' method, the income is calculated on a quarterly basis on an amount equal to different percentages of gross revenue (based on the entity's activities) and adjusted as determined by the prevailing legislation.

### *Inventory valuation*
Brazilian income tax regulations require that inventory may be valued at the actual average cost or by the cost of the most recently acquired or produced goods. Rulings to the effect that last in first out (LIFO) is not acceptable have been given.

### *Capital gains*
Capital gains derived from the sale of assets and rights, including shares/quotas, are taxed as ordinary income. However, profits on certain long-term sales of permanent assets may be computed for tax purposes on a cash basis. Profits on long-term contracts may be computed on a percentage-of-completion basis. When these contracts are entered into with the government or government-owned companies, the profit may be recognised on a cash basis for tax purposes.

Except during the year when incurred, capital losses may be offset only against capital gains. Unused capital losses are treated similarly to income tax losses with regard to limits on use and carryforward period.

Capital gains derived by non-residents (including transactions carried out abroad between two non-resident investors, involving assets or rights located in Brazil) are taxed in Brazil. The Brazilian source performing the remittance of capital gains to the non-resident (whether a Brazilian acquirer or the local solicitor of a foreign acquiring entity) must withhold the applicable income tax on such amounts on behalf of the latter at the rate of 15% (or 25% if the beneficiary is located in a tax haven jurisdiction).



### Foreign income
Brazilian resident companies are taxed on worldwide income. Profits of foreign subsidiaries, affiliates, and controlled companies are taxed at the date of the financial statements in which the profits are calculated, regardless of remittance. Double taxation may be avoided by means of foreign tax credits.

### Foreign currency exchange gain/loss
With respect to foreign currency exchange gain/loss, which may arise from receivables or liabilities denominated in foreign currency, Brazilian tax legislation allows the local company to elect to consider the related effect, for tax computation purposes, either upon accrual or cash basis (i.e. actual receipt/payment of funds).

### Financial income
Fixed-rate interest income from short, medium, or long-term financial market transactions, including swap transactions, is subject to withholding tax (WHT) at rates ranging from 15% to 22.5%. Non-fixed financial gains related to stock/commodities exchange and/or futures market transactions are taxed at the rates of 20% (day-trade) and 15% (all other cases). The total income or gain is considered taxable income, and the tax withheld may be offset against the total tax due by the corporate taxpayer.

## Deductions

### Depreciation and depletion
Depreciation is allowable on a straight-line basis over the useful life of the asset. The annual rates normally allowable are 10% for machinery, equipment, furniture, and instalations; 20% for vehicles; and 4% for buildings. Accelerated depreciation is allowed for companies with a two or three working shift operation by increasing normal rates by 50% and 100%, respectively.

Depletion allowances are allowed for natural resources on a useful-life basis. Special incentive depletion allowances are granted for mining operations.

### Bad debts
Losses on bad debts are tax deductible, depending on the amounts, time overdue, and administrative and/or legal actions taken to recover losses. Losses arising from inter-company transactions are not tax deductible.

### Taxes/contributions
Taxes, contributions, and related costs, such as late-payment interest, are deductible for tax purposes on the accrual basis. This rule does not apply to taxes/contributions being or to be challenged by the taxpayer at any level of litigation, which are deductible for tax purposes only on a cash basis.

### Travel expenses
Travel expenses may only be considered deductible if they are duly documented and substantiated.

### Charitable contributions
Donations are deductible up to certain limits if recipients are registered as charitable institutions.

### Research and development (R&D) expenditures

At the option of the company, R&D expenditures may be deducted when incurred or deferred until termination of the project and then amortised over a period of not less than five years.

### Medical and pension expenses

Expenses of group medical care and health insurance programmes for employees and contributions to private supplementary pension schemes are considered deductible if supplied to all employees indistinctly.

### Interest on net equity

Companies can pay interest (calculated on a pro rata basis and up to a given rate known as the 'long-term interest rate' (Taxa de Juros de Longo Prazo or TJLP), which is currently set at 6% in 2011) to partners and/or share/quotaholders, based on the company's net equity. Such interest, which may not exceed the highest of 50% of the annual profits or 50% of the accumulated earnings and profits, is deductible for both IRPJ and CSLL purposes and is subject to 15% WHT at the source (or 25% if the beneficiary is located in a tax haven jurisdiction). Whenever the beneficiary is a legal entity subject to normal income tax in Brazil, the tax withheld at the source may be taken by the recipient as a tax credit against the normal corporate income tax due or the tax due at the source on distributions of interest. If the beneficiary is a Brazilian resident individual, such interest will not become subject to any further taxation.

### Interest and other payments to entities in a tax haven or under a privileged tax regime

Provisions similar to those for thin capitalisation *(see the Group taxation section)* are also applicable to interest paid or credited by a Brazilian entity to an individual or legal entity (whether or not a related party) resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime. In these cases, the interest expense is only deductible for Brazilian income tax purposes if it is viewed as necessary to the company's activities and the total amount of the Brazilian entity's debt with any foreign party resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime does not exceed 30% of the Brazilian entity's net equity.

The Law also provides that amounts paid, credited, delivered, used, or remitted under any title, directly or indirectly, to related or unrelated individuals or legal entities which are resident or domiciled in a tax haven or in a jurisdiction under a privileged tax regime will only be viewed as deductible for Brazilian income tax purposes if all of the following conditions are met: (i) the effective beneficiary of the payment is identified; (ii) there is evidence that the payment beneficiary has operational capacity (i.e. substance); and (iii) there is adequate documentation to support the relevant payments and the corresponding supply of goods, rights, or utilisation of services.

#### Tax havens and privileged tax regime lists

On 7 June 2010, Brazilian tax authorities issued a Normative Instruction (NI RFB 1,037/2010), with an updated tax havens list. The regulation is divided in two separate articles. Article 1 enumerates jurisdictions which are considered not to tax income or to tax it at a rate lower than 20% or that deny access to information regarding shareholding and ownership of assets and rights. The main change made to the new tax haven list was the inclusion of Switzerland, who's inclusion has been temporarily suspended pending a review requested by the Swiss government.

Article 2 of the NI, by its turn, enumerates jurisdictions which are considered to have 'privileged tax regimes', as set forth in Brazilian legislation. The following types of entities are included in the updated list:

- Holding Companies incorporated under the law of Denmark, which do not carry out substantial economic activity.
- Holding Companies incorporated under the law of the Netherlands, which do not carry out substantial economic activity. Note that inclusion has been temporarily suspended pending a review requested by the Dutch government.
- International Trading Companies (ITC) incorporated under the law of Iceland.
- Offshore Companies (KFT) incorporated under the law of Hungary.
- Limited Liability Companies incorporated under the state law of the United States, owned by non-residents and not subject to US federal income tax.
- Holding Companies (ETVE) incorporated under the law of Spain. Note that inclusion has been temporarily suspended pending a review requested by the Spanish government.
- International Trading Companies (ITC) and International Holding Companies (IHC) incorporated under the law of Malta.

It is generally understood that the concept of a privileged tax regime is subject to stricter transfer pricing, thin capitalisation, and tax deduction rules. As for the jurisdictions considered as tax havens, besides the tax consequences applicable for privileged tax regimes, the withholding income tax rate due on capital gains and cross-border payments such as services fees, royalties, and interest is increased from 15% to 25%.

### *Net operating losses*

Tax losses may be carried forward without any time limitation. However, the tax loss may not reduce taxable income by more than 30% of its amount prior to the compensation of the tax loss itself. Tax loss is defined as the accounting loss adjusted for tax purposes. There is no carryback of tax losses.

### *Payments to foreign affiliates and related companies*

Royalties and technical service fees payable to foreign companies with a direct or indirect controlling interest in the Brazilian company are deductible for tax purposes (observing applicable deduction limits), provided the contract has been duly registered with the National Institute of Industrial Property (Instituto Nacional da Propriedade Industrial or INPI) and approved by the Brazilian Central Bank.

In addition to the recently introduced thin capitalisation rules, which restrict the deductibility of interest expenses in Brazil, deductibility of interest is also conditioned to approval of the respective contract by the Brazilian Central Bank. However, on unregistered related-party loans, the deductible interest may not exceed interest calculated using the six-month US dollar deposit LIBOR (London Interbank Offered Rate) rate plus 3%.

## *Group taxation*

Consolidated tax returns are not permitted in Brazil.

### *Transfer pricing*

The Brazilian transfer pricing rules apply to import and export transactions of goods, services, and rights between related parties (the legislation provides a broad list of the parties considered as 'related' for transfer pricing purposes). Under such rules, the transfer price determined between related parties will be acceptable, for Brazilian tax purposes, if it is determined that such price is at arm's length according to one of the traditional methods established by the legislation (no profit methods available). Moreover, all operations with jurisdictions considered as tax havens will also be subject to transfer pricing rules whether involving related parties or not.

The statutory rules provide that interest on related party loans that are duly registered with the Brazilian Central Bank will not be subject to transfer pricing adjustments. However, interest paid on a loan contracted with a related party, not registered with the Brazilian Central Bank, will be deductible only to the extent that the interest rate equals the LIBOR dollar rate for six-month loans plus 3% per year (adjusted to the contract's period).

Operations involving royalty agreements will not be subject to the rules below if the related contract is registered with the Banco Central do Brasil (BACEN) and INPI.

Therefore, the adequacy of the price practiced between the related parties in any operations involving goods, services, and rights may be supported through the application of one of the following methods, as determined under the Brazilian transfer pricing regulations (the company may choose the most convenient method).

Methods used on import transactions:

- Comparable Independent Price Method (PIC).
- Resale Price Less Profit Method (PRL).
- Production Cost Plus Profit Method (CPL).

Methods used in export transactions:

- Export Sales Price Method (PVEx).
- Resale Price Method.
- Acquisition or Production Cost Plus Taxes and Profit Method (CAP).

Relief of proof rules for inter-company export transactions are available.

### *Thin capitalisation*

On 14 June 2010, Provisional Measure 472/2009, which introduced new thin capitalisation rules in Brazil, was converted into Law 12,249.

The Law establishes that interest paid or credited by a Brazilian entity to a related party (individual or legal entity), resident or domiciled abroad, not constituted in a tax haven or in a jurisdiction with a privileged tax regime, may only be deducted for income tax purposes if the interest expense is viewed as necessary for the activities of the local entity and the following requirements are met: (i) the amount of debt granted by the foreign related party (which has participation in the Brazilian entity) does not exceed twice the amount of its participation in the net equity of the Brazilian entity; (ii) the amount of debt granted by a foreign related party (which does not have participation in the Brazilian entity) does not exceed twice the amount of the net equity of the Brazilian entity; (iii) the total amount of debt granted by foreign related parties as per (i) and (ii) does not exceed twice the sum of participation of all related parties in the net equity of the Brazilian entity; and (iv) in case debt is only granted by related parties that do not have a participation in the Brazilian entity, the total amount of debt granted by all of these related parties does not exceed twice the amount of the Brazilian entity's net equity. If one of the mentioned 2:1 ratios is exceeded, the portion of interest related to the excess debt amount will not be deductible for Brazilian income tax purposes.



Normative Instruction 1,154, issued by the Brazilian Revenue Service on 13 May 2011, further regulated the concept of related party and the calculation procedures in connection with the thin capitalisation tests.

## *Tax credits and incentives*

### *Investment project incentives*

Total or partial exemption from duty, excise tax, and social contributions on imported equipment is granted on certain approved investment projects.

Approved investment projects are also granted accelerated depreciation on nationally produced equipment and access to low-cost financing. Sales of some capital equipment are exempt from state sales tax.

Brazilian corporate taxpayers can apply a percentage of their income tax liability on deposit for reinvestment and investment in their own approved investment projects. These approved investment projects are normally granted total or partial income tax exemption.

The Brazilian legislation also provides tax incentives for projects focusing on technological innovation.

### *Regional incentives*

Income tax exemptions or reductions are also available for companies set up in specified regions within Brazil, primarily the north and northeast regions. These incentives are designed to accelerate the development of certain less-developed regions and industries considered to be of importance to the economy.

### *Other incentives*

Excise and sales tax exemptions are granted to exporters of manufactured goods.

## *Withholding taxes*

Profits/dividends distributed to resident or non-resident beneficiaries (individuals and/or legal entities) are not subject to WHT. This provision is also applicable to dividends paid to non-resident companies located in a tax haven jurisdiction.

The WHT rate applicable to payments for services rendered by non-resident companies or individuals is generally 15% but can be increased to 25% in certain cases.

Payments for services, royalties, and interest to non-resident companies located in a tax haven jurisdiction are subject to WHT at the rate of 25%.

Certain types of income paid by Brazilian companies to non-resident recipients are subject to WHT as follows:

| Recipient | Dividends (%)(1, 3) | Interest (%) (3) | Royalties (%) (3) |
|---|---|---|---|
| Non-resident companies and individuals: | | | |

# Brazil

| Recipient | Dividends (%)(1, 3) | Interest (%) (3) | Royalties (%) (3) |
|---|---|---|---|
| Non-treaty: | 0 | 15 | 15 |
| Tax Haven | 0 | 25 | 25 |
| | | | |
| Treaty (2): | | | |
| Argentina | 0 | 15 | 15 |
| Austria | 15 | 15 | 10/15/25 |
| Belgium | 10/15 | 10/15 | 10/15/20 |
| Canada | 15 | 10/15 | 15/25 |
| Chile | 10/15 | 15 | 15 |
| China, P.R. | 15 | 15 | 15/25 |
| Czech Republic | 15 | 10/15 | 15/25 |
| Denmark | 25 | 15 | 15/25 |
| Ecuador | 15 | 15 | 15/25 |
| Finland | 10 | 15 | 10/15/25 |
| France | 15 | 10/15 | 10/15/25 |
| Hungary | 15 | 10/15 | 15/25 |
| India | 15 | 15 | 15/25 |
| Israel | 10/15 | 15 | 10/15 |
| Italy | 15 | 15 | 15/25 |
| Japan | 12.5 | 12.5 | 12.5/15/25 |
| Korea, Rep. of | 10/15 | 10/15 | 10/15/25 |
| Luxembourg | 15/25 | 10/15 | 15/25 |
| Mexico | 10/15 | 15 | 10/15 |
| Netherlands | 15 | 10/15 | 15/25 |
| Norway | 15 | 15 | 15/25 |
| Peru | 10/15 | 15 | 15 |
| Philippines | 15/25 | 10/15 | 15/25 |
| Portugal | 10/15 | 15 | 15 |
| Slovak Republic | 15 | 10/15 | 15/25 |
| South Africa | 10/15 | 15 | 10/15 |
| Spain | 10/15 | 10/15 | 10/15 |
| Sweden | 25 | 25 | 25 |
| Ukraine | 10/15 | 15 | 15 |

Notes

1. Note that the remittance of dividends is not subject to taxation in Brazil.
2. Treaty rates in excess of those in force for non-treaty countries are automatically reduced. The treaty concerned should be consulted to confirm that the tax reduction is applicable in each case.
3. For treaties with multiple WHT rates, the following rules generally apply:
    - Dividends: if there was WHT on dividends, which is not the case according to Brazilian legislation, the 10% (or 15%) rate would generally apply if the beneficial owner is a company which holds directly a certain minimum participation in the capital of the company paying the dividends; the 15% (or 25%) rate is considered for all other cases.
    - Interest: the 10% rate generally applies to loans with a certain minimum term granted for specific purposes (e.g. acquisition of capital goods); the 15% rate is considered for all other cases.
    - Royalties: the 10% rate generally applies to royalties arising from the use of, or the right to use, cinematograph films, and films or tapes for television or radio broadcasting, and any copyright of literary, artistic, or scientific work produced by a resident of a contracting state; the 25% (or 15%) rate generally applies to royalties arising from the use of, or the right to use, trademarks; and the 15% (or 10%) rate is considered for all other cases.

## Tax administration

### Returns
For tax purposes, a company's year-end is 31 December. A different year-end for corporate purposes is irrelevant.

With few exceptions, corporate entities, including those that are foreign-controlled, must file an annual adjusting tax return consolidating the monthly results of the previous calendar year. This tax return must normally be filed by the end of June following the tax year ending on 31 December.

Supporting documentation must be retained for at least five years.

### Payment of tax
In the case of income tax, it is calculated monthly, and prepayments must be paid by the last working day of the subsequent month. Any amounts of income tax due for the year (exceeding the prepayments performed) must be paid by the last working day of March of the subsequent year.

There is an option to pay the tax due at the end of each quarter in three installments, the first one starting from the subsequent month to the end of the quarter. When income tax is calculated quarterly, the taxpayer must perform the applicable payment by the last working day of the month subsequent to the end of the quarter.

### Public digital bookkeeping system (SPED)
Brazil is currently implementing a new public system of digital bookkeeping known as SPED, which aims at gradually replacing paper copies of invoices and tax records for electronic files. SPED can be defined as an instrument that unifies the activities of reception, validation, storage, and legalisation of records and documents that are part of the commercial and tax bookkeeping of companies, through a single, computerised flow of data.

Comprised of three pillars (electronic invoice, digital fiscal bookkeeping, and digital accounting bookkeeping), the implementation of SPED requires adjustments to the relationship with tax authorities, clients, suppliers and, mainly, on the internal operational processes, which will demand an integrated action from different areas (tax, accounting, IT, supplies, production, commercial, and others). On the other hand, occasional inconsistencies from databases, as well as operational errors related to tax and accounting information to be generated, usually unknown to the companies' administration, will be subject to an increased visibility and monitoring by the Brazilian tax authorities.

# Bulgaria

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## Significant developments

### Tax relief for interest and royalties payable between European Union (EU)/European Economic Area (EEA) companies

As of 1 January 2011, interest and royalty payments payable to EU-based associated companies are subject to a reduced 5% withholding tax (WHT) rate in Bulgaria. Associated company criteria are identical to those in the Interest and Royalty Directive and require holding of at least 25% for at least two years. Exemption from WHT on interest and royalties payable to associate companies will be introduced as of 1 January 2015.

### WHT on service fees payable to offshore companies

As of 1 January 2011, any fees for services and use of rights (in addition to technical services fees and royalties) accrued to entities in low-tax jurisdictions attract 10% Bulgarian WHT unless there is proof of the effective provision of the supply. Subject to 10% WHT would also be any accruals for penalties or damages payments to entities in low-tax jurisdictions, except for insurance compensations.

### Increased value-added tax (VAT) for tourist services

As of 1 April 2011, the reduced VAT rate applicable to certain tourist services was increased from 7% to 9%.

### Insurance premium tax

A tax of 2% is levied on all insurance premiums paid after 1 January 2011 under insurance agreements covering risks insured in Bulgaria. Life insurance, reinsurance, aircraft, vehicle, and international transport insurance agreements are exempted from this tax.

### Tourist tax

As of 1 January 2011, a tourist tax was introduced, replacing the previously existing tourist fee. The tourist tax is levied with respect to the number of nights spent in hotels and other places for accommodation and may vary between 0.20 Bulgarian leva (BGN) and BGN 3 per night.

## Taxes on corporate income

In general, corporate income is subject to corporate income tax (CIT) at a flat rate of 10%.

### Alternative tax

Income earned by organisers of games of chance is subject to 12% or 15% alternative tax, applied on a specific tax basis (e.g. the total value of the stakes made). A fixed-sum tax is applied to the operation of gaming machines.

### Tonnage tax regime
A special alternative tax regime applies to the operation of commercial maritime vessels, as per their net tonnage, at a rate of 10%.



## Corporate residence

A corporation is resident in Bulgaria for tax purposes if it is incorporated in Bulgaria.

### Permanent establishment (PE)
Permanent establishments (PE) of foreign tax residents (e.g. branches) are treated as separate entities similar to Bulgarian residents for tax and accounting purposes.

The definition of a PE in the Bulgarian legislation follows, in general, the Organisation for Economic Co-operation and Development (OECD) model; however, it covers a broader scope of activities leading to a tax presence in Bulgaria. A PE is generally defined as a fixed place (own, rented, or otherwise used) through which a foreign entity partly or wholly carries out business activities in the country.

## Other taxes

### Value-added tax (VAT)
The standard VAT rate is 20%. As of 1 April 2011, a reduced VAT rate of 9% applies to certain tourist services (7% prior to 1 April 2011). Some activities are zero-rated, including intracommunity supplies, exports of goods to countries outside the European Union, and international transport of goods (i.e. transport to or from countries outside of the European Union).

Some supplies are VAT exempt without the right to a VAT credit, including (but not limited to) certain land transactions; leasing of residential property to individuals; and financial, insurance, gambling, educational, and health services. Options to charge VAT exist for certain land transactions, leasing of residential property to individuals, and finance lease contracts.

The following statutory periods for VAT refunds apply:

- 30 days for persons that have performed supplies subject to zero-rate (e.g. exports) within the last 12 months exceeding 30% of the total value of all taxable supplies performed by them in the same period, as well as by large investors meeting certain specific conditions.
- Two months and 30 days in all other cases.

The following mechanism for VAT recovery applies to VAT-registered companies: the positive or negative difference between the output VAT charged by the company and the input VAT for the respective month for which recovery is claimed results, respectively, in VAT payable or refundable. The VAT payable should be remitted to the state budget not later than the 14th day of the month following the respective month. VAT refundable is offset against any VAT payable in the following two months, and any remainder is effectively recovered within 30 days thereafter.

It is possible to claim a refund for VAT paid with respect to assets acquired not earlier than five years prior to the VAT registration, under certain conditions. In the case of real estate, the term is 20 years.

### *Excise duties*
Excise duties are charged as a percentage of the sales price or customs value or as a flat amount in BGN per unit, unless a suspension regime applies. For 2011, excisable products include petrol and diesel fuel, LPG, heavy oil, kerosene, beer and spirits, tobacco products, and electricity.

The applicable rates are as follows:

- Unleaded petrol: BGN 710 per 1,000 litres.
- Diesel: BGN 615 per 1,000 litres.
- LPG: BGN 340 per 1,000 kg.
- Kerosene: BGN 615 per 1,000 litres.
- Natural gas: BGN 0 per gigajoule.
- Heavy oil: BGN 600 per 1,000 litres.
- Electricity: BGN 2 per MWh (zero rate if used by households).
- Beer: BGN 1.50/hl/°Plato.
- Wine: zero rate.
- Ethyl alcohol: BGN 1,100 per hectolitre.
- Cigarettes: 23% *ad valorem* + 101/1,000 pieces (min. BGN 148).

Lower rates may apply in certain cases (e.g. energy products used for heating purposes or mixed with bio fuels, beer produced by independent small breweries, etc.).

The Excise Duties and Tax Warehouse Act introduced the tax warehousing regime and regulates the production, storage, and movement of excisable products.

### *Insurance premium tax*
A tax of 2% is levied on all insurance premiums paid after 1 January 2011 under insurance agreements covering risks insured in Bulgaria. Life insurance, reinsurance, aircraft, vehicle, and international transport insurance agreements are exempted from this tax. The taxable base is the insurance premium received by an insurance company under an insurance agreement.

Insurance companies and their tax representatives are liable to collect the tax and remit it to the budget monthly by the end of the month following the month when the insurance premium was collected.

### *Property tax*
The property tax rate is determined by each municipality and currently ranges from 0.01% to 0.45% of the tax value of property. Individuals and legal entities that are owners of immovable property (i.e. land and buildings) are liable for property tax. For individuals and residential properties of the enterprises, the taxable base is the tax value as determined by the municipal authorities based on certain statutory criteria. The taxable base for properties of enterprises is the higher of the property's gross book value and its tax value determined by the respective municipal authorities.

A garbage collection fee is payable for immovable property at a rate determined by the local municipal council annually.

### *Transfer tax*
A transfer tax is due on the value of transferred real estate or motor vehicles, subject to certain exemptions (e.g. contributions in-kind, acquisitions under the Law on Privatisation and Post-privatisation Control). The rate of the transfer tax ranges from 0.1% to 3% and is determined by each municipality.

### Tourist tax

As of 1 January 2011, a tourist tax was introduced, replacing the previously existing tourist fee.

The tourist tax is levied with respect to the number of nights spent in hotels and other places for accommodation. The municipalities may determine the tax within a range of BGN 0.20 to BGN 3 per night depending on the type of accommodation facility.

The tax is payable on a monthly basis by the 15th day of the following month.

### One-off taxes

The following corporate expenses are subject to a one-off tax:

- Representative expenses related to a company's business.
- Social expenses provided to employees in kind (monetary social expenses are subject to personal income tax).
- Expenses related to the exploitation and maintenance of cars where they are used for management activities (as distinguished from administrative activities).

The rate of the one-off tax with respect to the above expenses is 10%. Both the expenses and the related one-off taxes are deductible for CIT purposes.

## Branch income

Although branches are not deemed to be separate legal persons, branches of non-resident companies have separate balance sheets and profit and loss accounts and are subject to CIT at the standard rate of 10% as well as other general taxes (e.g. VAT, property tax).

Representative offices of foreign entities are not allowed to carry out business activities and are not subject to CIT. A representative office registered under the Encouragement of Investments Act may perform only those activities that are not regarded as 'economic activities' (e.g. marketing activities normally carried out by a representative office and auxiliary to the activities of its head office). Representative offices do not constitute PEs of the non-resident entities, unless they engage in business activities in breach of the law.

Profits repatriated by a branch to its head office abroad are not subject to WHT. However, certain income payable by a Bulgarian branch or a PE to other parts of the enterprise abroad may trigger WHT (e.g. income from technical services, interest, royalties), unless the respective expenses are not deductible to the branch or the PE, or are recharged at cost.

## Income determination

The taxable result is based on the statutory accounting principles relating to profit/loss and adjusted for tax purposes. Statutory accounting is maintained on an accrual basis in line with the applicable accounting standards.

Small and medium-sized companies may apply specific national standards for the financial statements of small and medium-sized companies, or optionally, International Financial Reporting Standards (IFRS). The principles provided by the Standards for the Financial Statements of Small and Medium-sized Companies are similar to those provided by IFRS. Certain types of companies, including banks and insurance companies, are obliged to apply IFRS.

### *Inventory valuation*

The tax legislation follows the accounting rules for inventory valuation methods. The accounting rules may restrict the application of certain methods (e.g. last in first out (LIFO) is not allowed under IFRS).

Inventory valuation and revaluation methods applicable under accounting standards may be used for tax purposes. Companies may choose the method of inventory valuation but must apply the chosen method consistently throughout the accounting period. An inventory of assets and liabilities is carried out in each accounting period. Accounting gains and losses realised upon revaluation of inventory will not be recognised for tax purposes and will form a temporary tax difference. These gains and losses will be recognised for tax purposes in the period in which the inventory is disposed of.

### *Capital gains*

Realised capital gains are included in corporate income and are taxed at the full CIT rate.

Note that capital gains from securities will not be subject to taxation if resulting from shares in listed companies and tradable rights in such shares on a regulated securities market in the EU/EEA. Assets distributed as dividends are deemed realised at market value, and any capital gains arising from this will be subject to tax.

### *Dividend income*

Inter-company dividend payments between Bulgarian companies and dividends distributed by EU/EEA residents to Bulgarian companies (except for dividends from special purpose investment companies or in case of 'hidden distribution of profits') are not included in the tax base of the recipient company.

Dividends distributed by Bulgarian companies to foreign shareholders and resident individuals are subject to 5% WHT under the domestic legislation *(see the Withholding taxes section for exceptions for payments to EU/EEA tax residents and under double tax treaties (DTTs))*.

### *Stock dividends*

No explicit regulation with respect to stock dividends exists in the Bulgarian CIT act. Rather, the tax treatment of stock dividends would follow accounting treatment.

### *Exchange rate gains/losses*

Exchange rate gains and losses are reported in the profit and loss account and reflected in the assessment of taxable profit.

### *Foreign income*

Income derived outside Bulgaria by resident legal entities and income derived in Bulgaria by Bulgarian branches of non-residents is included in the taxable base for the purpose of CIT, regardless of whether such income is subject to taxation abroad.

In instances where the provisions of a DTT are applicable, a tax credit or exemption for the foreign tax paid may be allowed. There is also a unilateral tax credit which may not exceed the amount of the tax that would be payable in Bulgaria for the same type of income.



Undistributed income of foreign subsidiaries of a Bulgarian resident company is not taxed.

## Deductions

### Depreciation and depletion

For accounting purposes, depreciation is calculated in accordance with the straight-line, progressive, or declining methods of depreciation. Accounting regulations permit Bulgarian companies to establish a depreciation schedule for each tangible and intangible fixed asset on the basis of the method chosen by the company.

For tax purposes, only the straight-line method is permitted. For machines and equipment that are part of the initial investment, accelerated depreciation may also apply, subject to certain conditions.

For tax purposes, fixed assets are divided into the following seven categories:

| Category | Assets | Maximum rates (%) |
|---|---|---|
| I | Massive buildings, industrial constructions/equipment, transmission facilities/lines (incl. electricity) | 4 |
| II | Machinery, production facilities, apparatuses | 30/50 |
| III | Vehicles (except cars), coverage of roads and runways | 10 |
| IV | Computers, peripherals to computers, software and rights to use software | 50 |
| V | Cars | 25 |
| VI | Long-term intangibles with legal or contractual limitations on the period of use | 33 1/3 |
| VII | Other assets | 15 |

Under certain conditions, assets classified in Category II that are new may be depreciated at a maximum rate of 50% for tax purposes.

The depreciation rate for Category VI is determined by the period of limitations, but not more than 33 1/3%.

Depletion is not specifically regulated for tax purposes.

### Net operating losses

The taxpayer has the right to carry forward tax losses incurred in a given year over the following five years. The loss subject to carryforward is the negative amount of the financial result adjusted for tax purposes, with certain add-backs and deductions specified in the tax legislation.

Tax losses may be reversed up to the amount of the positive financial result after tax adjustments (without the effect of the loss subject to be carried forward itself).

Carryforwards of foreign-source losses may only offset income from the same source. However, EU/EEA-source losses may offset income from other sources, including Bulgarian sources.

Loss carryback is permitted in very specific cases.

### *Payments to foreign affiliates*
Payments to foreign affiliates may be subject to recalculation by the tax authorities if such payments are not made at arm's length.

## *Group taxation*

No group consolidation is permitted for tax purposes in Bulgaria. All companies must pay tax on the basis of individually assessable profits and losses.

### *Transfer pricing rules*
Bulgarian law requires that taxpayers determine their taxable profits and incomes applying the arm's-length principle to prices at which they exchange goods, services, and intangibles with related parties (transfer prices). Bulgarian transfer pricing rules generally follow OECD Transfer Pricing Guidelines.

Transfer prices are not set in compliance with the arm's-length principle where:

- prices of the supply of goods or services differ from the market prices or
- loans are received or granted against an interest rate that differs from the market interest rate effective at the time the loan agreement is concluded.

The market interest rate is defined as the interest payable under the same conditions for a loan provided or received, notwithstanding the form of the loan, between non-related parties. The market interest is determined according to the market conditions.

The taxable person should be able to evidence that its relations with related parties are in line with the arm's-length principle.

For the purposes of transfer pricing rules, market prices are determined by the following methods:

- Comparable uncontrolled price method.
- Resale price method.
- Cost plus method.
- Transactional net margin method.
- Profit split method.

Preparation of transfer pricing documentation is not mandatory but is recommendable for material related party transactions. Recently, the revenue authorities tend to focus more on the transfer pricing area.

Currently, there is no possibility to obtain an advance pricing agreement (APA). However, it is possible to obtain an opinion from the revenue authorities on a case-by-case basis. Such opinions are not binding, but they may provide protection from assessment of interest for late payment and penalties.

### Thin capitalisation rules

Interest payable by local companies to local or foreign persons may be restricted by the thin capitalisation rules (which also apply to interest due to non-affiliated companies).

The tax deductibility for interest expenses that exceed interest income is restricted to 75% of the accounting result of the company, exclusive of interest income and expense. If the accounting result of the company before including the effect of the interest income and expenses is a loss, none of the net interest expense will be deductible for tax purposes. Interest on bank loans and interest under financial lease agreements are subject to thin capitalisation regulations only when the agreements are between related parties or guaranteed by or extended at the order of a related party.

The thin capitalisation rules do not apply if the debt-to-equity ratio does not exceed 3:1 for the respective tax period.

Interest expenses restricted in a given year under the thin capitalisation rules may be deducted from the financial result for tax purposes during the following five consecutive years. This reversal may be made up to the tax allowed interest expenses, as per the above formula.

## Tax credits and incentives

Tax incentives may apply in certain circumstances, including:

- Partial granting back of CIT due for performance of agricultural activities.
- Additional tax deductions for hiring of long-term unemployed, handicapped, or elderly persons.
- Full granting back of CIT due for investment in regions with high unemployment.

## Withholding taxes

Bulgarian companies are required to withhold tax on payments of dividends and liquidation proceeds; interest (including that incurred under finance lease agreements and on bank deposits); royalties; fees for technical services; payments for the use of properties; payments made under operating leasing, franchising, and factoring agreements; and management fees payable to non-residents.

Capital gains from the transfer of shares in a Bulgarian company or immovable property located in Bulgaria realised by a non-resident are also subject to domestic WHT; however, the tax is payable by the non-resident. Capital gains from securities are not subject to WHT if they result from shares in listed companies and tradable rights in such shares on a regulated securities market in the EU/EEA.

Dividends and liquidation proceeds are also taxed where payments are made to resident individuals and non-profit organisations. (*For details on dividend payments between domestic companies see Dividend income in the Income determination section.)* Dividends capitalised into shares (stock dividends) are not subject to WHT.

As of 1 January 2011, interest and royalty payments payable to EU-based associated companies are subject to a reduced 5% WHT rate in Bulgaria. Associated company criteria are identical to those in the Interest and Royalty Directive and require holding of at least 25% for at least two years. Exemption from withholding tax on interest and royalties payable to associated companies will be introduced as of 1 January 2015.

As of 1 January 2011, any fees for services and use of rights (in addition to technical services fees and royalties) accrued to entities in low-tax jurisdictions will attract 10% Bulgarian WHT unless there is proof of the effective provision of the supply. Subject to 10% WHT would also be any accruals for penalties or damages payments to entities in low-tax jurisdictions, except for insurance compensations. The tax legislation introduces a list of low-tax jurisdictions. These are certain off-shore territories which are explicitly listed, as well as countries with which Bulgaria has not signed a DTT and in which the applicable corporate tax rates are more than 60% lower than the applicable rate in Bulgaria.

Certain types of income (other than dividends) accrued by a PE of a foreign person to other parts of its enterprise located outside the country are subject to WHT *(except for that mentioned in the Branch income section).*

### *Dividends*
When a dividend is accrued to a non-resident company or an individual (both resident and foreign), it is subject to WHT at a rate of 5%, unless the rate is reduced by an applicable DTT. No differentiation is made between portfolio and substantial holdings for purposes of this WHT on dividends.

Dividends distributed by a Bulgarian resident company to an entity that is a tax resident in an EU/EEA member state are not subject to Bulgarian WHT.

### *Interest*
A 10% rate applies to interest (including interest from bank deposits) payable to a non-resident, unless the rate is reduced by an applicable DTT.

Interest on borrowings by the government or the Bulgarian National Bank from international financial institutions is not taxable if the respective loan agreements contain relevant exemption arrangements (international treaties override domestic legislation).

Interest paid to an associated EU-based related company is subject to a 5% WHT unless reduced by a DTT (require at least 25% holding for at least two years).

### *Royalties*
Royalties payable to foreign persons are taxed at a rate of 10% at source, unless the rate is reduced by an applicable DTT.

Royalty payments to an associated EU-based related company are subject to a 5% WHT unless reduced by a DTT (require at least 25% holding for at least two years).

### *Capital gains and technical services*
Capital gains and technical service fees payable to foreign residents are subject to 10% WHT, unless the rate is reduced by an applicable DTT. As per the domestic legislation, technical services include installation and assembly of tangible assets as well as consultancy services and marketing research.

### *Application of DTT relief*
Applying DTT relief is generally possible only after completing an advance clearance procedure with the Bulgarian tax authorities. Companies have to evidence that they

satisfy the requirements for applying the DTT (e.g. tax residence, beneficial ownership, existence of contractual relationship, actual accrual/payment of the income). The procedure usually takes 60 days to complete.



The above procedure has to be followed only if the annual income payable by a Bulgarian resident exceeds BGN 500,000 (approximately EUR 250,000). In all other cases, DTT relief can be applied directly, through submitting a tax residence certificate and a beneficial ownership declaration with the payer of the income.

Beneficial ownership is explicitly defined in Bulgarian legislation. A company is considered a beneficial owner of the income if it has the right to dispose of the income, has discretion over its use, bears the whole or a significant part of the risk of the activity from which the income is realized, and does not qualify as a conduit company.

A conduit company is a company which is controlled by persons who would not benefit from the same type and amount exemption if the income was realised directly by them, does not carry out any economic activity except for owning and/or administering the rights or the assets from which the income was realized, and does not own assets, capital, or personnel relevant to its economic activity or does not control the use of the rights or assets from which the income was realised.

The conduit company restriction does not apply to companies which have more than a half of their voting shares traded on a registered stock exchange.

The following is a summary of the main parameters of the Bulgarian DTTs as of 1 January 2011:

| Recipient | Dividends* (%) | Interest** (%) | Royalties** (%) | Capital gains (%) |
|---|---|---|---|---|
| Albania (3, 6, 9, 28) | 5/15 | 0/10 | 10 | 0/10 |
| Algeria (24) | 10 | 0/10 | 10 | 0 |
| Armenia (1, 2, 6, 28, 36) | 5/10 | 0/5/10 | 5/10 | 0/10 |
| Austria (12, 28) | 0 | 0 | 0 | 0 |
| Azerbaijan (6, 28, 34) | 8 | 7 | 5/10 | 0 |
| Bahrain (6) | 5 | 0/5 | 5 | 0 |
| Belarus (6) | 10 | 0/10 | 10 | 0 |
| Belgium (6, 10, 27) | 10 | 0/10 | 5 | 0 |
| Canada (9, 16, 28) | 10/15 | 10 | 10 | 0/10 |
| China (2, 6, 9, 28) | 10 | 0/10 | 7/10 | 0/10 |
| Croatia | 5 | 5 | 0 | 0 |
| Cyprus (3, 26, 27) | 5/10 | 7 | 10 | 0/10 |
| Czech Republic (11, 27) | 10 | 10/0 | 10 | 0 |
| Denmark (3, 27) | 5/15 | 0 | 0 | 0 |
| Egypt (6) | 10 | 0/12.5 | 12.5 | 10 |
| Estonia (9, 16) | 0/5 | 5 | 5 | 0/10 |
| Finland (4, 9, 12, 27) | 10 | 0 | 0/5 | 0/10 |
| France (5, 27) | 5/15 | 0 | 5 | 0 |
| Georgia (6) | 10 | 0/10 | 10 | 0 |
| Germany (11, 16, 26, 27, 36) | 5/15 | 0/5 | 5 | 0/10 |
| Greece (27) | 10 | 10 | 10 | 0 |
| Hungary (6, 27) | 10 | 0/10 | 10 | 0 |

# Bulgaria

| Recipient | Dividends* (%) | Interest** (%) | Royalties** (%) | Capital gains (%) |
|---|---|---|---|---|
| India (6) | 15 | 0/15 | 15/20 | 10 |
| Indonesia (6) | 15 | 0/10 | 10 | 0 |
| Iran (6, 9, 28) | 7.5 | 0/5 | 5 | 0/10 |
| Ireland (3, 6, 9, 27, 28) | 5/10 | 0/5 | 10 | 0/10 |
| Israel (18, 19, 20, 21) | 10/7.5 to 12.5 | 0/5/10 | 7.5 to 12.5 | 7.5 to 12.5 |
| Italy (27) | 10 | 0 | 5 | 0 |
| Japan (3, 6) | 10/15 | 0/10 | 10 | 10 |
| Jordan (6, 28) | 10 | 0/10 | 10 | 0 |
| Kazakhstan (8, 9, 28) | 10 | 0/10 | 10 | 0/10 |
| Kuwait (3, 22) | 0/5 | 0/5 | 10 | 0 |
| Latvia (3, 9, 24, 25, 27, 28) | 5/10 | 0/5 | 5/7 | 0/10 |
| Lebanon (6) | 5 | 7/0 | 5 | 0 |
| Lithuania (16, 28, 29) | 0/10 | 0/10 | 10 | 0/10 |
| Luxembourg (3, 10, 27) | 5/15 | 10 | 5 | 0 |
| Macedonia (3, 6) | 5/15 | 0/10 | 10 | 0 |
| Malta (12, 17, 27) | 0/30 | 0 | 10 | 0 |
| Moldova (3, 6, 9, 28) | 5/15 | 0/10 | 10 | 0/10 |
| Mongolia (6) | 10 | 0/10 | 10 | 0 |
| Morocco (5, 9, 28) | 7/10 | 10 | 10 | 0/10 |
| The Netherlands (3, 7, 9, 27) | 5/15 | 0 | 0/5 | 0/10 |
| North Korea (6) | 10 | 0/10 | 10 | 0 |
| Norway | 15 | 0 | 0 | 0 |
| Poland (6, 27) | 10 | 0/10 | 5 | 0 |
| Portugal (3, 6, 27) | 10/15 | 0/10 | 10 | 0 |
| Qatar (6, 36) | 0 | 0/3 | 5 | 0 |
| Romania (3, 6) | 10/15 | 0/15 | 15 | 0 |
| Russian Federation (6) | 15 | 0/15 | 15 | 0 |
| Serbia (3) | 5/15 | 10 | 10 | 0 |
| Singapore (6) | 5 | 0/5 | 5 | 0 |
| Slovak Republic (27) | 10 | 10 | 10 | 0 |
| Slovenia (3, 23, 27, 28) | 5/10 | 0/5 | 5/10 | 0/10 |
| South Africa (3, 6, 23, 24) | 5/15 | 0/5 | 5/10 | 0/10 |
| South Korea (5, 6) | 5/10 | 0/10 | 5 | 0 |
| Spain (3, 27) | 5/15 | 0 | 0 | 0 |
| Sweden (9, 27, 28) | 10 | 0 | 5 | 0/10 |
| Switzerland (3, 10, 13) | 5/15 | 0/10 | 0/5 | 0 |
| Syria | 10 | 0/10 | 18 | 0 |
| Thailand (14, 15) | 10 | 10/15 | 5/15 | 10 |
| Turkey (3, 6, 9) | 10/15 | 0/10 | 10 | 0/10 |
| Ukraine (3, 6, 9, 28) | 5/15 | 0/10 | 10 | 0/10 |
| United Arab Emirates (6, 22, 34) | 0/5 | 0/2 | 0/5 | 0 |
| United Kingdom (27) | 10 | 0 | 0 | 0 |
| United States (16, 24, 28, 30, 31, 32, 33) | 5/10 | 5/10 | 5 | 0 |
| Uzbekistan (6, 28) | 10 | 0/10 | 10 | 0/10 |

| Recipient | Dividends* (%) | Interest** (%) | Royalties** (%) | Capital gains (%) |
|---|---|---|---|---|
| Vietnam (6, 9) | 15 | 0/10 | 15 | 0/15 |
| Zimbabwe (3, 6, 9, 28) | 10/20 | 0/10 | 10 | 0/10 |



Notes

*Under Bulgarian domestic legislation, dividends distributed to non-residents are subject to 5% WHT, unless the recipient is a resident of an EU/EEA member state.

** Under Bulgarian domestic legislation, interest and royalty payments to EU-resident companies satisfying the Interest and Royalty Directive requirements are subject to a reduced 5% WHT rate.

1. The lower rate applies to dividends paid out to a non-resident that is the direct owner of at least the equivalent of USD 100,000 forming part of the capital of the company making the payment.
2. The reduced rate for royalties is available for the use of (or right to use) industrial, commercial, or scientific equipment.
3. The lower rate applies to dividends paid out to a foreign company that controls directly at least 25% of the share capital of the payer of the dividends. In the specific cases of the different countries, more requirements may be in place.
4. There is no WHT on royalties for the use of (or the right to use) scientific or cultural works.
5. The lower rate applies to dividends paid out to a foreign company that controls directly at least 15% of the share capital of the payer of the dividends.
6. There is no WHT on interest when paid to public bodies (government, the central bank, and, in several cases, certain governmental bodies).
7. 5% royalties are applicable if the Netherlands applies WHT under its domestic law.
8. Up to 10% branch tax may be imposed on PE profits.
9. The 10% rate on capital gains from securities applies in specific cases that are described in the respective treaty.
10. The zero rate on interest applies if the loan is extended by a bank and also for industrial, trade, and scientific equipment on credit.
11. The zero rate on interest applies if the interest is paid to public bodies (government, municipality, the central bank, or any financial institution owned entirely by the government), to residents of the other country when the loan or the credit is guaranteed by its government, or if the loan is extended by a company for any equipment or goods.
12. The Council of Ministers has stated its intention to renegotiate the DTTs with Austria, Malta, and Finland.
13. A 5% rate on royalties applies if the Swiss Confederation introduces in its domestic law WHT on royalties paid to non-residents.
14. The 10% rate on interest applies if the interest is received from a financial institution, including an insurance company.
15. The 5% rate on royalties applies if the royalties are paid for the use of copyright for literary, art, or scientific work.
16. The lower rate applies to dividends paid out to a foreign company that controls directly at least 10% of the share capital of the payer of the dividends.
17. The zero rate applies to dividends payable by a Bulgarian resident entity to an entity resident in Malta. The 30% rate applies to dividends payable by a Maltese entity to a Bulgarian entity.
18. The 10% rate applies to dividends distributed by companies that enjoy a reduced or zero CIT by virtue of a tax incentive for investments. In all other cases, the rate is equal to one half of the applicable rate as per the national legislations of Bulgaria and Israel. Nevertheless, the WHT rate may not be less than 7.5% or more than 12.5%.
19. The 5% rate applies to interest payable to banks or other financial institutions. The zero rate applies to interest payable to certain public bodies (governments, municipalities, central banks) or to residents of the other country when the loan or credit is guaranteed, insured, or financed by a public body of that country or by the Israeli International Trade Insurance Company.
20. The rate on royalties is equal to one half of the applicable rate as per the national legislations of Bulgaria and Israel. Nevertheless, the WHT rate may not be less than 7.5% or more than 12.5%.
21. The rate on capital gains from securities is equal to one half of the applicable rate as per the national legislations of Bulgaria and Israel. Nevertheless, the WHT rate may not be less than 7.5% or more than 12.5%. However, capital gains from transfers of shares in entities whose real estate properties exceed 50% of their assets are taxed in the country in which the real estate is located.
22. The zero rate applies to dividends and interest paid to certain public governmental and local bodies as well as entities fully owned by the state.
23. The 5% rate on royalties applies if the royalties are paid for the use of copyright for literary, art, or scientific work as well as for the use of industrial, commercial, or scientific equipment.
24. There is no WHT on interest when paid to and beneficially owned by public bodies (government, local public authorities, the central bank, or any financial institution wholly owned by the government), as well as on interest derived on loans guaranteed by the foreign government or based on an agreement between the governments of the states.

25. The 7% rate on royalties applies if the royalties are paid for the use of, or the right to use, cinematograph films and films or tapes for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula, or process.
26. The zero rate applies for capital gains from shares in a Bulgarian resident company that are traded on the Bulgarian Stock Exchange.
27. In accordance with the EU Parent-Subsidiary Directive implemented in the Bulgarian legislation, dividends distributed by a Bulgarian resident company to an entity that is a tax resident in an EU member state may not be subject to Bulgarian WHT.
28. Full WHT at source may be levied on capital gains from the sale of shares in companies, the main assets of which are directly or indirectly holdings in real estate situated in Bulgaria, and in some other cases (subject to the specifics stipulated in the respective treaty).
29. There is no WHT on interest when paid to public bodies (government, the central bank, governmental institutions) or any financial institution wholly owned by the government.
30. Pension funds and charities are considered resident persons.
31. The zero rate does not apply to dividends distributed to real estate investment trusts (REITs).
32. The zero rate does not apply to interest paid under a back-to-back loan.
33. The benefits of the treaty are limited to entities that satisfy certain criteria (Limitation of Benefits clause).
34. The 5% rate on royalties applies if the royalties are paid for the use of, or the right to use, any patent, design, model, plan, secret formula, process, or know-how.
35. A new Bulgaria-Austria DTT has entered into force recently. Its WHT provisions, which will take effect as of 2012, provide for the following WHT rates: 5% on dividends, 5% on interest (except for bank and government loans and credit sale of equipment), 5% on royalties, 10% on capital gains unless shares were sold on a stock exchange or seller owned at least 20% of the issuing company's capital. The CIT provisions of the treaty entered into force as of 1 January 2011.
36. The reduced rate for interest is available for bank loans (subject to specifics in the treaty).

Under some DTTs, technical service payments fall within the definition of royalty payments and are taxed accordingly.

## *Tax administration*

### *Returns*

Annual profit must be declared no later than 31 March of the year following the financial (tax) year. The financial and tax years coincide with the calendar year. Along with their annual CIT returns, companies are required to file financial information for their business activities during the year in a standard statistical form not subject to a financial audit. The self-assessment principle is applied.

### *Payment of tax*

If a company ended the preceding financial year with a taxable profit, it is liable for advance CIT payments each month in the current year at the rate of 10%. The monthly taxable base for the second, third, and fourth quarters is one-twelfth of the annual taxable profit for the preceding year multiplied by a coefficient determined in the State Budget Act for the current year. However, the taxable base for the advance payments during the first quarter is one-twelfth of the taxable profit of the company for the year before the preceding year multiplied by a coefficient defined in the State Budget Act for the current year.

Corporate taxpayers having a tax loss or zero taxable result in the previous year and companies established during the current year make quarterly advance payments during the current fiscal year. The base of the quarterly advance payments is the profit for the corresponding period accumulated from the beginning of the current year.

Companies with a net sales revenue below BGN 200,000 for the preceding year and newly incorporated companies (if not established as a result of a transformation of another entity) are not required to make advance payments of CIT.

Overpayment of CIT may be offset against advance and annual payments of the respective taxes due for the next period. The difference between the annual tax declared in the CIT return and the advance tax paid for the corresponding year must be paid by the deadline for submitting the tax return on 31 March of the following year.

# Cambodia

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## Significant developments

### Tax on immovable property (ToIP)

Further to the 2010 Law on Financial Management, the Ministry of Economy and Finance (MEF) has issued Prakas No. 493 MEF/PrK on the ToIP. Based on the Prakas, the ToIP is levied at 0.1% per annum on the market value of immovable property (determined by the Immovable Property Valuation Committee) less the threshold of 100 million Cambodian riels (KHR) (approximately 25,000 US dollars (USD)). Immovable property valued below the threshold is not subject to ToIP.

Immovable property is defined to include land, buildings, and other constructions on land (e.g. infrastructures built on land, regardless of having a wall or roof). Certain exemptions exist for government-owned property, agricultural land, property owned and used for cultural and religious purposes, property of foreign embassies and non-governmental organisations (NGOs), and property in the special economic zones.

At the first phase of implementation, the ToIP will only cover immovable property located in all cities in Cambodia.

The owners, possessors, and final beneficiaries of immovable property are required to register and obtain a Tax Identification Number for each immovable property valued above the threshold from the tax administration where the immovable property is located. Any changes in relation to the registered immovable property (e.g. a change of title) are also required to be reported.

The owners, possessors, and final beneficiaries hold responsibility for calculating ToIP, preparing and filing ToIP return, as well as remitting the ToIP liability to the tax administration once per year by 30 September. A ToIP return is required for every single immovable property and must be completed and filed separately. Since this is a self-assessment tax, the tax administration will perform tax audit on ToIP in the subsequent years.

### Tax on profit (ToP) and other taxes of insurance companies

Further to Circular No. 006 MEF, dated 29 December 2009, on ToP and Tax on Salary of Insurance Company, the MEF has issued Circular No.003 MEF.GDT, dated 10 February 2011, on ToP and Other Taxes of Insurance Company that provides insurance and reinsurance companies with additional guidelines on taxation issues in relation to ToP, patent tax, and other taxes. The additional guidelines include the following:

**ToP**

- The tax rate of 5% only applies to gross insurance premium earned during a taxable year.
- Income derived from other business activities, except insurance/reinsurance, is subject to the standard ToP rate at 20%.

- Net interest income paid by local registered banks and saving institutions after withholding 4% or 6% withholding tax (WHT) is exempt from ToP.

**Patent tax and other taxes**

- Insurance companies have to submit patent tax returns for all business activities and remit the patent tax by 31 March each year.
- Insurance companies shall comply with the tax laws and regulations in respect with other taxes.



### *The amendment of custom duties on certain imported goods*

The MEF has issued Prakas No. 1194 MEF/PrK to change customs duties on certain imported petroleum products, those are: gasoline from 35% to 15%, diesel from 15% to 0%, and kerosene from 7% to 0%. The Sub-decree became effective as of 1 January 2011.

### *The amendment of specific tax and export duties on certain products*

This Sub-decree was issued by the Royal Government of Cambodia to alter specific tax (SPT) rates on certain imported products and export duties on certain exported products and to implement a unit-based tariff on the exportation of rubber products. Based on the Sub-decree, the SPT rate is increased from 10% to 20% for import of vehicles, and decreased from 33.33% to 10% for import of gasoline. Export duty rate is increased from 10% to 20% for export of stone (e.g. marble, granite, and pebble) and metal (e.g. steel, iron, copper, aluminium, lead, zinc, and tin), and decreased from 10% to 0% for export of cement. In addition, unit-based tariffs are introduced to export of rubber products as follows:

- USD 50 per ton if export prices are less than USD 2,000 per ton.
- USD 150 per ton if export prices range from USD 2,000 to below USD 3,000 per ton.
- USD 200 per ton if export prices range from USD 3,000 to below USD 4,000 per ton.
- USD 250 per ton if export prices equal to or are greater than USD 4,000 per ton.

The Sub-decree became effective as of 1 February 2011.

## *Taxes on corporate income*

### *Corporate tax system*

Cambodia's taxation rules vary according to the taxpayer's regime, the classification of taxpayers under different tax collection and control procedures of the General Department of Taxation (GDT). Real-regime taxpayers include large or incorporated taxpayers duly registered with the Ministry of Commerce and the GDT. The majority of foreign investors will fall into the real regime. Unless otherwise stated, the focus of this summary is on real-regime taxpayers.

Resident taxpayers are subject to tax on worldwide income while non-residents are taxed on Cambodian-sourced income only. A permanent establishment (PE) is taxable on its Cambodian-source income only.

### *Corporate tax rate*

The standard rate of corporate income tax, known as tax on profit (ToP), for companies and PEs is 20%.

### Industry-specific tax rates

Oil and gas and certain mineral exploitation activities are subject to ToP at the rate of 30%.

Insurance companies are taxable at a rate of 5% on the gross premium income and at the rate of 20% on other income derived from non-insurance/reinsurance activities. Net interest income of insurance companies received after withholding 4% or 6% WHT is not taxable income.

### Minimum tax

Real-regime taxpayers are subject to a separate minimum tax. The minimum tax is an annual tax with a liability equal to 1% of annual turnover inclusive of all taxes except value-added tax (VAT). However, an exemption has been provided for Qualified Investment Projects (QIP) *(see the Tax credits and incentives section for more information)*.

As a separate tax to the ToP, the minimum tax is due irrespective of the taxpayer's profit or loss position (i.e. the minimum tax will be liable if the 1% of total annual turnover exceeds the 20% ToP liability).

### Prepayment of ToP

A prepayment of ToP equal to 1% of monthly turnover inclusive of all taxes, except VAT, is required to be paid on a monthly basis. The prepayment can be offset against the annual ToP liability and the minimum tax.

Where a taxpayer is in the period of ToP holiday, the taxpayer is also exempted from the prepayment obligations. However, a nil monthly return will need to be lodged.

Where a taxpayer is not subject to minimum tax, a monthly prepayment of ToP must still be made. However, unutilised prepayments from a prior year can be used to offset the current amount due, and no physical payment may be required.

### Additional ToP on dividend distribution

A dividend-paying taxpayer is required to pay an additional ToP at the time of dividend distribution if the profit was previously subject to a 9% or 0% ToP.

A shareholder is entitled to establish a special dividend account from which the relevant dividend that was already subject to 20% ToP may be on-paid without further additional ToP obligations.

A dividend will be exempt from tax in the hands of the shareholder if additional ToP and WHT for non-resident shareholders has been paid.

## Corporate residence

Resident taxpayers include companies organised, managed, or having their principal place of business in Cambodia.

### Permanent establishment (PE)

A PE may be determined if there is a permanent place or entity through which the non-resident persons carry on their business or if there is an exercise of the authority to conclude a contract on behalf of a foreign entity or if business activities exceed certain time periods in Cambodia.

Factors to be considered in determining a PE include a place of management, an agent or office, a warehouse or factory, a workshop, any place of extraction of natural resources, a plantation, etc. Carrying out projects (e.g. supervisory activities of construction project, provision of services) exceeding a time period of six months in any 12 month period may also be considered as having a PE.



## *Other taxes*

### *Value-added tax (VAT)*
VAT is applicable to real-regime entities and is charged at 10% on the value of the supply of most goods and services. Exported goods and services rendered outside Cambodia are zero-rated. In addition, 0% VAT applies to the supporting industries or contractors who directly supply goods or services to the export-oriented garment manufacturers, textile, and footwear industries. Some supplies are VAT exempt, the main categories being public postal services, medical and dental services, electricity, transportation of passengers by wholly state-owned public transport systems, insurance services, and primary financial services. Note that strict record-keeping requirements do exist.

### *Specific tax on certain merchandise and services (SPT)*
SPT is a form of excise tax that applies to the importation or domestic production and supply of certain goods and services. SPT on domestically produced goods is generally applied to the ‘ex-factory selling price’, which is defined as 65% of the selling price before VAT and any discount. For imported goods, SPT is due on the CIF (cost, insurance, and freight) value inclusive of customs duty. For hotel and telecommunication services, SPT is payable based on the invoice prices.

For local and international air transportation of passengers, SPT is 10%, payable based on the air ticket value issued in Cambodia for travel within and outside Cambodia. The SPT base is inclusive of all taxes other than SPT and VAT. For example, for return air tickets from Phnom Penh to Singapore costing USD 500, exclusive of airport tax, the SPT payable is USD 45.45 (USD 500/1.1 x 10%).

### *Import and export duties*
Import duties are levied on a wide range of products. Rates vary from 0% to 35%. Following Cambodia’s entry into the Association of South-East Asia Nations (ASEAN) during 1999, the government is required to reduce import duties in accordance with the Common Effective Preferential Tariffs program.

Export duties are levied on a limited number of items, such as timber and certain animal products (including most seafood).

### *Accommodation tax*
Accommodation tax is calculated at 2% of the accommodation fee inclusive of all taxes and other services except accommodation tax and VAT.

### *Tax for public lighting (TPL)*
TPL is imposed on the distribution in Cambodia of both foreign made and locally produced alcoholic and tobacco products. TPL is levied at 3% of the value of such products at the time of each in-country sale. Value for these purposes includes all taxes other than TPL and VAT.

### Tax on immovable property (ToIP)
ToIP is levied at 0.1% per annum on the market value of immovable property (determined by the Immovable Property Valuation Committee) less the threshold of KHR 100 million (approximately USD 25,000). Immovable property valued below the threshold is not subject to ToIP.

Immovable property is defined to include land, buildings, and other constructions on land (e.g. infrastructures built on land, regardless of having a wall or roof). Certain exemptions exist for government-owned property, agricultural land, property owned and used for cultural and religious purposes, property of foreign embassies and non-governmental organisations (NGOs), and property in the special economic zones.

At the first phase of implementation, the ToIP will only cover immovable property located in all cities in Cambodia.

The owners, possessors, and final beneficiaries of immovable property are required to register and obtain a Tax Identification Number for each immovable property valued above the threshold from the tax administration where the immovable property is located. Any changes in relation to the registered immovable property (e.g. a change of title) are also required to be reported.

The owners, possessors, and final beneficiaries hold responsibility for calculating ToIP, preparing and filing ToIP return, as well as remitting the ToIP liability to the tax administration once per year by 30 September. A ToIP return is required for every single immovable property and must be completed and filed separately. Since this is a self-assessment tax, the tax administration will perform tax audit on ToIP in the subsequent years.

### Tax on unused land
Land in towns and other specified areas without any construction, or with construction that is not in use, and even certain built-upon land, is subject to the tax on unused land. The tax is calculated at 2% of the market value of the land per square metre as determined by the Commission for Valuation of Unused Land on 30 June each year. The owner of the land is required to pay the tax on 30 September each year.

### Patent tax
Registered businesses must pay a (relatively nominal) patent tax on initial business registration and annually thereafter. Patent tax is levied with reference to turnover or estimated turnover.

In practice, the GDT imposes patent tax at the top band regardless of the level of turnover.

### Tax on means of transportation
The tax on means of transportation imposes a number of statutory fees on the registration of certain vehicles including trucks, buses, motor vehicles, and ships.

### Registration tax (property transfer tax)
Certain documents relating to the establishment, dissolution, or merger of a business, or the transfer of title in certain assets (such as land and vehicles), are subject to registration tax. The tax is imposed at the rate of 4% and is generally levied on the transfer value.

### Fiscal stamp tax
Fiscal stamp tax is to be paid on certain official documents and, perhaps more importantly for foreign investors, certain advertising postings and signage. Amounts vary according to such factors as the location of the signage, illumination, and nationality of any scripted words.

### Tax stamp
Domestic producers or importers of cigarettes have the obligation to buy and affix tax stamps on packets of cigarettes. No person is allowed to sell or display packaged cigarettes for sale without a tax stamp.

### Tax on salary (ToS)/fringe benefits (ToFB)
Cambodia's ToS rules follow internationally familiar residency and source principles. A Cambodian resident taxpayer's worldwide salary will be subject to Cambodian ToS. For non-residents, only the Cambodian sourced salary will be subject to ToS. The place of salary payment is not considered relevant in determining source.

A distinction is made between cash and fringe benefit salary components. Different tax scales also apply.

ToS or ToFB is a tax on employees' income, but employers are held liable to these taxes if the employers fail to withhold.

## Branch income

Income of a branch is taxable in the same way as those for corporate profits.

## Income determination

### Inventory valuation
Inventory can be valued at weighted-average cost, first in first out (FIFO), or current value at the close of the period, where this value is lower than the purchase price or production cost. Work-in-progress should be valued at production costs.

### Capital gain
There is no specific provision on capital gain tax in Cambodia. However, capital gains form part of taxable profit.

### Inter-company dividend
Inter-company dividends between residents are exempt from ToP *(see the Withholding taxes section for more information)*.

### Passive income
Designated passive income (such as interest, royalties, and rent) forms part of the taxable profit.

### Foreign income
Resident entities are taxed on their worldwide income, and tax credits are available for foreign taxes incurred.

## Deductions

### Depreciation and amortisation

Property should be depreciated at rates according to four classes of assets as specified in the tax legislation. Land is not considered a depreciable asset. The straight-line or the declining-balance method is specifically required to be used for each class of assets.

| Assets | Method | Rate (%) |
|---|---|---|
| Building and structures | Straight line | 5 |
| Computers, electronic information systems, software, and data handling equipment | Declining balance | 50 |
| Automobiles, trucks, office furniture, and equipment | Declining balance | 25 |
| All other tangible property | Declining balance | 20 |

Expenditures on intangible property are amortisable over the life of the property or at 10% per annum.

### Special depreciation

A QIP will be entitled to a 40% special depreciation in the first year of purchase or, if later, the first year the assets are used. However, the special depreciation will only apply to assets used in 'manufacturing and processing' (still to be defined) and only if the taxpayer has elected not to use a tax holiday. A clawback provision exists for assets held for less than four years.

### Interest expense

Interest deductibility in any year is limited to the amount of interest income plus 50% of the net profits excluding interest income and interest expense. The excess non-deductible interest expense can be carried forward to the following tax years indefinitely.

### Taxes

Taxes that are not a charge to the enterprise (e.g. WHT, ToS, ToFB, ToP, and additional ToP on dividend distribution) are not deductible.

### Net operating losses

Taxpayers may carry forward their losses for five years. The carryback of losses is not permitted. There is no provision for any form of consolidated filing or group loss relief.

To be eligible to carry forward tax losses a taxpayer must not change its activities or ownership.

If a taxpayer received a unilateral tax reassessment from the GDT, a taxpayer will not be able to utilise the tax losses brought forward in the year of reassessment.

### Loss between related parties

No deduction is available for certain losses incurred on dealings between 51% commonly owned parties.

## Group taxation

There is no specific provision for group taxation in Cambodia.

### *Transfer pricing*
The GDT has wide powers to redistribute income and deductions between parties under common ownership in order to prevent the avoidance or evasion of taxes. Common ownership exists at a relatively low level of 20%.



### *Thin capitalisation*
There is no provision for thin capitalisation in Cambodia.

## *Tax credits and incentives*

### *Foreign tax credit*
Residents earning foreign-sourced income can receive credits for foreign taxes paid.

### *Inbound investment*
The Council for the Development of Cambodia (CDC) may be approached for a one-stop service to register a project and obtain approval for a QIP status. CDC licensing is, however, not mandatory (except for certain large, politically sensitive projects) and is applicable to those projects that do not fall within the ‘negative list’. We list some of the projects in the ‘negative list’ below:

- All kinds of commercial activities, import and export, any transportation services (except the railway sector).
- Currency and financial services.
- Activities that relate to newspapers and media.
- Production of tobacco products.
- Provision of value-added services of all kinds of telecommunication services.
- Real estate development.

The current investment incentives which are applicable to the QIP registered with the CDC include a ToP exemption period of up to six years or special depreciation *(see Special depreciation in the Deductions section)*, import duty exemptions, and exemption from minimum tax. Not all QIP will be entitled to all incentives.

Annually, a QIP is required to obtain a Certificate of Compliance (CoC) from the CDC to guarantee its investment incentives. The CoC is intended to provide confirmation that the QIP has acted in compliance with the relevant tax regulations.

## *Withholding taxes*

WHT needs to be withheld on payments made by residents (and it seems only to those who fall under the real regime). The withheld tax constitutes a final tax when withheld in respect of resident and non-residents.

The types of payments caught are as follows.

### *WHT on payment to residents*
- Rental: 10%.
- Interest: 15% (except payment to a Cambodian bank).
- Services: 15% (except payment to a registered taxpayer and supported by a valid VAT invoice).
- Royalties: 15%.

### WHT on payment to non-residents

- Interest: 14%.
- Rent or right for use of property: 14%.
- Management or technical fees (not defined): 14%.
- Dividends: 14%.

WHT is due when the amount is paid. An expense is considered 'paid' when it is recorded in the accounting records.

## Tax administration

### Returns

The standard tax year is the calendar year, although different accounting year-ends may be granted upon application. The return for annual tax (i.e. ToP/minimum tax) is to be filed annually, within three months of tax year-end.

Return for annual patent tax is to be filed annually, within three months of calendar year-end.

Returns for monthly taxes (e.g. 1% Prepayments of ToP, WHT, ToS or ToFB, SPT, PLT, and accommodation tax) are to be filed monthly, within 15 days of the following month. However, return for VAT is due within 20 days of the following month.

### Payment of tax

ToP or minimum tax is due for payment three months after tax year-end. The ToP or minimum tax liability can be reduced by prepayment of ToP payments.

Patent tax is due three months after calendar year-end.

Monthly taxes are due for payment by the 15th day of the succeeding month, except for VAT which is by the 20th day.

## Other issues

### Statutory audit requirement

All enterprises (physical or legal persons) that meet two of the following criteria are required to have their financial statements audited by an independent external auditor registered with the Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA):

- Annual turnover above KHR 3 billion (approximately USD 750,000).
- Total assets above KHR 2 billion (approximately USD 500,000).
- More than 100 employees.

QIPs registered with the CDC are required to have their financial statements audited by independent external auditors registered with the KICPAA.

The law does not state the deadline for the enterprises to submit their audited financial statements. However, the deadline for audited financial statements to be completed is six months after accounting year-end (i.e. for the financial year ended 31 December 2010, the deadline is 30 June 2011).

# Cameroon, Republic of

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## Significant developments

The following significant tax developments were part of the 2011 Finance Law which went into effect as of 1 January 2011:

- General fees settled in cash for amounts equal to or more than 1 million CFA francs (BEAC) (XAF) are no longer deductible.
- A 5.5% withholding tax (WHT) has been instituted on remuneration of services rendered by members of liberal professions domiciled in Cameroon.
- The deduction at source of VAT and instalments of income tax has been reintroduced.
- There is now an obligation to deposit corporate tax returns in hard and soft copy.
- The rate of WHT on rents of buildings has increased from 5% to 10%.

## Taxes on corporate income

The total Cameroon corporate income tax (CIT) rate is 38.5%.

Resident corporations in Cameroon are taxed on their worldwide income; non-resident corporations are taxed only on Cameroon-source income.

The profits subject to the company tax are determined with sole regard to profits earned by entities located in Cameroon or transactions effected in Cameroon.

The net taxable profits are established after deduction of all charges directly entailed by the exercise of activities subject to assessment in Cameroon.

### Reduced CIT rate for newly listed companies

The basic CIT rate of 38.5% is reduced to 33% for companies during their first three years of listing on the national stock exchange of Cameroon.

### Minimum tax

There is a 1.1% minimum tax in Cameroon that is based on the turnover. This 1.1% minimum tax is an instalment of CIT. As such, it shall be offset against CIT. It is the sole tax payable if it is greater than CIT.

# Cameroon, Republic of

## Corporate residence

An entity is deemed resident if its registered office, centre of activity, or management is located in Cameroon, if it has resident employees in Cameroon that provide services to customers, or if it has a permanent establishment (PE) in Cameroon.

### Permanent establishment (PE)

In Cameroon, the internal regulations do not provide for any definition of the concept of PE. For this reason, the tax authorities may refer to the definitions provided by the models of United Nations (UN) and that of Organisation for Economic Co-operation and Development (OECD) Tax Conventions, which constitute the basis of the double tax treaties concluded between Cameroon and France, Canada, and Tunisia.

According to these conventions, a PE is a fixed place of business through which an enterprise wholly or partly performs its activities.

## Other taxes

### Value-added tax (VAT)

VAT shall be levied on natural persons or corporate bodies which automatically, habitually, or occasionally carry out taxable transactions consisting of provisions of services or sales of goods.

The total VAT in Cameroon is 19.25%. Exports are zero rated. The VAT paid upstream is recoverable, except where otherwise stated.

### Custom duties

Customs duties of between 5% and 30%, depending on the nature of the goods imported, are levied based of the customs value.

### Excise taxes

An excise duty of 25% is applicable to cigarettes, drinks, cosmetics, or luxury (e.g. jewels, precious stones). A reduced rate of excise duty (12.5%) shall apply to soft drinks and private vehicles with engine capacities of 2,000 cm3.

### Real property tax

Cameroon property tax is payable annually on real estate with or without an ownership certificate or an administrative or judicial order issued. Tax is charged at 0.11% of the assessed property value.

### Transfer tax

The sale of a business in Cameroon is subject to a transfer tax rate of 15%.

### Business license tax

Any natural person or corporate body carrying on trade, industry, or profession in Cameroon shall be liable to a business license tax. The business license tax is paid annually according to a graduated scale and is assessed on turnover.

New enterprises shall be exempt from the payment of the business license tax during the first two years of operation.

### Registration duty

The registration duty applies to certain deeds listed by the general tax code. The assessment basis depends on the nature of transactions, and the rate varies from 1% to 15%.

The formation of a company and subsequent capital increases in Cameroon are not subject to registration duties. This exemption was provided by the Finance Law for 2010.

### Social security contributions

Employer and employee must contribute on a monthly basis to Cameroon's National Social Insurance Fund at 11.2% and 2.8%, respectively. The basis of contribution is capped at XAF 300, 000 per month. Employers in Cameroon must also contribute 1.75%, 2.5%, or 5% of total salaries to the National Social Insurance Fund for Industrial Accidents, depending on the risk category of activities performed by employees. The calculation basis in this category is the gross salary including the benefits in kind assessed for their actual amount.

### Payroll tax

Employers in Cameroon are required to make monthly contributions of 2.5% of the total amount of salaries and fringe benefits of their employees to the Housing Loan and Employment Fund of Cameroon.

## Branch income

The local branch of any foreign company is taxed at the same rate as a company. The net profits (after CIT) of entities having their residence or head office outside Cameroon (such as the branch of a foreign company) are assumed to be distributed each fiscal year to companies not located in Cameroon.

## Income determination

### Inventory valuation

Stocks shall be valued at cost price; however, if the market price is lower than the cost price, the undertaking shall make provisions for depreciation of inventory.

### Capital gains

Capital gains are normally taxed at full CIT rates.

### Foreign income

As matter of both fact and law, revenue from abroad earned by corporate bodies situated in Cameroon shall be subject to CIT in Cameroon. There is a provision on tax deferral in Cameroon.

## Deductions

### Depreciation

Depreciation is generally computed on a straight-line basis over the useful life according to the rates provided for by the Tax Code, including those which might have already been deferred in times of deficit.

The following depreciation rates are generally accepted for tax purposes:

- Construction: the rates vary from 5% to 20%.
- Stationary equipment and tools: the rates vary from 5% to 20%.
- Portable equipment: the rates vary from 10% to 100%.
- Transport equipment: the rates vary from 10% to 33.33%.
- Railway lines: the rates vary from 1% to 10%.
- Engines: the rate is 5%.
- Rehabilitation: the rates vary from 5% to 25%.
- Furniture fittings and other equipment: the rates vary from 10% to 33.33%.
- Fishing equipment and fishing vessels: 15%.

The deduction of depreciation can be carried forward indefinitely.

### *Net operating losses*
Any loss sustained in a given year can be carried forward up to the fourth year following the recording of the loss. The carryback of losses is not permitted in Cameroon.

### *Payments to foreign entities*
Head office overhead expenses for operations carried out in Cameroon and the remuneration of certain effective services (studies, technical, financial, or accounting assistance) provided to Cameroonian firms by foreign natural persons or corporate bodies are not totally deductible. Fees paid are deductible up to a maximum of 10% of the taxable profit before deducting the expenses concerned.

## *Group taxation*

There is specific taxation of groups within the Economic and Monetary Community of Central Africa (CEMAC) area.

Where a joint stock company and a private limited company own either registered stock in a joint stock company or shares in a private limited company, the net proceeds of the share in the second company paid to the first during the financial year shall be deducted from the total net profit of the latter, less a percentage for costs and charges. This percentage is fixed at 10% of the total amount of the proceeds. This system shall apply when all of the following conditions are met:

- The stocks or shares owned by the parent establishment represent at least 25% of the capital of the subsidiary firm.
- The parent and subsidiary firms have their registered office in a CEMAC state (Cameroon, Central African Republic, Chad, Gabon, Equatorial Guinea, and Republic of Congo).
- The stocks or shares allotted at the time of issue are still registered in the name of the participating company which undertakes to retain them for at least two consecutive years in registered form.

### *Transfer pricing*
There are provisions in the General Tax which relate to transfer pricing, but audits from Tax Administration are not yet aggressive.

### *Thin capitalisation*
There is no specific thin capitalisation rule in Cameroon.

## Tax credits and incentives

Three major tax incentives are granted in Cameroon under the tax systems.

### The system of reinvestment relief

Any corporate body reinvesting in Cameroon may be granted, under certain conditions, a reduction in CIT.

The reinvestment must take a form described by the general tax code as construction or extension of permanent buildings for industrial, agricultural, forestry, tourism, or mining purposes, including technical offices, housing salaried workers free of charges, etc.

Note that total investment less than XAF 25 million are not eligible for reinvestment relief.

The reinvestment relief consists of a deduction from the taxable basis in an amount equal to 50% of the investment effected by the undertaking and approved by the tax authorities. The rate is 25% for telecommunication companies.

### The special fiscal regime for structuring projects

The special fiscal regime for structuring projects applies to major enterprises with annual turnover not less than XAF 1 billion and small and medium-sized enterprises with annual turnover of less than XAF 1 billion.

The tax incentives consist of:

- Exemption from payment of the business license tax for the first two years of operation.
- Fixed registration fee of XAF 50,000 for transfers of real estate which directly concern the establishment of the project.
- Exemption from payment of VAT on local purchases of building materials and on imports related to the establishment of the project.
- Extension of the carryover period for deficits from four to five years.

A taxpayer must apply, required conditions must be met, and authorisation must be issued for this tax incentive to be granted.

### Incentives applicable to listed companies

Companies whose ordinary shares are listed on the Cameroon Stock Exchange shall be entitled to the following CIT reduced rates:

- 22% for a period of three years for capital increases which represent at least 20% of the share capital.
- 27.5% for a period of three years for transfers of shares which represent at least 20% of the share capital.
- 30.8% for a period of three years from the date of listing for capital increases or transfers of shares which represent less than 20% of the share capital.

Companies whose ordinary shares are listed on the bond market in Cameroon shall be entitled to pay basic CIT at a reduced rate of 33% for three years, effective from the date of listing.

### Foreign tax credit
Taxes paid abroad are not considered as tax credits unless provided as such by international tax treaties.

## Withholding taxes

A special tax is levied at an overall discharging rate of 15% on income paid to natural persons and corporate bodies domiciled outside of Cameroon by enterprises or establishments based in Cameroon for various services provided or used in Cameroon. The tax is withheld at source by the Cameroonian entity which pays the remuneration.

### Dividends
A total WHT of 16.5% applies to dividends paid to both Cameroon residents and non-residents. The WHT rate may be reduced under an applicable tax treaty.

### Interest
As of 1 January 2011, the interest from foreign loans is subject to 16.5% WHT. Prior to 1 January 2011, the payment of 16.5% WHT on interest from foreign loans had been suspended.

### Royalties
Royalties paid to non-residents are subject to a 15% WHT. The tax rate may be reduced under an applicable tax treaty.

### Tax treaties
Cameroon has tax treaties with France, Canada, Tunisia, and members of CEMAC (Cameroon, Gabon, Equatorial Guinea, Congo, Chad, and Central African Republic).

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Head office expenses and technical assistance (%) |
|---|---|---|---|---|
| CEMAC | 16.5 | 16.5 | N/A | N/A |
| Canada | 16.5 | 16.5 | 16.5 | 15 |
| France | 15 | 15 | N/A | 7.5 |
| Tunisia | 12 | 15 | 15 | 15 |

## Tax administration

### Returns
The tax year in Cameroon is the calendar year.

On or before 15 March, taxpayers are expected to submit to the tax administration the annual return of revenue derived from their business venture during the period serving as tax base.

This return must be presented in conformity with the Organisation for the Harmonisation of Business Law in Africa (OHADA) accounting system.

### *Payment of tax*
An instalment representing the 1.1% minimum tax of turnover realised during each month shall be paid to the tax authorities not later than the 15th of the following month.

Advance payment of 1% on imports or purchases of goods for resale is withheld at source by the supplier.

The balance of CIT is paid, at the latest, on 15 March following the fiscal year-end, when submitting the CIT return.

### *Surplus tax payments*
A surplus tax payment can be offset against future taxes of the same nature to be paid. For the specific case of VAT, a reimbursement process is provided for by the General Tax Code under certain conditions.

# Canada

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## Significant developments

Canada's corporate summary reflects all 2011 federal, provincial, and territorial budgets. Many of the tax changes are aimed at tightening perceived loopholes or inequities in various aspects of the tax system. Notably, a proposed measure curtails a corporation's ability to defer income tax by taking advantage of the timing of the year-ends of partnerships of which it is a member. This proposal will affect tax planning that is common in a number of sectors, including oil and gas, real estate, and retail, as well as in income trust conversions. Other measures enhance targeted programs, such as book publishing, film, and media tax credits and incentives for manufacturing and processing. The summary is based on enacted and proposed legislation and assumes that the proposed legislation will become law.

Note that on 25 March 2011, the federal minority government was defeated. As a result, the 22 March 2011 federal budget died, along with outstanding bills and legislation. However, because the same party won a majority in the 2 May 2011 federal election, those measures are expected to be reintroduced, and therefore are reflected in this summary.

### Corporate income tax rates

Federal general (and manufacturing and processing) corporate income tax rates decreased from 18% to 16.5% on 1 January 2011, and will decrease to 15% on 1 January 2012. Provincial corporate rates have generally declined.

### Capital tax

All provincial general capital taxes have been eliminated, except for Nova Scotia's, which will be eliminated by 1 July 2012.

### Stock options

Significant changes to the rules for stock options permit only the employer or employee (not both) to claim a tax deduction for cashed-out stock options and eliminate employee elections to defer the payment of tax on stock option benefits until the shares are sold (relief may be available). The changes also eliminate the undue hardship exemption for withholdings on stock option benefits and require withholdings in connection with these benefits after 2010. Grandfathering rules may apply.

### Canada Revenue Agency (CRA) access to documents

The CRA's revised policy on access to taxpayer and third-party documents demonstrates its heightened interest in supporting documents that assist in the determination of tax obligations and entitlements, and signals that taxpayers may receive more frequent requests for supporting documents.

### *Tax avoidance*
Draft legislation makes an 'avoidance transaction' meeting certain conditions a 'reportable transaction' that must be reported to the CRA, generally for transactions entered into after 2010, and those that are part of a series of transactions completed after 2010. Quebec already has a provincial reporting regime for certain aggressive tax planning transactions, generally carried out after 14 October 2009.

### *Non-resident trusts (NRTs)*
Draft legislation refines the NRT rules that generally apply to taxation years ending after 2006; trusts subject to these rules will be deemed resident for Canadian income tax purposes. A trust will be allowed to elect to be deemed resident for the 2001 and subsequent years.

### *Offshore investment funds*
Draft legislation maintains the enacted provision for investments in offshore investment funds, but increases the prescribed income percentage by 2%, and extends the statute-barred period for taxpayers that have invested in offshore investment funds by three years, for taxation years ending after 4 March 2010.

### *Specified investment flow-throughs (SIFTs)*
Certain earnings of SIFTs (i.e. publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be a dividend when distributed. These rules apply starting the 2007 taxation year, for SIFTs first publicly traded after 31 October 2006, and starting the 2011 taxation year, for other SIFTs. New rules facilitate the conversion of SIFT trusts into corporations, generally for transactions that occur after 13 July 2008 and before 2013.

### *Group taxation*
The federal government has issued a consultation paper, *The Taxation of Corporate Groups*, that explores possible approaches for a new system for taxing corporate groups in Canada.

### *Partnership deferral*
Under proposed rules that apply to corporate partners with taxation years ending after 22 March 2011, corporate partners with a significant interest in a partnership will generally be unable to defer taxation on the partnership income. Instead, they must accrue partnership income up to the end of the corporation's taxation year. An election may be available to change the partnership's fiscal period. Partnerships in multi-tier structures must adopt the same fiscal period (31 December, unless otherwise elected by the partnerships). Certain transitional reserves may be available for up to five years.

### *Partnership information returns*
For partnerships with fiscal periods ending after 31 December 2010, the CRA has replaced the requirement to file a partnership information return that is based on the number of partners with one related to financial thresholds and partner structure.

### *Stop-loss rule on share redemption*
Subject to certain exceptions, an existing rule reduces the loss realised by a corporation from the disposition of a share by the amount of tax-free dividends received, or deemed to be received, on the share on or before the disposition. A proposal removes the exceptions, with respect to any deemed dividend arising on the redemption of shares held by a corporation, for redemptions after 21 March 2011, unless the corporation

and the shareholder are both private corporations and the shareholder is not a financial institution.

### *Financial statement reporting*
For fiscal years beginning after 31 December 2010:

- Most 'publicly accountable enterprises' must adopt International Financial Reporting Standards (IFRS).
- Private enterprises must adopt either IFRS or Accounting Standards for Private Enterprises (ASPE).

As a result, IFRS and ASPE have become Canadian generally accepted accounting principles (GAAP). This could affect the measurement and reporting of income taxes for financial statement purposes and the calculation of Canadian taxes payable.

### *Provincial sales tax harmonisation*
Although British Columbia's provincial sales tax (PST) was harmonised with the federal goods and services tax (GST) on 1 July 2010, a referendum will be held from June to July 2011 to determine if the harmonised sales tax (HST) will be cancelled and replaced with the former PST and GST regime. If the HST regime is retained in British Columbia:

- the HST rate will decrease in stages from 12% to 10% by 1 July 2014, and
- the general corporate income tax rate will increase from 10% to 12% on 1 January 2012.

## *Taxes on corporate income*

### *Federal income tax*
The following rates apply for 31 December 2011 year ends. For non-resident corporations, the rates apply to business income attributable to a permanent establishment in Canada. Different rates may apply to non-resident corporations in other circumstances. Non-resident corporations may also be subject to branch tax (*see below*).

| | **Federal rate (%)** |
|---|---|
| Basic rate | 38 |
| Less—Provincial abatement (1) | 10 |
| Federal rate | 28 |
| Less—General rate reduction or manufacturing and processing (M&P) deduction (2) | 11.5 |
| Net federal tax rate (3, 4) | 16.5 |

Notes

1. The basic rate of federal tax is reduced by a 10% abatement to give the provinces and territories room to impose corporate income taxes. The abatement is available in respect of taxable income allocated to Canadian provinces and territories. Taxable income allocable to a foreign jurisdiction is not eligible for the abatement and normally is not subject to provincial or territorial taxes.
2. The general rate reduction and M&P deduction do not apply to the first 500,000 Canadian dollars (CAD) of active business income earned in Canada by Canadian-controlled private corporations (CCPCs), investment income of CCPCs, and income from certain other corporations (e.g. mutual fund corporations, mortgage investment corporations and investment corporations), which may benefit from preferential tax treatment. The general rate reduction and M&P deduction increased from 10% to 11.5% on 1 January 2011, and will increase to 13% on 1 January 2012.
3. Provincial or territorial taxes apply in addition to federal taxes. Provincial and territorial tax rates are noted below.

4. For small CCPCs, the net federal tax rate is levied on active business income above CAD 500,000; a federal rate of 11% applies to the first CAD 500,000 of active business income. Investment income (other than most dividends) of CCPCs is subject to the federal rate of 28%, in addition to a refundable federal tax of 6 2/3%, for a total federal rate of 34.7%.



## *Provincial/territorial income tax*

All provinces and territories impose income tax on income allocable to a permanent establishment in the province or territory. Generally, income is allocated to a province or territory by using a two-factor formula based on gross revenue and on salaries and wages. Provincial and territorial income taxes are not deductible for federal income tax purposes. The rates given apply to 31 December 2011 year ends and do not take into account provincial tax holidays, which reduce or eliminate tax in limited cases.

| | **Provincial/territorial rate (%) (1, 2)** |
|---|---|
| Alberta | 10.0 |
| British Columbia (3) | 10.0 |
| Manitoba (4) | 12.0 |
| New Brunswick (5) | 10.5 |
| Newfoundland and Labrador | 14.0 or 5.0 |
| Northwest Territories | 11.5 |
| Nova Scotia | 16.0 |
| Nunavut | 12.0 |
| Ontario (6) | 11.7 or 10.0 |
| Prince Edward Island | 16.0 |
| Quebec | 11.9 |
| Saskatchewan (7) | 12.0 or 10.0 |
| Yukon Territory | 15.0 or 2.5 |

Notes

1. When two rates are indicated, the lower rate applies to M&P income.
2. In all provinces and territories, the first CAD 500,000 (CAD 400,000 in Manitoba and Nova Scotia and before 2011, the Yukon) of active business income of a small CCPC is subject to reduced rates that range from 0% to 8.0%, depending on the jurisdiction.
3. British Columbia's rate decreased from 10.5% to 10% on 1 January 2011, but will increase to 12% on 1 January 2012, if British Columbia keeps the harmonised sales tax regime *(see Harmonised sales tax below)*.
4. Manitoba's rate will decrease from 12% to 11% at a date to be determined, subject to balanced budget requirements.
5. New Brunswick's rate decreased from 12% to 11% on 1 July 2010 and will decrease to 10% on 1 July 2011. New Brunswick's 2011 budget maintains the rate at 10%. The rate was to decline to 8% on 1 July 2012.
6. The lower Ontario rate applies to profits from manufacturing and processing, and from farming, mining, logging, and fishing operations carried on in Canada and allocated to Ontario. This rate decreased from 12% to 10% on 1 July 2010.

   Ontario's non-M&P rate decreased from 14% to 12% on 1 July 2010, and will decrease to 11.5% on 1 July 2011, and to 11% on 1 July 2012, and to 10% on 1 July 2013.

   Corporations subject to Ontario income tax may also be liable for corporate minimum tax (CMT) based on adjusted book income. The CMT is payable only to the extent that it exceeds the regular Ontario income tax liability. The CMT rate decreased from 4% to 2.7% on 1 July 2010, and the CMT thresholds increased as shown in the following table.

| | | Taxation years ending | |
|---|---|---|---|
| | | before 1 July 2010 | after 30 June 2010 |
| Thresholds for CMT to apply (6a) | Total assets | > CAD 5 million | ≥ CAD 50 million |
| | | or | and |
| | Annual gross revenues | > CAD 10 million | ≥ CAD 100 million |

6a. Thresholds apply on an associated basis.

7. Saskatchewan's M&P rate is as low as 10% (reduced from the 12% non-M&P rate), depending on the extent to which the corporation's income is allocated to the province.

## *Corporate residence*

As a general rule, corporations resident in Canada are subject to Canadian income tax on worldwide income. As a result of special provisions in the Income Tax Act, almost all corporations incorporated in Canada are resident in Canada. A corporation not incorporated in Canada may be considered resident in Canada if its central management and control are exercised in Canada.

A corporation incorporated in Canada will cease to be a Canadian resident if it is granted articles of continuance in a foreign jurisdiction or if it is a predecessor corporation in a cross-border amalgamation. Similarly, a foreign corporation will become resident in Canada if it is continued in Canada or is a predecessor corporation of an amalgamated corporation that is resident in Canada.

Non-resident corporations are subject to income tax on income derived from carrying on a business in Canada and on capital gains arising upon the disposition of taxable Canadian property. The purchaser of the taxable Canadian property is generally required to withhold tax from the amount paid unless the non-resident vendor has obtained a clearance certificate.

Taxable Canadian property includes, among other things, real or immovable property situated in Canada, both capital and non-capital property used in carrying on a business in Canada and shares in Canadian-resident corporations that are not listed on a stock exchange. In certain circumstances, shares in Canadian-resident corporations that are listed on a stock exchange, shares in non-resident corporations, and interests in non-resident trusts will be considered taxable Canadian property. However, commencing 5 March 2010, taxable Canadian property excludes shares of corporations, and certain other interests, that do not derive their value (over a 60-month look-back period) principally from real or immovable property situated in Canada, Canadian resource property, or timber resource property. Therefore, with some exceptions, non-residents are no longer required to report dispositions of these properties and obtain a clearance certificate.

Withholding tax at a rate of 25% is imposed on interest (other than most interest paid to arm's length non-residents), dividends, rents, royalties, certain management and technical service fees, and similar payments, made by a Canadian resident to a non-resident of Canada.

Canadian income tax and withholding tax can be reduced or eliminated if Canada has a treaty with the non-resident's country of residence. A list of treaties that Canada has negotiated and applicable withholding tax rates is provided under *the Withholding taxes section.*

## Other taxes

### Goods and services tax

The federal goods and services tax (GST) is levied at a rate of 5%. It is a value-added tax applied at each level in the manufacturing and marketing chain and applies to most goods and services. However, the tax does not apply to sales of zero-rated goods, such as exports and basic groceries, or to tax-exempt supplies, such as certain services provided by financial institutions.



Generally, businesses pay GST on their purchases and charge GST on their sales, and remit the net amount (i.e. the difference between the GST collected and the input tax credit for the tax paid on purchases). Suppliers are entitled to claim input tax credits on zero-rated goods and services, but not on tax-exempt supplies.

### Harmonised sales tax

Five provinces have harmonised their sales tax systems with the GST and impose a single harmonised sales tax (HST). The HST includes the 5% GST and a provincial sales tax component. It is imposed on essentially the same base as the GST. HST rates follow.

| | **HST rate (%)** |
|---|---|
| British Columbia (1) | 12 |
| New Brunswick | 13 |
| Newfoundland and Labrador | 13 |
| Nova Scotia (2) | 15 |
| Ontario (3) | 13 |

Notes

1. British Columbia harmonised its 7% Social Services Tax (SST) with the 5% GST on 1 July 2010. However, British Columbia's government has indicated that it will honour the results of a provincial referendum to be held from June to July 2011, to determine if the 12% HST will be cancelled and replaced with the former regime. If the HST regime is retained:
   - the HST rate will decrease from 12% to 11% on 1 July 2012, and to 10% on 1 July 2014 (i.e. the provincial component will decrease from 7% to 6% and then to 5%), and
   - the general and M&P corporate income tax rate will increase from 10% to 12% on 1 January 2012.
2. Nova Scotia's HST rate increased from 13% to 15% on 1 July 2010.
3. Ontario harmonised its 8% retail sales tax with the 5% GST on 1 July 2010.

### Retail sales tax

Manitoba, Prince Edward Island, and Saskatchewan levy a retail sales tax at rates ranging from 5% to 10% on most purchases of tangible personal property for consumption or use in the province and on the purchase of specific services. As mentioned, on 1 July 2010, retail sales tax in British Columbia and Ontario was replaced with the harmonised sales tax.

Quebec's sales tax is structured essentially in the same way as the GST and applies to most goods and services that are subject to the GST. The general Quebec sales tax rate is 8.5% (7.5% before 2011 and 9.5% after 2011). Quebec administers the GST in that province.

Only Prince Edward Island and Quebec levy sales tax on prices that include the GST.

Alberta and the three territories (the Northwest Territories, Nunavut, and the Yukon) do not impose a retail sales tax. However, the GST applies in those provinces/territories.

### Property tax

Property taxes are levied by municipalities in Canada on the estimated market value of real property within their boundaries and by provinces and territories on land not in a municipality. In most provinces and territories, a general property tax is levied on the owner of the property. Some municipalities levy a separate business tax, which is payable by the occupant if the premises are used for business purposes. These taxes are based on the assessed value of the property at tax rates that are set each year by the various municipalities. School taxes, also generally based on the value of real property, are levied by local and regional school boards or the province or territory.

### Land transfer tax

All provinces and territories levy a land transfer tax or registration fee on the purchaser of real property within their boundaries. These levies are expressed as a percentage, primarily on a sliding scale, of the sale price or the assessed value of the property sold, and are generally payable at the time title to the property is registered. Rates generally range from 0.02% to 2%, depending on the province or territory, but may be higher if the purchaser is a non-resident. Some exemptions (or refunds) are available. Additional land transfer taxes apply for properties purchased in the municipalities of Montreal or Toronto. Other municipalities may also impose these taxes and fees.

### Federal capital taxes

The federal government does not levy a general capital tax. It imposes the Financial Institutions Capital Tax (Part VI Tax) on banks, trust and loan corporations, and life insurance companies at a rate of 1.25% when taxable capital employed in Canada exceeds CAD 1 billion. The tax is not deductible in computing income for tax purposes. It is reduced by the corporation's federal income tax liability. Any unused federal income tax liability can be applied to reduce Part VI Tax for the previous three and the next seven years. The thresholds are shared among related financial institutions. In effect, the tax constitutes a minimum tax on financial institutions.

### Provincial capital taxes

All provincial general capital taxes have been eliminated, except for Nova Scotia's, which will be eliminated by 1 July 2012. However, most provinces still impose a capital tax on financial institutions. Capital taxes are deductible for federal income tax purposes. The federal government has proposed to limit the deductibility of capital taxes, but has delayed implementing this proposal indefinitely. As an interim measure, any increase in these taxes, with certain exceptions, is not deductible. The territories do not impose capital taxes.

Provincial capital taxes are imposed at the following rates for 31 December 2011 year ends. Certain exemptions and reduced rates apply.

| | General (%) | Banks, trust and loan corporations (%) |
|---|---|---|
| Alberta | – | – |
| British Columbia (1) | – | – |
| Manitoba (2) | – | 3 |
| New Brunswick | – | 3 |
| Newfoundland and Labrador | – | 4 |
| Nova Scotia (3) | 0.075 | 4 |
| Ontario (4) | – | – |
| Prince Edward Island | – | 5 |
| Quebec (5) | – | 0.25 |

| | General (%) | Banks, trust and loan corporations (%) |
|---|---|---|
| Saskatchewan (6) | – | 3.25 |

Notes

1. British Columbia's financial institutions capital tax was eliminated on 1 April 2010. Before 1 April 2010, for financial institutions with either a head office in British Columbia or net paid-up capital of CAD 1 billion or less, the rate was 0.33%, and for other financial institutions, the rate was 1%. A financial institutions minimum tax that was to apply starting 1 April 2010, will not come into effect.
2. Manitoba's general capital tax was eliminated on 1 January 2011 (earlier for certain manufacturing and processing companies), except for Crown corporations, for which the rate remains 0.3%. The rate had been 0.2% for taxation years commencing after 1 January 2010; other rates applied to the first CAD 21 million of taxable capital employed in Manitoba. Manitoba's 2011 budget eliminates the financial institutions capital tax when taxable paid up capital is under CAD 4 billion, for taxation years ending after 12 April 2011.
3. Nova Scotia's general rate decreased from 0.15% to 0.1% on 1 July 2010 and will decrease to 0.05% on 1 July 2011. These rates are doubled for corporations with taxable capital under CAD 10 million. The general capital tax will be eliminated on 1 July 2012.
4. Ontario's capital tax was eliminated for all corporations on 1 July 2010 (it was reduced or eliminated earlier for certain manufacturing and resource corporations). Ontario's general rate had been 0.15%, and its financial institutions rates were 0.45% (deposit-taking institutions) and 0.36% (other); lower rates applied to financial institutions with taxable capital of CAD 400 million or less.
5. Quebec's 0.12% general capital tax was eliminated on 1 January 2011 (it was reduced or eliminated earlier for certain manufacturing corporations).
   Quebec's 0.25% financial institution rate is the 0.25% compensatory tax on paid-up capital. A compensatory tax of 3.9% (2% for taxation years ending before 31 March 2010 or beginning after 31 March 2014) on payroll also applies. Quebec's financial institutions base rate of 0.24% was eliminated on 1 January 2011.
6. Saskatchewan's rate for financial institutions that have taxable paid-up capital of CAD 1.5 billion or less is 0.7%. However, retroactive to taxation years ending after 31 October 2009, financial institutions that qualified for the 0.7% capital tax rate in taxation years ending after 31 October 2008 and before 1 November 2009, will be subject to a 0.7% capital tax rate on their first CAD 1.5 billion of taxable capital, and a 3.25% capital tax rate on taxable capital exceeding CAD 1.5 billion.

### *Additional taxes on insurers*
All provinces and territories impose a premium tax ranging from 2% to 4.4% on insurance companies (both life and non-life). In addition, Nova Scotia imposes a capital tax on all insurance companies (which will be eliminated on 1 July 2012), while Ontario and Quebec impose a capital tax on life insurance companies only. Quebec also levies a compensatory tax on insurance premiums at a rate of 0.55% (0.35% for taxation years ending before 31 March 2010 or beginning after 31 March 2014).

### *Part III.1 tax on excess designations*
Federal Part III.1 tax applies at a 20% or 30% rate if, during the year, a CCPC designated as eligible dividends an amount that exceeds its general rate income pool (GRIP), or a non-CCPC pays an eligible dividend when it has a positive balance in its low rate income pool (LRIP). A corporation subject to Part III.1 tax at the 20% rate (i.e. the excess designation was inadvertent) can elect, with shareholder concurrence, to treat all or part of the excess designation as a separate non-eligible dividend, in which case Part III.1 tax will not apply to the amount that is the subject of the election.

Eligible dividends are designated as such by the payor and include dividends paid by:

- public corporations or other corporations that are not CCPCs, that are resident in Canada and are subject to the federal general corporate income tax rate (i.e. 16.5% in 2011), or
- CCPCs, to the extent that the CCPC's income is:
  - not investment income (other than eligible dividends from public corporations), and
  - subject to the general federal corporate income tax rate (i.e. the income is active business income not subject to the federal small business rate).

Non-eligible dividends include dividends paid out of either income eligible for the federal small business rate or a CCPC's investment income (other than eligible dividends received from public companies).

### *Provincial/territorial payroll taxes*

Employers in Manitoba, Newfoundland and Labrador, Ontario, and Quebec are subject to payroll tax. Maximum rates range from 1.95% to 4.3%. In addition, Quebec employers with payroll of at least CAD 1 million must allot 1% of payroll to training or to a provincial fund. Employers in the Northwest Territories and Nunavut must deduct from employees' salaries a payroll tax equal to 2% of employment earnings.

### *Social security taxes*

For 2011, employers are required to pay, for each employee, government pension plan contributions up to CAD 2,217.60 and employment insurance premiums up to CAD 1,101.46. However, Quebec employers contribute, per employee, a maximum of CAD 872.51 in employment insurance premiums and up to CAD 481.28 to a Quebec parental insurance plan.

### *Excise taxes and duties*

Excise duties are levied at various rates on alcohol, alcoholic beverages, and tobacco products manufactured in Canada, while imports are subject to customs duties (*see below*).

Excise tax is imposed on petroleum products and automobiles. In addition, a 10% federal excise tax is imposed on insurance against a risk in Canada if it is placed by insurers through brokers or agents outside Canada or with an insurer that is not authorised under Canadian or provincial law to transact the business of insurance. Certain premiums are exempt, including those for life, personal accident, marine, and sickness insurance.

### *Custom duties*

Custom duties generally are intended to protect Canadian industry from foreign competition and not as a source of revenue. The majority of most-favoured-nation (MFN) duty rates are below 10%; notable exceptions are footwear, textiles and apparel, and certain food products (the last may be subject to 'tariff rate quotas'). Goods imported from developed countries with which Canada does not have free trade agreements will attract the MFN duty rate. Many products, however, are duty-free regardless of their country of origin.

Qualifying goods that originate in the North American Free Trade Agreement (NAFTA) territory (Canada, the United States and Mexico) can enter Canada duty-free. Canada has implemented free trade agreements (FTAs) with Chile, Costa Rica, the European Free Trade Association countries, Israel, and Peru, and has signed or is negotiating agreements with several other countries. Like the NAFTA, these agreements set out rules of origin for determining whether the goods are eligible for preferential duty rates under the particular FTA.

Canada extends preferential duty rates to most (but not all) products imported from developing countries (the General Preferential Tariff) and has granted further concessions to goods originating in 'Least Developed Countries'. In either case, goods must satisfy rules of origin and be shipped directly to Canada from the beneficiary countries to qualify for these rates.

Canada applies the 'general duty rate' of 35% only to North Korea.

## Branch income

A non-resident corporation will be subject to income tax at normal corporate rates on profits derived from carrying on a business in Canada. However, Canada's tax treaties generally restrict taxation of a non-resident's business income to the portion allocable to a permanent establishment located in Canada.



In addition, a special 25% 'branch tax' applies to a non-resident's after-tax profits that are not invested in qualifying property in Canada. The branch tax essentially is equivalent to a non-resident withholding tax on funds repatriated to the foreign head office. In the case of a company resident in a treaty country, the rate at which the branch tax is levied may be reduced to the withholding tax rate on dividends prescribed in the relevant tax treaty (generally 5%, 10% or 15%). Some of Canada's treaties prohibit the imposition of branch tax or provide that branch tax is payable only on earnings in excess of a threshold amount. The branch tax does not apply to transportation, communications and iron-ore mining companies. Nor does it apply to non-resident insurers, except in special circumstances.

Whether or not a treaty applies, a non-resident corporation that has a permanent establishment in Canada may be subject to federal capital taxes (i.e. financial institutions capital tax) and provincial capital taxes (*see Provincial capital taxes under Other taxes section*).

## Income determination

### Inventory valuation

In most cases, all property included in an inventory can be valued at fair market value, or each item can be valued at its cost or fair market value, whichever is lower. Most well-established and reasonable approaches to inventory costing can be used for tax purposes, except for the last in first out (LIFO) method. Conformity between methods used for book and tax reporting is not mandatory, but the method chosen should be used consistently for tax purposes. Inventory must be valued at the commencement of the year at the same amount as at the end of the immediately preceding year.

### Capital gains

Half of a capital gain constitutes a taxable capital gain, which is included in the corporation's income and taxed at ordinary rates. Capital losses are deductible, but generally only against capital gains. Any excess of allowable capital losses over taxable capital gains in the current year can be carried back three years and forward indefinitely, to be applied against net taxable capital gains from those years, except in the case of an acquisition of control. No particular holding period is required. Intent is a major factor in determining whether the gain or loss is income or capital in nature. Complex transitional rules ensure that gains and losses accrued to the end of 1971 have no tax effect. Capital gains were not taxable before 1972.

### Interest, rents and royalties

Interest that accrued, became receivable by, or was received by a corporation, and rents and royalties received by a corporation are taxable as income from a business or property, as the case may be.

### Intercompany dividends

Dividends received by one Canadian corporation from another Canadian corporation generally can be deducted in full in determining taxable income. However, dividends on certain preferred shares are an important exception and are taxed at full corporate rates. The intent is to allow preferred share investors to transfer benefits of accumulated deductions or losses from the entity that incurred the expense.

Dividends on most preferred shares are subject to a 10% tax in the hands of the recipient, unless the payer elects to pay a 40% tax (instead of a 25% tax) on the dividends paid. The payer can offset the tax against its income tax liability. The tax is not imposed on the first CAD 500,000 of taxable preferred-share dividends paid in a taxation year. Nor does it apply to dividends paid to a shareholder with a 'substantial interest' in the payer (i.e. at least 25% of the votes and value).

Dividends received by private corporations (or public corporations controlled by one or more individuals) from Canadian corporations are subject to a special refundable tax of 33 1/3%. The tax is not imposed if the recipient is connected to the payer (i.e. the recipient owns more than a 10% interest in the payer) unless the payer was entitled to a refund of tax in respect of the dividend. When the recipient pays dividends to its shareholders, the tax is refundable at CAD 1 for every CAD 3 of dividends paid.

### *Foreign income*

Corporations resident in Canada are subject to Canadian federal income taxes on worldwide income, including income derived directly from carrying on business in a foreign country, as earned. In addition, resident corporations may be taxable currently on certain passive and active income earned by foreign subsidiaries and other foreign entities. Relief from double taxation is provided through Canada's international tax treaties, as well as foreign tax credits and deductions for foreign taxes paid on income derived from non-Canadian sources.

Canada is negotiating 11 Tax Information Exchange Agreements (TIEAs) and has signed 13. One TIEA has entered into force (with the former Netherlands Antilles). Canada intends to sign more TIEAs with other non-treaty countries. To encourage non-treaty countries to enter into TIEAs:

- an exemption will be available for dividends received out of active business income earned by foreign affiliates resident in non-treaty countries that have agreed to a TIEA with Canada, and
- active business income earned by foreign affiliates in non-TIEA, non-treaty countries will be treated as foreign accrual property income (FAPI), which is taxable on an accrual basis, if a TIEA with Canada is not concluded within a specified time period.

Foreign investment income earned directly, other than dividends, is taxed as earned, with foreign tax credits available in respect of foreign withholding taxes. Dividends received by private corporations from non-connected foreign corporations are subject to the special refundable tax of 33 1/3% referred to above, to the extent that the dividends are deductible in determining taxable income.

The tax treatment of foreign dividends depends on whether the payer corporation is a foreign affiliate of the recipient. A foreign corporation is considered a foreign affiliate of a Canadian corporation if the Canadian corporation owns, directly or indirectly, at least 1% of any class of the outstanding shares of the foreign corporation and the Canadian corporation and related persons (together) own, directly or indirectly, at least 10% of any class of the outstanding shares of the foreign corporation.

Dividends received from foreign corporations that are not foreign affiliates are taxed when received, with foreign tax credits available in respect of foreign withholding taxes. Dividends received from foreign affiliates are permitted to flow tax-free between corporations, subject to certain limitations. These limitations pertain to the nature of the earnings from which the dividends were paid, the underlying foreign taxes paid and withholding tax paid.

Canadian corporations are taxed on certain investment income (foreign accrual property income) of controlled foreign affiliates (e.g. more than 50% voting shares owned by the Canadian corporation, related parties or a limited number of Canadian residents, among other things) as it is earned, whether or not distributed. A grossed-up deduction is available for foreign income and withholding taxes paid in respect of the income.

In light of recommendations made by the Advisory Panel on Canada's System of International Taxation and others, draft legislation refines the tax treatment of certain investments in non-resident trusts (NRTs) and in offshore investment funds.

Draft legislation treats NRTs as being deemed resident for Canadian income tax purposes. The NRT rules will apply commencing 2007. A trust will be allowed to elect to be deemed resident for the 2001 and subsequent years.

Draft legislation maintains the enacted version of the rules for offshore investment funds property, but with some modifications. The legislation increases the prescribed income percentage by 2%, and extends the statute-barred period for taxpayers that have invested in offshore investment funds by three years, for taxation years ending after 4 March 2010.

### *Stock dividends*

If the payer is resident in Canada, stock dividends are treated for tax purposes in the same manner as cash dividends. The taxable amount of a stock dividend is the increase in the paid-up capital of the payer corporation because of the payment of the dividend. Stock dividends received from a non-resident are exempt from this treatment. Instead, the shares received have a cost base of zero.

### *Foreign exchange gains and losses*

The foreign exchange gains and losses of a Canadian taxpayer that arise from business transactions (i.e. on income account), including the activities of a branch operation, are generally fully includable in income or fully deductible, as the case may be. Any method that is in accordance with generally accepted accounting principles may be used to determine foreign exchange gains or losses on income transactions, providing the treatment is consistent with previous years and conforms to the accrual method of accounting.

A foreign exchange gain or loss that is on capital account is treated the same as any other capital gain or loss. The accrual method of accounting cannot be used for purposes of reporting gains or losses on capital account. This follows from the CRA's view that a taxpayer has not made a capital gain or sustained a capital loss in a foreign currency until a transaction has taken place. Therefore, paper gains and losses are disregarded.

### *Partnership income*

For Canadian tax purposes, a partnership is treated as a conduit, and the partners are taxed on their share of the partnership income, whether or not distributed. A corporation is not restricted from being a member of a partnership. Income is determined at the partnership level and is then allocated among the partners according to the terms of the partnership agreement. However, certain deductions, such as depletion allowances, exploration and development expenses, and donations, will flow through to be deducted by the various partners directly, as will any foreign tax credits, dividend tax credits, or donation credits. Partners generally may deduct expenses incurred directly, such as interest on borrowings to acquire partnership interests, in computing income from the partnership.

Under current rules, income earned by a corporation as a member of a partnership is included in the corporation's income for the corporate taxation year in which the fiscal period of the partnership ends. Therefore, if the fiscal year of a partnership differs from the taxation year of a corporate partner, income and tax could be deferred by up to one year (or longer, potentially, in the case of multiple 'tiers' of partnerships with different fiscal periods). Proposed rules that apply to corporate partners with taxation years ending after 22 March 2011, will generally not allow these partners to defer taxation on partnership income in respect of partnerships in which they (together with related parties) hold a greater than 10% interest (share of income or entitlement to assets); income from these partnerships must be accrued up to the end of the corporation's taxation year.

The accrual will be based on partnership income for the fiscal period ending in the corporation's taxation year (the 'formulaic amount'), unless a lower amount is designated by the partner. Penalties can apply if the designated amount reported is less than both the formulaic amount and the actual prorated income of the subsequent partnership fiscal period. An election may be available to change the partnership's fiscal period. Partnerships in multi-tier structures must adopt the same fiscal period (31 December unless otherwise elected by the partnerships). Certain transitional reserves may be available for up to five years.

### *Earnings of specified investment flow-throughs (SIFTs)*
Certain earnings of SIFTs (i.e. publicly traded income trusts and partnerships) are subject to a SIFT tax and are deemed to be a dividend when distributed, starting the 2007 taxation year for SIFTs first publicly traded after 31 October 2006, and starting the 2011 taxation year for other SIFTs. These rules are intended to discourage corporations from converting to income trusts and effectively force existing trusts to consider either restructuring or abandoning the income trust model. The rules do not apply to Real Estate Investment Trusts that meet certain conditions.

## *Deductions*

### *Business expenses*
Business expenses that are reasonable and paid out to earn income are deductible for income tax purposes unless disallowed by a specific provision in the Income Tax Act. Some expenses are deductible subject to limitation, e.g. charitable donations, entertainment expenses and the cost of providing an automobile to employees. Deduction of capital expenditures is specifically prohibited, but special provisions may allow depreciation or amortisation of these expenditures. Because Canadian corporations are taxable on worldwide income, there are basically no territorial limits on the deductibility of related expenses. Payments to affiliates are deductible if they reflect arm's length charges.

### *Depreciation*
Generally, depreciation for tax purposes (capital cost allowance) is computed on a pool basis, with only a few separate classes (pools) of property. Annual allowances

are generally determined by applying a prescribed rate to each class on the declining-balance basis. For example, the prescribed annual rate on most furniture and fixtures is 20%, on automotive equipment 30% and on most buildings 4% to 10%. In the year of acquisition, only half of the amount otherwise allowable may be claimed on most classes of property. Generally, capital cost allowance may not be claimed until the taxation year the property is available for use. The taxpayer can claim any amount of capital cost allowance up to the maximum. Capital cost allowance previously claimed may be recaptured if assets are sold for proceeds that exceed the undepreciated cost of the class. Temporary incentives to accelerate depreciation for eligible manufacturing and processing machinery and equipment acquired after 18 March 2007, and before 2014, revise the rate and method from 30% declining balance to 50% straight-line.

### *Mining and oil and gas activity*

Generally, mining and oil and gas companies are allowed a 100% deduction for exploration costs and certain preproduction development costs. Other development costs are deductible at the rate of 30% on a declining-balance basis. Capital property costs are subject to the depreciation rules noted above under *the Depreciation section.* In addition, in certain cases, significant asset acquisitions and assets acquired for a new mine or major expansion benefit from accelerated depreciation up to 100% of the income from the mine. For certain oil sands assets acquired after 18 March 2007, accelerated depreciation will be reduced gradually starting 2011 and will be eliminated by 2015.

Provinces levy mining taxes and royalties on mineral extraction and on oil and gas production. These provincial levies are mostly deductible.

Proposed changes that bring the taxation of oil sands properties more in line with that of the conventional oil and gas sector, generally for acquisitions after 21 March 2011, reduce the deduction rate per year:

- for the cost of acquiring oil sands leases and other oil sands resource or oil shale property from 30% to 10% on a declining balance basis, and
- for preproduction development expenses from 100% to 30% on a declining balance basis (transitional relief is available).

Investment tax credits (ITCs) are available federally (and in some provinces) to individuals who invest in shares to fund prescribed mineral exploration expenditures. The federal credit in 2011 for qualified ‘flow-through’ share investments is 15% of qualifying mining grassroots exploration expenditures. Certain mining exploration and preproduction expenditures that are incurred by a Canadian corporation and not used for flow-through are eligible for a 10% ITC. These credits can be used to offset current taxes payable or carried over to certain previous or subsequent taxation years.

### *Net operating losses*

Net operating losses generally may be carried back three tax years and forward 20 (ten years if the loss was incurred in taxation years ending before 2006 and after 22 March 2004, seven years if before 23 March 2004). Special rules may prohibit the use of losses from other years when there has been an acquisition of control of the corporation.

### *Payments to foreign affiliates*

Royalties, management fees, and similar payments to affiliated non-residents are deductible expenses to the extent that they are incurred to earn income of the Canadian company and do not exceed a reasonable amount (fair market value in most cases).

### Interest

Interest on borrowed money used for earning business or property income or interest in respect of an amount payable for property acquired to earn income is deductible, provided the interest is paid pursuant to a legal obligation and is reasonable in the circumstances.

Thin capitalisation rules can limit interest deductions when debt owing to certain non-resident shareholders (or persons not dealing at arm's length with a non-resident shareholder) exceeds two times the corporation's equity.

The Anti-Tax-Haven Initiative, which would have restricted the deductibility of certain interest payable after 2011 on investments in debt or equity of foreign affiliates, was repealed. The rule would have prevented multinational corporations from using tax havens and other tax avoidance structures to generate two expense deductions (one in Canada and another in a foreign subsidiary) for only one borrowing (so-called double-dipping).

### Taxes

Federal, provincial, and territorial income taxes are not deductible in determining income subject to tax. The tax treatment of federal capital taxes and provincial payroll and capital taxes is discussed above.

### Scientific research and experimental development (SR&ED)

Canada provides a generous combination of deductions and tax credits. Current and capital expenditures on research and development can be deducted in the year incurred or carried forward indefinitely to be used at the taxpayer's discretion to minimise tax payable.

In addition, a taxpayer can benefit from the ITC, which is generally a 20% non-refundable credit on SR&ED expenditures that can be applied against taxes payable. Alternatively, this tax credit can be carried back three years or forward 20 to be applied against taxes owing.

A qualifying CCPC can qualify for a 35% refundable tax credit annually on its first CAD 3 million in expenditures. This enhanced credit is subject to certain income and capital limitations.

SR&ED ITCs have been extended to certain salary and wages (limited to 10% of salary and wages directly attributable to SR&ED carried on in Canada) incurred in respect of SR&ED carried on outside Canada.

In addition to the federal research and development incentives, all provinces (except Prince Edward Island) and the Yukon provide tax incentives to taxpayers that carry on research and development activities.

### Business meals and entertainment

Deductions by a corporation for business meals and entertainment expenses are limited to 50% of their cost. This includes meals while traveling or attending a seminar, conference, or convention, overtime meal allowances, and room rentals and service charges, etc., incurred for entertainment purposes. If the business meal and entertainment costs are billed to a client or customer and itemised as such, the disallowance (i.e. the 50% not deductible) is shifted to the client or customer.

### *Doubtful accounts and bad debts*
A reasonable reserve for doubtful accounts may be deducted for tax purposes. The reserve calculation should be based on the taxpayer's past history of bad debts, industry experience, general and local economic conditions, etc. Special rules apply for determining reserves for financial institutions. A taxpayer can deduct the amount of debts owing that are established to have become bad debts in the year, provided the amount has previously been included in the taxpayer's income or relates to loans made in the ordinary course of business. Recoveries of bad debts previously written off must be included in income in the year of recovery.

### *Fines and penalties*
Most government-imposed fines and penalties are not deductible. Fines and penalties that are not government-imposed are generally deductible, if they were made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property.

### *Other significant items*
Transfers of losses and other deductions between unrelated corporate taxpayers are severely limited after an acquisition of control.

Three-quarters of capital expenditures for goodwill and certain other intangible properties can be amortised at a maximum annual rate of 7%, on a declining-balance basis. A portion of proceeds may be taxable as recapture or as a gain on disposition.

Charitable donations made to registered Canadian charitable organisations are deductible in computing taxable income, generally to the extent of 75% of net income. A five-year carryforward is provided.

Insurance premiums relating to property of a business are generally deductible, but life insurance premiums are generally not deductible if the company is the named beneficiary. However, if a financial institution lender requires collateral security in the form of life insurance, a deduction is allowed for the associated net cost of any pure insurance for the period.

## *Group taxation*

Group taxation is not permitted. However, the federal government has issued a consultation paper, *The Taxation of Corporate Groups*, that explores possible approaches for taxing corporate groups.

### *Transfer pricing*
Canadian transfer pricing legislation and administrative guidelines are generally consistent with the Organisation for Economic Cooperation and Development (OECD) Guidelines. Statutory rules require that transactions between related parties be carried out under arm's length terms and conditions.

Penalties may be imposed when contemporaneous documentation requirements are not met. A taxpayer will be deemed not to have made reasonable efforts if the taxpayer does not maintain complete and accurate documentation to evidence that it has determined and used arm's length prices for its related party transactions. The documentation must be prepared on or before the taxpayer's documentation due date, which is six months after the end of the taxation year.

The transfer pricing penalty is 10% of the transfer pricing adjustment, if the adjustment exceeds the lesser of CAD 5 million and 10% of the taxpayer's gross revenue for the year. The penalty is not deductible in computing income, applies regardless of whether the taxpayer is taxable in the year and is in addition to any additional tax and related interest penalties.

Canada has an Advance Pricing Agreement (APA) program that is intended to help taxpayers determine transfer prices acceptable to the local tax authorities and, when negotiated as bilateral or multilateral APAs, with tax authorities in other jurisdictions. Under this program, 237 APAs have been completed or are in progress.

Many of Canada's international tax agreements contain provisions concerning income allocation in accordance with the arm's length principle. These include a Mutual Agreement Procedure, which is a treaty-based mechanism through which taxpayers can petition competent authorities for relief from double taxation resulting from transfer pricing adjustments.

## *Tax credits and incentives*

### *Regional incentives*

In specified regions of Canada (i.e. Atlantic provinces, the Gaspé region, and Atlantic offshore region) a 10% federal ITC is available for various forms of capital investment (generally, new buildings, and/or machinery and equipment to be used primarily in manufacturing or processing, mining, oil and gas, logging, farming, or fishing.) The ITC is fully claimed against a taxpayer's federal tax liability in a given year. Unused ITCs reduce federal taxes payable for the previous three years and the next twenty, or they may be partly refundable.

The provinces and territories may also offer incentives to encourage corporations to locate in a specific region. Income tax holidays are available in Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island, and Quebec for certain corporations operating in specific industries (e.g. in Ontario and Quebec, commercialisation of intellectual property; in Prince Edward Island, bioscience or aviation) or meeting certain conditions (e.g. job creation for Newfoundland and Labrador).

### *Industry incentives*

Canada offers many tax incentives at the federal, provincial, and territorial levels, for various industries and activities, including those related to:

- Research and development *(see Scientific research and experimental development under the Deductions section)*.
- Film, media, computer animation and special effects, and multi-media productions.
- Manufacturing and processing.
- Environmental sustainability.

## *Withholding taxes*

Canada is continually renegotiating and extending its network of treaties, some with retroactive effect. This table summarises withholding tax rates on payments arising in Canada. The applicable treaty should be consulted to determine the withholding tax rate that applies in a particular circumstance.

| Recipient | Dividends % | Related-party Interest (1) % | Royalties (2)% |
|---|---|---|---|
| Resident corporations and individuals | 0 | 0 | 0 |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 25 | 25 | 25 |
| Treaty | | | |
| Algeria | 15 | 15 | 0 or 15 |
| Argentina | 10 or 15 (4) | 12.5 | 3, 5, 10, or 15 |
| Armenia | 5 or 15 (4) | 10 | 10 |
| Australia | 5 or 15 (4) | 10 | 10 |
| Austria | 5 or 15 (4) | 10 | 0 or 10 |
| Azerbaijan (7) | 10 or 15 (4) | 10 | 5 or 10 |
| Bangladesh | 15 | 15 | 10 |
| Barbados | 15 | 15 | 0 or 10 |
| Belgium | 5 or 15 (4) | 10 | 0 or 10 |
| Brazil | 15 or 25 (4) | 15 | 15 or 25 |
| Bulgaria | 10 or 15 (4, 5) | 10 | 0 or 10 (5) |
| Cameroon | 15 | 15 | 15 |
| Chile (5) | 10 or 15 (4) | 15 | 15 |
| China, P.R. (6) | 10 or 15 (4) | 10 | 10 |
| Columbia (3) | 5 or 15 (4) | 10 | 10 (5) |
| Croatia | 5 or 15 (4) | 10 | 10 |
| Cyprus | 15 | 15 | 0 or 10 |
| Czech Republic | 5 or 15 (4) | 10 | 10 |
| Denmark | 5 or 15 (4) | 10 | 0 or 10 |
| Dominican Republic | 18 | 18 | 0 or 18 |
| Ecuador | 5 or 15 (4) | 15 | 10 or 15 (5) |
| Egypt | 15 | 15 | 15 |
| Estonia (7) | 5 or 15 (4) | 10 | 10 (5) |
| Finland | 5 or 15 (4) | 10 | 0 or 10 |
| France | 5 or 15 (4) | 10 | 0 or 10 |
| Gabon | 15 | 10 | 10 |
| Germany | 5 or 15 (4) | 10 | 0 or 10 |
| Greece (9) | 5 or 15 (4) | 10 | 0 or 10 |
| Guyana | 15 | 15 | 10 |
| Hungary | 5 or 15 (4) | 10 | 0 or 10 |
| Iceland | 5 or 15 (4) | 10 | 0 or 10 |
| India | 15 or 25 (4) | 15 | 10, 15, or 20 |
| Indonesia | 10 or 15 (4) | 10 | 10 |
| Ireland, Republic of | 5 or 15 (4) | 10 | 0 or 10 |
| Israel | 15 | 15 | 0 or 15 |
| Italy (8) | 5 or 15 (4) | 10 | 0, 5, or 10 |
| Ivory Coast | 15 | 15 | 10 |
| Jamaica | 15 | 15 | 10 |
| Japan | 5 or 15 (4) | 10 | 10 |
| Jordan | 10 or 15 (4) | 10 | 10 |

| Recipient | Dividends % | Related-party Interest (1) % | Royalties (2)% |
|---|---|---|---|
| Kazakhstan (7) | 5 or 15 (4) | 10 | 10 (5) |
| Kenya | 15 or 25 (4, 5) | 15 | 15 |
| Korea, Republic of | 5 or 15 (4) | 10 | 10 |
| Kuwait | 5 or 15 (4) | 10 | 10 |
| Kyrgyzstan (7) | 15 (5) | 15 (5) | 0 or 10 |
| Latvia (7) | 5 or 15 (4) | 10 | 10 (5) |
| Lebanon (3) | 5 or 15 (4) | 10 | 5 or 10 |
| Lithuania (7) | 5 or 15 (4) | 10 | 10 (5) |
| Luxembourg | 5 or 15 (4) | 10 | 0 or 10 |
| Malaysia | 15 | 15 | 15 |
| Malta | 15 | 15 | 0 or 10 |
| Mexico | 5 or 15 (4) | 10 | 0 or 10 |
| Moldova | 5 or 15 (4) | 10 | 10 |
| Mongolia | 5 or 15 (4) | 10 | 5 or 10 |
| Morocco | 15 | 15 | 5 or 10 |
| Namibia (3) | 5 or 15 (4) | 10 | 0 or 10 |
| Netherlands | 5 or 15 (4) | 10 | 0 or 10 |
| New Zealand | 15 | 15 | 15 |
| Nigeria | 12.5 or 15 (4) | 12.5 | 12.5 |
| Norway | 5 or 15 (4) | 10 | 0 or 10 |
| Oman | 5 or 15 (4) | 10 (5) | 0 or 10 |
| Pakistan | 15 | 15 | 0 or 15 |
| Papua New Guinea | 15 | 10 | 10 |
| Peru (5) | 10 or 15 (4) | 15 | 15 |
| Philippines | 15 | 15 | 10 |
| Poland | 15 | 15 | 0 or 10 |
| Portugal | 10 or 15 (4) | 10 | 10 |
| Romania | 5 or 15 (4) | 10 | 5 or 10 |
| Russia (7) | 10 or 15 (4) | 10 | 0 or 10 |
| Senegal | 15 | 15 | 15 |
| Singapore | 15 | 15 | 15 |
| Slovak Republic | 5 or 15 (4) | 10 | 0 or 10 |
| Slovenia | 5 or 15 (4) | 10 | 10 |
| South Africa | 5 or 15 (4) | 10 | 6 or 10 |
| Spain | 15 | 15 | 0 or 10 |
| Sri Lanka | 15 | 15 | 0 or 10 |
| Sweden | 5 or 15 (4) | 10 | 0 or 10 |
| Switzerland | 5 or 15 (4) | 10 | 0 or 10 |
| Tanzania | 20 or 25 (4) | 15 | 20 |
| Thailand | 15 | 15 | 5 or 15 |
| Trinidad and Tobago | 5 or 15 (4) | 10 | 0 or 10 |
| Tunisia | 15 | 15 | 0, 15, or 20 |
| Turkey (10) | 15 or 20 (4) | 15 | 10 |
| Ukraine (7) | 5 or 15 (4) | 10 | 0 or 10 |
| United Arab Emirates | 5 or 15 (4) | 10 | 0 or 10 |
| United Kingdom | 5 or 15 (4) | 10 | 0 or 10 |

| Recipient | Dividends % | Related-party Interest (1) % | Royalties (2)% |
|---|---|---|---|
| United States | 5 or 15 (4) | 0 (11) | 0 or 10 |
| Uzbekistan (7) | 5 or 15 (4) | 10 | 5 or 10 |
| Venezuela | 10 or 15 (4, 5) | 10 | 5 or 10 |
| Vietnam | 5, 10, or 15 (4) | 10 | 7.5 or 10 |
| Zambia | 15 | 15 | 15 |
| Zimbabwe | 10 or 15 (4) | 15 | 10 |

Notes

1. Interest—Canada does not impose withholding tax on interest (except for 'participating debt interest') paid to arm's length non-residents. Most treaties have an explicit provision for higher withholding tax on interest in excess of fair market values in non-arm's length circumstances.
2. Royalties—A zero royalty rate generally applies to:
   - copyright royalties and payments for a literary, dramatic, musical, or other artistic work (but not royalties for motion picture films, work on film or videotape, or other means of reproduction for use in television), and/or
   - royalties for computer software, a patent, or for information concerning industrial, commercial, or scientific experience (but not royalties for a rental or franchise agreement).

   Different rates may apply in the case of immovable property (e.g. payments that relate to Canadian natural resources). Most treaties explicitly provide for higher withholding tax on royalties in excess of fair market value in non-arm's length circumstances. A zero rate of tax may apply in certain circumstances.
3. The treaty has been signed, but is not yet in force. Absent a treaty, Canada imposes a maximum 25% rate of withholding on dividends, interest, and royalties.
4. The lower (lowest two for Vietnam) rate applies if or when the beneficial owner of the dividend is a company that owns/controls a specified interest in the paying company. The nature of the ownership requirement, the necessary percentage (10%, 20%, 25%, or higher), and the relevant interest (e.g. capital, shares, voting power, equity percentage) vary by treaty.
5. If the other state (Canada for the treaty with Oman) concludes a treaty with another country providing for a lower withholding tax rate (higher rate for Kenya), the lower rate (higher rate for Kenya) will apply in respect of specific payments within limits, in some cases.
6. Canada's treaty with China does not apply to Hong Kong.
7. The treaty status of the republics that comprise the former U.S.S.R. is as follows:
   - Azerbaijan, Estonia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Russia, Ukraine, and Uzbekistan—new treaties entered into force *(see table for rates).*
   - Other republics—no negotiations are underway.

   Belarus, Tajikistan, and Turkmenistan will not honour the treaty with the former U.S.S.R. As a result, Canada will impose a maximum 25% rate of withholding on dividends, interest, and royalties until a new treaty enters into force. For other republics that comprise the former U.S.S.R., the status of the former treaty with the U.S.S.R. is uncertain. Because the situation is subject to change, Canadian taxpayers are advised to consult with the CRA as transactions are carried out.
8. A treaty with Italy was signed on 3 June 2002. Upon ratification, its provisions will apply:
   - for purposes of non-resident withholding tax, to amounts paid or credited after 31 December of the calendar year the treaty is ratified, and
   - for other taxes, for taxation years beginning after that date.

   The rates in the table are from this treaty. Under this treaty, the withholding tax rate will:
   - be reduced from 15% to 5% on dividends paid to a company that owns at least 10% of the payor's voting stock (the rate will remain 15% on other dividends)
   - be reduced from 15% to 10% on interest, but certain interest payments will be exempt, and
   - remain 10% on royalties, but certain royalties for the use of computer software, patents, and know-how will be subject to a rate of 5% and certain copyright royalties will be exempt.
9. The Canada-Hellenic Republic (Greece) treaty entered into force on 16 December 2010. Its provisions apply:
   - for purposes of non-resident withholding tax, to amounts paid or credited after 31 December 2010, and
   - for other taxes, to taxable years beginning after 2010.
10. The Canada/Republic of Turkey treaty entered into force on 4 May 2011. Its provisions apply:
    - for purposes of non-resident withholding tax, to amounts paid or credited after 31 December 2011, and
    - for other taxes, to taxable years beginning after 2011.

    Before then, the rates are 25%.
11. For the United States, the zero rate applies between related persons, subject to the Limitations of Benefits article.

# Canada

## *Tax administration*

### *Returns*

Both the federal and the provincial/territorial corporation tax systems operate on an essentially self-assessing basis. The tax year of a corporation, which is normally the fiscal period it has adopted for accounting purposes, cannot exceed 53 weeks. The tax year need not be the calendar year. Once selected, the tax year cannot be changed without approval from the tax authorities.

All corporations must file federal income tax returns. Alberta and Quebec tax returns must also be filed by corporations that have permanent establishments in those provinces, regardless of whether any tax is payable. Corporations with permanent establishments in other provinces that levy capital tax must also file capital tax returns. Tax returns must be filed within six months of the corporation's tax year end. No extensions are available.

Certain corporations with annual gross revenues exceeding CAD 1 million are required to electronically file (e-file) their federal corporate income tax returns via the Internet. Also, information return filers that submit more than 50 information returns annually must e-file via the Internet. Penalties are assessed for failure to e-file.

For partnerships with fiscal periods ending after 31 December 2010, the CRA has replaced the requirement to file a partnership information return based on the number of partners with one related to financial thresholds and partner structure.

### *Functional currency*

The amount of income, taxable income, and taxes payable by a taxpayer is determined in Canadian dollars. However, certain corporations resident in Canada can elect to determine their Canadian tax amounts in the corporation's 'functional currency'.

### *Payment of tax*

Corporate tax instalments are generally due on the last day of each month (although some CCPCs can remit quarterly instalments, if certain conditions are met). Any balance payable is generally due on the last day of the second month following the end of the tax year.

### *Assessments, audit cycle, and statute of limitations*

The tax authorities are required to issue an assessment notice within a reasonable time following the filing of a tax return. These original assessments usually are based on an initial high level review of the corporation's income tax return and either indicate agreement with the return (which is the result in the majority of cases) or outline in detail any differences that arise from this limited initial review.

A reassessment of the tax payable by a corporation that is not a Canadian-controlled private corporation (CCPC) may be made within four years from the date of mailing of the original notice of assessment, usually following a detailed field audit of the return and supporting information. The limitation period is three years for CCPCs. The three- and four-year limits are extended a further three years to permit reassessment of transactions with non-arm's length non-residents. Reassessments generally are not permitted beyond these limits unless there has been misrepresentation or fraud. Different time limits may apply for provincial reassessments.

The CRA has traditionally audited larger corporations (gross income exceeding CAD 250 million) annually. Medium-sized corporations (gross income between CAD 20 million and CAD 250 million) are generally selected based on a screening process and identified risks. Smaller CCPCs (gross income under CAD 20 million) are subject to compliance or restricted audits, selected based on statistical data and a screening process, and generally are subject to audits covering the current and previous years. However, the CRA announced in the fall of 2010 that, over the next five years, it will implement a new 'risk assessment' model to select corporations, partnerships, income trusts and private equity funds for audit. Large corporations and their affiliated entities will be classified as high, medium or low risk and will be subject to either a full, restricted or compliance audit. Factors that will determine the risk category include the taxpayer's history with the CRA, the type of industry and the internal controls in place.

The CRA's policy on access to taxpayer and third-party documents confirms that the CRA is authorised to inspect, audit, review or examine a taxpayer's books and records, and documents of any other person that relate to a taxpayer's books and records.

### *Appeals*

A taxpayer that disagrees with a tax assessment or reassessment may appeal. The first step is to file a formal notice of objection within 90 days from the date of mailing of the notice of assessment or reassessment, setting out the reasons for the objection and other relevant information. Different time limits may apply for provincial reassessments. Corporations that qualify as 'large corporations' must file more detailed notices of objection. The CRA will review the notice of objection and vacate (cancel), amend or confirm it. A taxpayer that still disagrees has 90 days to appeal the CRA's decision to the Tax Court of Canada, and if necessary, to the Federal Court of Appeal and the Supreme Court of Canada. However, the Supreme Court hears few income tax appeals.

### *Topics of focus for tax authorities*

Topics of interest to Canadian tax authorities include:

- The deductibility of:
  - royalty payments made by Canadian corporations to non-arm's length non-residents
  - business restructuring expenses incurred by a group of corporations located in more than one country
  - interest paid on loans if the funds derived from the loans are used offshore, and
  - guarantee fees paid by Canadian corporations to related non-resident corporations.
- The offshoring of Canadian-source income by factoring the accounts receivable of Canadian corporations.
- Treaty shopping to reduce Canadian withholding taxes and capital gains tax.
- Surplus stripping to reduce Canadian withholding taxes by artificially increasing a Canadian corporation's paid-up capital and subsequently distributing the surplus as a return of capital.
- The generation of foreign tax credits by a corporation for foreign income taxes that have not been borne by the corporation.

### *Foreign reporting*

Reporting requirements apply to taxpayers with offshore investments. The rules impose a significant compliance burden for taxpayers with foreign affiliates. Failure to comply could result in substantial penalties.

### *Tax avoidance*

Draft legislation makes an 'avoidance transaction' meeting certain conditions a 'reportable transaction' that must be reported to the CRA, generally for transactions entered into after 2010, and those that are part of a series of transactions completed after 2010. Quebec already has a provincial reporting regime for certain aggressive tax planning transactions, generally carried out after 14 October 2009.

## *Other issues*

### *Forms of business enterprise*

Canadian law is based on the British common-law system, except in Quebec where a civil-law system prevails. The principal forms of business enterprise available in Canada are the following.

- Corporation – A legal entity distinct from its shareholders. Whether public or private, incorporated federally, provincially or territorially.
- Partnership – A business relationship between two or more 'persons' (i.e. individuals, corporations, trusts, or other partnerships) formed for the purpose of carrying on business in common. Not treated as a legal entity distinct from its partners.
- Sole proprietorship – An unincorporated business operated by an individual that is carried on under the individual's own name or a trade name.
- Trust – A relationship whereby property (including real, tangible and intangible) is managed by one person (or persons, or organisations) for the benefit of another. May hold commercial enterprises.
- Joint Venture – Generally, the pursuit of a specific business objective by two or more parties whose association will end once the objective is achieved or abandoned. Not treated as a legal entity distinct from the participants.

Foreign investors usually conduct business in Canada through one or more separate Canadian corporations, although operation as a branch of a profitable foreign corporation may be preferable during the start-up period. In addition, foreign investors may participate as partners in partnerships carrying on business in Canada or as joint venturers.

# Cape Verde

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## Significant developments

### Corporate income tax

It is envisaged that a new corporate income tax code will enter into force in the near future. The tax process code and a general tax law are already drafted. However, the date at which the new tax legislation will enter into force is still unknown.

### Other taxes

As of August 2010, an ecologic charge applies to packing material, whether empty or full, imported or produced internally, non-biodegradable or made out of metal, glass, or plastic.

### Tax incentives

The following four new tax incentives recently entered into force. *For more information on these incentives, see the Tax credits and incentives section.*

- A new law entered into force on 8 December 2010 provides tax and custom benefits for industrial activity.
- A regime for promotion, encouragement and access, licensing, and exploitation inherent to the exercise of independent production and self-production of electricity based on renewable energy sources is in force as of 1 January 2011.
- The International Business Centre (IBC) regime entered into force on 2 March 2011 and provides tax benefits to entities licensed to operate in the IBC on income from industrial or business activities and services in respect of operations carried out with other IBC licensed entities or with non-residents entities (without a permanent establishment in Cape Verde).
- A regime that provides for tax and financial incentives for investment projects in order to promote the internationalisation of Cape Verdean companies is in force as of 23 March 2011.

## Taxes on corporate income

### Basis of taxation

Cape Verde has a single tax on income, called Imposto Único sobre os Rendimentos (IUR), which is levied on profits arising from business activities carried out in Cape Verde by resident companies or individual entrepreneurs and by Cape Verdean permanent establishments (PE) of non-resident entities.

Taxable profit is computed according to the local accounting rules and adjusted for tax purposes. The taxation system in Cape Verde is based on a territorial principle; if the source of the income is located abroad, no Cape Verde taxation is imposed on it.

### Tax rates
The IUR rates applicable are the following:

- Companies are subject to a tax rate of 25%, where taxable income corresponds to the profit less any tax benefits and any losses carried forward, as stated in the tax return.
- Non-residents without a PE in Cape Verde are subject to a 20% withholding tax (WHT) on the amount of the invoice.

### Surcharge
The IUR rate is increased by a fire brigade surcharge, called Taxa de Incêndio, of 2% on the tax due. This surcharge is levied in the municipalities of Praia (Island of Santiago), and Mindelo (Island of São Vicente).

## Corporate residence

A company or entity is deemed to be resident in Cape Verde if its registered head office or its place of effective management is in the Cape Verde territory.

### Permanent establishment (PE)
Non-resident companies deemed to have a PE in Cape Verde are also subject to tax in Cape Verde.

Under Cape Verdean tax law, a non-resident company is deemed to have a PE if the non-resident company:

- has any fixed installation or permanent representation located in Cape Verde through which, among others, activities of commercial, industrial, or agricultural nature, or fishing and rendering of services are carried out (including agricultural, fishing, and cattle raising explorations, or other quarries or any other places of natural resources extraction) or
- carries out its activity in Cape Verde through employees, or any other personnel hired for that purpose, for a period (continuous or not) of not less than 90 days within a twelve month period.

## Other taxes

### Value-added tax (VAT)
The VAT system in Cape Verde closely follows the European Union (EU) VAT system, and it is assessed at the standard rate of 15% and at a reduced rate of 6%.

The standard VAT rate of 15% is a general tax on consumption, applicable to the import and sale of goods and services in Cape Verde territory.

The 6% reduced VAT rate applies to lodging and restaurants, due to the important role they assume in the Cape Verde economy.

The VAT regulations establish two types of exempt transactions: exempt transactions without credit and exempt transactions with credit (i.e. zero-rated transactions). VAT incurred is recoverable in as far as the goods and services are used for the purposes of the taxed transactions of a taxable person or for zero-rated transactions.

Exempt transactions without credit include the following:

- Hospital and medical care and closely related activities undertaken by bodies governed by public law, or comparable activities undertaken by other hospitals and centres for medical treatment.
- The provision of medical care through the exercise of the medical and paramedical professions, as well as the supply of transport services for sick or injured persons, and the supply of human organs, blood, and milk.
- The supply of services and goods closely linked to welfare and social security work.
- The supply of services and goods closely linked to the protection of children and young persons by bodies governed by public law.
- The provision of children's or young people's education, school or university education, including the supply of services and goods closely related thereto.
- The supply of services, and goods closely linked thereto, by non-profit-making organizations.
- The supply of copyright and art objects by the original creators or their heirs.
- The supply by the public postal services of stamps and stamped paper.
- The supply of certain cultural, educational, technical, and recreational services.
- Garbage removal.
- Burial and cremation supplies.
- Banking, financial, insurance, and reinsurance transactions, including related services performed by insurance brokers and insurance agents.
- Immovable property transactions (excluding the provision of accommodation in the hotel sector or in sectors with a similar function, the granting of facilities for collective parking of vehicles, the leasing of permanently installed machinery and equipment, and the granting of facilities for exhibitions and advertising).
- Specified basic foodstuffs and pharmaceutical products.
- Goods used in agriculture, stockbreeding, forestry, and fisheries.

Exempt transactions with credit (i.e. zero-rated transaction) on imports include the following:

- Import of goods whose supply qualifies for exemption.
- Re-import of goods by the person who exported them, in the state in which they were exported, where they qualify for exemption from customs duties.
- Services in connection with the import of goods where the value of such services is included in the taxable amount.
- Import of gold by the central bank.
- Import into ports by sea fishing undertakings of their catches, unprocessed or after undergoing preservation for marketing but before being supplied.
- Import of goods under diplomatic and consular arrangements which qualify for exemption from customs duties.
- Import of goods for the fuelling and provisioning of sea-going vessels and aircraft.

The most important exemptions with credit (i.e. zero-rated) for exports and connected transactions include the following:

- Supply, modification, repair, maintenance, chartering, and hiring of aircraft used by airlines operating both on domestic and international routes, and the supply, hiring, repair, and maintenance of equipment incorporated or used therein.
- The supply of goods for the fuelling and provisioning of such aircraft.
- Services meeting the direct needs of such aircraft or their cargoes.

### *Stamp duty*
Stamp duty is payable on a wide variety of transactions and documents, at rates that may be set in specific amounts or on a percentage basis.

Stamp duty rates:

| Item | Stamp duty rate |
|---|---|
| Loans | |
| With determined term, over one year | 0.5% |
| With undetermined term or under one year (for each month) | 0.05% |
| Bank interest and fees / commissions | 3.5% |
| Guarantees | 0.5% |
| Insurance | 3.5% |
| Promissory notes, securities | 0.5% |
| Corporate structuring operations | 0.5% |
| Real estate purchases and sales | 1% |
| Sale of a business as a going concern | 5% |
| Letting of immovable property | 10% |
| Property leasing | 1% |
| Emoluments, registrations acts | 15% |
| Contracts | CVE 1,000 * |

* Fixed exchange rate EUR 1 = 100.265 Cape Verde escudos (CVE) under an exchange agreement between Cape Verde and Portugal.

### *Property taxes*

A property tax, called Imposto Único sobre o Património (IUP), is levied at the rate of 3% in Cape Verde.

IUP is due on the ownership of immovable property on an annual basis by the owner of the real estate, registered as such on 31 December of the relevant year. The taxable basis corresponds to 25% of the value attributed by the Evaluation Commission.

IUP is also due on the transfer (gratuitously or for a consideration) of real estate, based on the value of the contract declared by the transferee.

Exemption of IUP due on the acquisition is granted to:

- Cape Verdean emigrants which own saving bank accounts.
- Retired individuals.
- Projects with Touristic Utility Status *(see the Tax credits and incentives section for more information)*.

In taxable transfers (not exempt), IUP is payable by the transferee.

IUP is also due on the capital gains arising from the sale of:

- Plots of land for construction if the sales price is more than double the purchase price.
- Buildings or other real estate if the sale price exceeds the purchase price by more than 30%.

IUP on capital gains is normally paid by the transferor, on the highest of the declared price and the official value of the property concerned.

Capital gains obtained by companies that are in the business of buying real estate for resale are not subject to IUP.

### *Special consumption tax*

A special consumption tax is imposed at rates ranging from 10% to 150% on goods which are deemed superfluous, luxurious, or undesirable for economic, social, or environmental policy reasons.



### *Customs duties/import tariffs*

Customs duties are levied at rates ranging from 0% to 50% on the customs value of most imported goods. Since Cape Verde imports the majority of the goods it consumes, a 50% tariff protection applies for certain domestically produced goods.

Raw materials or capital goods can be imported with an exemption from custom duties or at a low rate.

### *Ecologic charge*

Cape Verde's Ecologic Charge, in force since August 2010, is applied to packing material, whether empty or full, imported or produced internally, non-biodegradable or made out of metal, glass, or plastic.

The ecologic charge varies from CVE 2 to CVE 100 per item, depending on the quantity or weight of the goods.

This fee is due by the local producer or the importer.

Exemptions are available in the case of packing material used in medicine, essential food (e.g. corn, rice, sugar, flour, and milk), and construction (e.g. cement). Packing material that is exported, reutilized, or recycled is also exempt.

## *Branch income*

A branch is not considered a separate legal entity distinct from the foreign head office. It is governed by the domestic law of Cape Verde.

From a tax perspective, branches are subject to corporate income tax, if considered a PE under Cape Verde law.

## *Income determination*

Taxable income is computed on the basis of the accounting income, adjusted by deducting from taxable profits the prior years' losses and any deductions under the tax (incentive) legislation.

### *Capital gains*

Capital gains are not subject to a separate capital gains tax and are treated and taxed as ordinary business income.

The gain corresponds to the amount by which proceeds from disposal exceeds the cost of asset acquisition.

Capital gains realised from the sale of shares and part of the capital of companies with a registered head office or place of effective management in Cape Verde, if owned for at least one year, are not subject to taxation.

### *Dividend income*

Dividend income is currently fully exempt from taxation in Cape Verde.

### *Foreign income*

Resident companies and PEs of non-resident companies are taxable on a territorial base principle, meaning that income obtained outside Cape Verde is not subject to taxation therein.

## *Deductions*

### *Depreciation*

Depreciation is considered a deductible cost with respect to all fixed assets (except land), up to the limits determined by the applicable tax law.

As a general rule, depreciation must be computed by using the straight-line method. Tax authorities may allow other depreciation methods on the basis that the actual depreciation is higher than the one calculated at regular rates or according to the taxpayer's accounting practice.

Under the straight-line method, the maximum depreciation that is deductible is calculated by applying the general depreciation rates set out in a Ministerial Decree of 28 January 1984 to the adjusted purchase cost or production cost.

Land is not depreciable.

Main depreciation rates:

| Group | Asset | Depreciation rate (%) |
|---|---|---|
| 1 | **Plantations, land for exploration, other land and natural resources** | To be determined on a case-by-case basis |
| 2 | **Buildings and other constructions** | |
| | Residential, commercial, and industrial buildings | 4 |
| | Light structures (fibreglass wood, wood, metal) and other constructions | 10 |
| | Quays, docks, and similar harbour infrastructure | 2 |
| | Walls, silos, parks, roads, adornments, runways | 5 |
| 3 | **Basic equipment, machines, and other installations** | |
| | Fishing gear | 25 |
| | Electronic, sound, laboratory, telephone, and radar equipment | 20 |
| | Telecommunication stations and installations | 12.5 |
| | Water installations | 6.66 |
| | Machines | 16.66 |
| | Oil pipelines, fuel and gas reservoirs | 8.33 |
| | Transformation stations, air networks, equipment, and underground cables for communications and transport of energies | 5 |
| | Other equipment and machines | 10 |
| 4 | **Tools (for industries / others)** | 20/25 |

| Group | Asset | Depreciation rate (%) |
|---|---|---|
| 5 | **Cargo and transport material** | |
| | Animals and lightweight motor vehicles | 12.5 |
| | Aircrafts | 14.28 |
| | Ships and boats | 10 |
| | Cranes, barges, etc. | 7.14 |
| | Trucks | 20 |
| | Other cargo and transport material | 16.66 |
| 6 | **Administrative and social equipment and furniture** | |
| | Furnishings and decorative items | 16.16 |
| | Calculating machine, typewriter, and accounting machine | 20 |
| | Metallic furniture | 8.33 |
| | Non-metallic furniture | 12.5 |
| | Clothes, tableware, and glasses | 50 |
| | Others administrative and social equipment and furniture | 25 |
| 7 | **Packing material (wood / metal / other)** | 14.28/20/33.33 |
| 8 | **Other tangible fixed assets** | 10 |
| 9 | **Intangibles** | |
| | Patents, trademarks, licences, concessions and other rights, formation and organization of the company | 10 |
| | Other intangibles | 33.33 |

### *Net operating losses*
Income tax losses can be offset against taxable profit and can be carried forward for three years. Carryback of tax losses is not allowed in Cape Verde.

The tax losses incurred by a company are not transferable to another company, unless previously accepted by the tax authorities.

### *Payments to foreign affiliates*
Currently, there are no special restrictions on the deductibility of royalties, interest, and service fees paid to foreign affiliates, provided that the payments are regarded as indispensable to generate taxable profits and gains and to maintain the business of the company.

### *Taxes*
Taxes paid in connection with the activity of the company are tax deductible, excluding IUR and the IUP due on an annual basis. However, under the current tax law, the annual IUP can be deducted from the IUR assessed.

## *Group taxation*

There is no special tax regime for groups of companies in Cape Verde.

### *Transfer pricing regime*
There is no special tax regime regarding transfer pricing in Cape Verde.

## *Tax credits and incentives*

### *Foreign investor status (Estatuto do Investidor Externo)*

Direct foreign investments in Cape Verde made in any business sector by entities with the Foreign Investor Status benefit from an exemption from WHT on distribution of profits (this will be relevant once the new tax Codes enter into force), as well as interest derived from the financing of the investment, paid to foreign investors. Currently, dividends are not taxed in Cape Verde under a domestic exemption. The benefit applies for the first five years of the investment or whenever the profits are reinvested in Cape Verde, in the same or another economic activity. This benefit is granted following a request filed with the Cape Verdean Agency for Foreign Investment.

### *Industrial Activity Law*

A new law entered into force on 8 December 2010 provides the following tax and custom benefits for industrial activity:

#### IUR benefits

Industrial Entrepreneurs benefit from a five year exemption from IUR on the income generated by each industrial establishment. Under this regime, 'Industrial Entrepreneurs' are individuals and/or companies that solely or jointly declare the intention to develop an industrial project.

This exemption is renewable for the same period in the case of reinvestment, via a tax deduction corresponding to the total sum of the profits reinvested in the same or in other industrial unit.

The exemption period is increased to seven years in the case of industrial projects set up in less-developed areas (yet to be defined), which contribute to job creation or to diversify the production of goods and services.

#### IUP benefits

Industrial Entrepreneurs benefit from a ten year exemption from IUP on the ownership of real estate used exclusively for industrial purposes. There is also an exemption on the acquisition of real estate for the same purpose and on cargo and passenger transport vehicles used exclusively for the purposes of the industrial activity.

#### VAT benefits

Industrial Entrepreneurs benefit from a VAT exemption on the acquisition of equipment and vehicles (not more than five years old) for the transport of goods and workers of the industrial establishment.

#### Custom duty benefits

Industrial Entrepreneurs benefit from an exemption from custom duties on the import of construction material, machines, utensils, semi and finished materials, and products used exclusively in the production of goods within a new industrial product.

The law also provides for an exemption from custom duties on the acquisition of fuel and lubricants (except gasoline) used in the production of energy and desalinized water for consumption by the industrial establishment.

### *International Business Centre (IBC) of Cape Verde*

The IBC regime is in force as of 2 March 2011. The Cape Verdean Agency for Foreign Investment is the entity responsible for granting the licenses to operate within the IBC, upon previous proposal of the Zona Franca Comercial S.A.. The following tax benefits are applicable to entities licensed to operate in the IBC on income from industrial or business activities and services in respect of operations carried out with other IBC licensed entities or with non-residents entities (without a PE in Cape Verde).

Note that these tax benefits are not applicable to entities engaged in tourism, banking and insurance, real estate, or construction.



**IUR benefits**

From 1 January 2011 thru 31 December 2018, the IUR rate is reduced by 90% to an effective rate of 2.5%.

From 1 January 2019 thru 31 December 2025, the IUR rate is reduced by 85% to an effective rate of 3.75%.

Under current IUR law, foreign-sourced income is not subject to taxation in Cape Verde.

**VAT and custom duty benefits**

All the exemptions foreseen in the VAT Regulation apply.

An exemption from custom duties applies with respect to certain goods used within the scope of the activity developed and licensed under the IBC.

**WHT benefits to shareholders of entities licensed to operate in the IBC**

An exemption from WHT applies with respect to distributed profits which have been taxed at the reduced IUR rates applicable within the IBC. Currently, besides the foreign income not being subject to taxation in Cape Verde, distributed dividends are not subject to taxation.

An exemption from WHT applies with respect to interest, and other income, from shareholders loans or other capital entries.

***Tax and financial incentives for internationalisation of Cape Verdean companies***

A regime that provides for tax and financial incentives for investment projects in order to promote the internationalisation of Cape Verdean companies is in force as of 23 March 2011.

The following incentives, to be granted under a contract of not more than three years, apply to internationalisation projects of companies with head office and place of effective management in Cape Verde, which are undertaken before 31 December 2020.

**IUR benefits**

The IUR rate is reduced by 50% to an effective rate of 12.5% throughout the duration of the investment contract.

An additional deduction of 30% of costs incurred in training young (i.e. not older than 30 years of age) people is available, as is an additional deduction of 30% of costs incurred in hiring young people or long term unemployed people.

An additional deduction of 50% or 80% of the costs of non-fixed term labour agreements is available, provided there is creation of net employment (respectively more than 10 or more than 50 jobs).

### IUP benefits
An exemption from IUP is available on the acquisition of real estate for the establishment or expansion of the activity of the investor.

### VAT and custom duty benefits
Exemptions provided for in the VAT Code apply, as well as custom duties incentives as provided for in the applicable legislation.

### Stamp duty and other benefits
An exemption from stamp tax is available on the incorporation of companies and increase of share capital of existing companies. An exemption from stamp duty is also available on financing transactions.

An exemption from notary and registration fees is available on the incorporation and registration of companies.

### *Tax benefits for social housing*
Entities responsible for the construction of social housing, duly authorized by the competent regulatory authority (CCC-SNHIS), may benefit from the following:

- Only 30% of the income derived from the activity carried out within the scope of the social housing project is subject to IUR, under certain conditions.
- A refund of 80% of the VAT incurred in the Cape Verdean market is available in cases where those entities carry exclusively exempt operations without the right to deduct input VAT.
- A reduction of 75% of custom duties levied on construction material listed in an annex to the diploma is available.

Development promotion entities, provided they are also authorized by CCC-SNHIS, are also eligible for VAT benefits.

### *Touristic Utility Status (Estatuto de Utilidade Turística)*
Cape Verde may grant Touristic Utility Status to certain touristic projects. Touristic Utility Status is granted to the following types of touristic projects:

- Installation – granted to new touristic projects.
- Functioning – granted to touristic projects already running.
- Refurbishment – granted to touristic projects in case of refurbishment projects with a value of at least 25% of the initial investment.

Touristic Utility Status generally allows for the following tax incentives and benefits:

- Exemption from IUR – 100% in the first five years of activity, 50% in the following ten years.
- Exemption from IUP on the acquisition of real estate used for construction and installation of touristic projects.
- Exemption from custom duties on the importation of materials and equipment used in the touristic project, capped at 15% of the total amount of the investment.

### *Tax incentives for renewable energies*
A regime for promotion, encouragement and access, licensing, and exploitation inherent to the exercise of independent production and self-production of electricity based on renewable energy sources is in force as of 1 January 2011.

Water, wind, solar, biomass, biogas or industrial, agricultural or urban waste, oceans and tides, and geothermal are to be consider sources of renewable energy. Under the regime, renewable energy producers may benefit from the following.



**IUR benefits**
The IUR rate is reduced by 100% during the first five years of production of energy (per project) and by 50% during the next five years production of energy (per project). The IUR rate is reduced by 25% during another five years (years 11 thru 15) of production of energy (per project), provided the reinvestment accumulated in the last three years exceeds 50% of the initial investment.

**Custom duty benefits**
An exemption from custom duties and other custom charges (except stamp duty, charges, and fees due for the provision of services) applies on the importation of capital goods, raw materials and supplies, finished and semi-finished products and other materials which are incorporated or used in the production of goods or services involved in the production of electrical energy from renewable sources.

### *Shipping transport industry incentive*
A five-year income tax exemption, beginning in the year of activity, is available to Cape Verde individual entrepreneurs and domestic companies engaged in shipping transport as well as to shipping transport companies which are owned at least 25% by Cape Verde citizens and/or companies.

### *Job creation incentives*
Companies are entitled to an increased payroll expense deduction with respect to the net permanent job increase related to newly hired workers who are not older than 30 years of age or have been unemployed for one year or more. The total deduction allowed corresponds to 130% or 150% of the payroll costs, depending on whether the net job increase that year is between five and ten or more than ten, respectively.

A deduction equal to 180% of the payroll cost is available to companies that hire, for six months or more, workers with a disability between 50% and 66%. The deduction is 130% in case of workers with a disability of less than 50%. In case of disabled workers hired for less than six months, the deduction is reduced to 140% and 115%, respectively.

Companies are entitled to a deduction equal to 130% of expenses incurred for scholarships granted to students who are not older than 25 years of age.

Employers are entitled to a deduction equal to 150% of expenses incurred for training workers who are not older than 35 years of age in official training centres.

## *Withholding taxes*

Payments (services, interest, and royalties) between resident companies are generally not subject to withholding tax (WHT). Rental payments due by resident company are, however, subject to WHT of 10%.

For a Cape Verde-based recipient, tax withheld is a payment on account against the final single income tax due.

Any non-Cape Verdean resident entity carrying out an economic activity in Cape Verde is subject to a final 20% WHT, applied on interest, royalties, rents, and fees. The Cape Verdean Tax Authorities consider that the payment for services to non-residents is also subject to WHT at the rate of 20%, although this understanding does not fully adhere to the current wording of the Cape Verdean tax law.

Dividends are not subject to WHT, irrespective of the residence status of the recipient.

### *Tax treaties*

The only tax treaty that Cape Verde has in force is with Portugal. Under the Cape Verde/Portugal tax treaty, WHT is limited as follows:

- Royalties: 10%
- Interest: 10% (0% applies to interest paid by public bodies).

Note that WHT on dividends under the Cape Verde/Portugal tax treaty is limited to 10%. However, dividends are currently not taxed in Cape Verde.

## *Tax administration*

### *Tax returns*

As a general rule, the tax year is the calendar year. A different tax year may be applied, subject to authorization from the Ministry of Finance, in the case of non-resident companies with a PE in Cape Verde.

Taxpayers are required to file a tax return by 31 May of the year following the end of the tax year.

### *Payment of tax*

Corporate taxpayers must make a prepayment of their income tax liability for the current tax year. The prepayment is calculated as 30% of the preceding tax year's income tax liability and should be paid by 20 January of the following year.

Taxpayers are required to self-assess the tax due by 31 May of the year following the end of the tax year.

The tax authorities will verify the tax return and raise a final assessment of tax liability by 20 July of the same year. The taxpayer must then pay the remaining tax due by 31 July.

# Caribbean Netherlands

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## Significant developments

### Recent political developments

On 10 October 2010, the Netherlands Antilles dissolved, and the Caribbean Netherlands (Bonaire, Saba, and St. Eustatius, also known as the BES islands) have become a public body of the Kingdom of the Netherlands. Prior to dissolution, the Netherland Antilles consisted of five islands: St. Maarten, Curaçao, Bonaire, Saba, and St. Eustatius.

While each of the islands will remain within the Kingdom of the Netherlands structure, the ties between the islands will be loosened. Defence and foreign affairs will remain within the province of the government of the Kingdom of the Netherlands. Also, the judiciary system will remain an integral part of the Kingdom of the Netherlands.

### Compliance with sound international fiscal standards

In recent years, the Caribbean Netherlands, as part of the former Netherlands Antilles, has complied with international standards as set forth by the Organisation for Economic Co-operation and Development (OECD) and the European Union (EU). There is, for example, no distinction in the fiscal treatment of offshore and onshore taxpayers. The Caribbean Netherlands does not have bank secrecy laws, and the tax information exchange agreements (TIEAs) that in recent years have been concluded with several countries remain applicable to the Caribbean Netherlands.

## Taxes on corporate income

Income from immovable property is subject to real estate tax. The real estate tax is levied based on the value of real estate. As is the case at present, the value is established for five years each time. The income is deemed to be 4% of the value of the real estate and the tax rate is 25%. Therefore, effectively 1% of the value is taxed.

Exemptions apply for the dwelling that serves as the principal residence, real estate with a value not exceeding 50,000 US dollars (USD) (the ‘kunuku’ house), and land that is being commercially operated for agricultural or forestry purposes.

A revenue tax is levied on the revenues from shares and profit-sharing certificates, as well as on distributions from foundations, special purpose funds, or a closed-end common fund. The rate of the revenue tax is 5%.

There are no other taxes on income or capital gains.

The revenue tax and the real estate tax only apply if certain requirements of residency have been met. A corporation that is established in the Caribbean Netherlands that does not meet certain criteria will, for the purpose of the revenue tax and the real estate tax, be deemed to be established in the Netherlands and will be taxed accordingly. That means that instead of revenue tax and real estate tax, the Dutch corporate income tax of 25.5% will apply, as well as the Dutch dividend tax of 15% *(see the Corporate residence section for more information)*.

## *Corporate residence*

Corporate residence is, in principle, determined by the place of incorporation. However, other factors may also determine residence. For example, a foreign company with effective management in the Caribbean Netherlands is considered to be a resident.

However, for the purposes of the revenue tax and the real estate tax, a corporation is deemed to be established in the Netherlands, unless specific criteria have been met, the purpose of which is to guarantee commercial ties with the Caribbean Netherlands.

An entity is deemed to be established in the Caribbean Netherlands, not the Netherlands, based on the following criteria:

- It has been admitted to a bonded warehouse for commerce and services, or
- It obtained a declaration from the Inspector of Taxes that one of the following conditions applies:
  - It is not active in financial services or insurance, turnover is not more than USD 80,000, and assets are not more than USD 200,000.
  - The assets usually consist of less than 50% of investments, participations, liquidities, and assets that are made available for use to persons outside the Caribbean Netherlands, as well as assets, directly or indirectly, used for financing persons outside the Caribbean Netherlands.
  - It usually provides permanent work to at least three persons living in the Caribbean Netherlands who engage independently in activities relating to the assets mentioned above and whose responsibility is in line with their job position, and it has, at its disposal, real estate situated in the Caribbean Netherlands for a period of at least 24 months with a value of at least USD 50,000 for the activities, and this real estate is used as an office with facilities that are customary in the financial sector.
  - It holds, at a minimum, 95% of the shares of an entity as mentioned above.

Corporations that do not meet these criteria are deemed to be established in the Netherlands, which causes them to be subject to the Dutch corporate income and dividend withholding taxes (WHT). This does not apply to foundations, special purpose funds, or a closed-end common fund.

## *Other taxes*

### *Sales tax*

A general expenditure tax (Algemene Bestedings Belasting or ABB) has replaced the levy of import duties, as well as the former sales tax (Omzetbelasting or OB and Belasting op Bedrijfsomzetten or BBO), of the former Netherlands Antilles. The rate is 8% in Bonaire and 6% in Saba and St. Eustatius. The rate for insurances is 9% and 7%, respectively. A rate of 25% applies to cars, unless it concerns a very low energy car, in which case the rate is 0%.

ABB is levied in respect of:

- Sale of goods by manufacturers.
- Delivery of services within the levy area.
- Import of goods.

Therefore, the sale of goods will only be subject to tax once, at the manufacturer or at the time of import. The sale of bread has been exempt. In addition, the supply of grain, potatoes, and rice will also be exempt. Other exemptions that apply, similar to the former OB and BBO legislation, are:

- Public transportation.
- Medical services and hospitals.
- Water and electricity.
- Fuels and other products, including supplies, for international transportation.
- Renting of houses.

### *Transfer and property taxes*

The transfer of immovable property on the islands of the Caribbean Netherlands is subject to a 5% transfer duty. There is also a property tax of 0.3% on the value of real estate.

### *Excise tax*

Excise tax is due on gasoline. On Bonaire, excise tax is also due on alcohol, with different tariffs for liquor, wine, and beer, as well as for tobacco. This does not apply to Saba and St. Eustatius.

The excise rates are USD 41.86 per hectolitre of gasoline or approx. USD 1.60 per gallon on Bonaire (USD 1.30 on Saba and St. Eustatius).

Only on Bonaire:

- USD 67.04 per hectolitre of beer.
- USD 128.50 per hectolitre of wine.
- USD 12.85 per volume percent of alcohol per hectolitre of distilled products.
- USD 5.34 per 100 cigarettes.
- USD 9.78 per 100 cigars.
- USD 4.89 per 100 cigarillos.
- USD 30 per kilogram of smoking tobacco.

## *Branch income*

Entities not established in the Caribbean Netherlands are only taxed on the fixed income of local real estate (i.e. 25% real estate tax on 4% of the value of the property the corporation owns in the Caribbean Netherlands). The revenue tax does not apply to the remittance of profits from the PE to the head office of the corporation. No other taxes are levied.

## *Income determination*

In the Caribbean Netherlands, there is a tax on the fixed income of local real estate (real estate tax) and on profits distributed to the shareholders (revenue tax). As long as income is not distributed, profits other than from real estate are not subjected to tax. Therefore, there are no regulations with regard to income determination.

## Deductions

No deductions are allowed on the fixed income with regard to real estate tax or the distributions of profit for revenue tax purposes.

## Group taxation

Distribution of profits to another corporation on one of the islands of the Caribbean Netherlands is exempt from revenue tax if the other corporation holds, at minimum, a 5% interest in the corporation that is making the distribution.

## Tax credits and incentives

A corporation that has been designated as a bonded warehouse for commerce and services is exempt from ABB and excise tax. As a result, goods in transhipment remain tax free. However, if goods that have been admitted to a bonded warehouse are sold within the Caribbean Netherlands, this will be considered importing these goods and ABB and excise tax will be due.

## Withholding taxes

A revenue tax of 5% is levied on distributions from corporations as well as distributions from foundations, special purpose funds, or a closed-end common fund.

### Tax treaties

The Caribbean Netherlands currently has a tax treaty in effect with Norway. A DTA has been negotiated with Jamaica, but this has not entered into force yet. Furthermore, TIEAs have been signed with several countries including Australia, Canada, Denmark, Mexico, Spain, Sweden, New Zealand, and the United States. As a result, the Caribbean Netherlands, as part of the former Netherlands Antilles, has been moved to the white list of the OECD Global Forum.

### Tax arrangement for the Kingdom of the Netherlands (TAK)

As part of the Kingdom of the Netherlands (TAK), the Caribbean Netherlands is party to a federal tax agreement with Aruba, Curaçao, and St. Maarten as well as a tax agreement for the Netherlands (TAN) with regard to the attribution of tax between the Netherlands and the Caribbean Netherlands. Subject to the TAK and the TAN, dividends, interest, and royalties paid to a company resident in the Caribbean Netherlands may qualify for reduced rates of WHTs in the subject countries or in the Netherlands.

Dutch dividend WHTs are 15% if the Caribbean Netherlands company owns less than 10% of the Dutch company. If the Caribbean Netherlands company's interest is 10% or more, Dutch WHT can be reduced to 0%. Aruban dividend tax will be reduced from the statutory rate of 10% to 5%. In the Caribbean Netherlands, the dividends will not be taxed when they are received. However, at the time the dividends are distributed to the shareholder, they will be subject to the 5% revenue tax.

The TAN came into force on January 1, 2011. The TAK is to be revised.

## *Tax administration*

### *Returns*
Revenue tax must be paid at the end of the quarter of the year in which the distribution has been made.

The real estate tax is levied by way of a tax assessment.

### *Payment of tax*
Revenue tax must be paid at the time of filing and in a lump sum on the basis of the self-assessment.

The real estate tax must be paid within two months of the date of the tax assessment.

### *Statute of limitations*
A reassessment can be imposed until five years after the tax year.

# Cayman Islands

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## Significant developments

There have been no recent significant developments in Cayman Islands corporate taxation.

## Taxes on corporate income

Corporate income, capital gains, payroll, or other direct taxes are not imposed on corporations in the Cayman Islands.

## Corporate residence

Since no corporate income, capital gains, payroll, or other direct taxes are currently imposed on corporations in the Cayman Islands, corporate residency is not relevant in the context of Cayman Islands taxation.

Entities engaged in 'scheduled' trade and business in the Cayman Islands (as defined in the Trade & Business Licensing Law) are required to have a trade and business license. Effecting and concluding contracts in the Cayman Islands and exercising, in the Cayman Islands, powers necessary for the carrying on of a business outside the Cayman Islands is generally not considered to be engaging in trade and business in the Cayman Islands.

## Other taxes

### Value-added tax (VAT)
There is no VAT imposed in the Cayman Islands.

### Stamp taxes
Stamp duty is paid, at various rates, on transfers of land/property and execution of certain documents.

### Import duties
Import duty is paid, at various rates, on importation of most goods.

## Branch income

Branches are treated the same as other corporations doing business in the Cayman Islands.



## Income determination

Since no corporate income, capital gains, or other taxes are imposed on corporations in the Cayman Islands, income determination is not relevant in the context of Cayman Islands taxation.

## Deductions

Since no corporate income, capital gains, or other taxes are imposed on corporations in the Cayman Islands, deductions from income are not relevant in the context of Cayman Islands taxation.

## Group taxation

Since no corporate income, capital gains, or other taxes are imposed on corporations in the Cayman Islands, group taxation is not relevant in the context of Cayman Islands taxation.

## Tax credits and incentives

Since no corporate income, capital gains, or other taxes are imposed on corporations in the Cayman Islands, tax incentives are not relevant in the context of Cayman Islands taxation. However, Cayman entities carrying on business outside the Cayman Islands can register as 'exempted companies' (i.e. a company formed primarily to do business outside of the Cayman Islands and subject to certain requirements) and can apply under the Tax Concessions Law for an undertaking to be issued by the Governor-in-Council (i.e. the Cayman Islands government) exempting such company from any tax on profits, income, gains, or appreciation which might be introduced in the period of 20 years following the grant of such concessions. The concession is extendable for a further ten years after expiry. 'Exempted limited liability partnerships' (i.e. certain partnerships formed primarily to do business outside of the Cayman Islands) can apply under the Exempted Limited Partnership Law for a similar concession which is for 50 years (rather than 20 years).

## Withholding taxes

Currently, no withholding taxes are imposed on dividends or payments of principal or interest.

## Tax administration

No tax returns, forms, or procedures are required to be completed for tax compliance purposes in the Cayman Islands.

# Cayman Islands

While there are no tax treaties, there are tax information exchange agreements between the Cayman Islands and a number of countries. Please refer to the Cayman Islands Tax Information Authority's website (http://www.tia.gov.ky/html/assistance.htm) for the latest list.

The Cayman Islands agreed with the United Kingdom government to implement the Savings Directive, and so the Reporting of Savings Income Information (European Union) Law (2007 Revision) came into force, setting out a reporting regime whereby Cayman paying agents making interest payments to individuals who are tax resident in a European Union member state may have to report interest paid. The Cayman Tax Information Authority receives or facilitates submission of such information reporting.

# Chad

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## Significant developments

There have been no significant corporate tax developments in Chad during the past year.

## Taxes on corporate income

The profits subject to the company tax are determined with sole regard to profits earned by businesses carried out or transactions conducted in Chad.

The net taxable profits are established after deduction of all charges directly entailed by the exercise of activities subject to assessment in Chad. As income from other countries is not liable to tax, foreign charges and losses are not deductible either.

The corporate tax rate in Chad is 40%.

The minimum tax is 1.5% based on the turnover in excess of XAF 1 million.

## Corporate residence

Registered entities (i.e. companies, branches, and subsidiaries) conducting economic activities in Chad are liable to pay corporate tax.

## Other taxes

### Capital gains and dividends tax

Capital gains and dividends are taxed at 20%.

### Valued-added tax (VAT)

An operation performed in Chad which constitutes an economic activity and for which payment is made, unless included in the list of exemptions in the law governing VAT, is liable for VAT even if the residence of the natural person or the registered office of the legal entity is located outside Chad.

The standard VAT in Chad is 18%.

The VAT law provides a list of transactions exempt from VAT which includes the following:

- Sales of products that are directly made by farmers, cattle farmers, or fishermen to consumers, farming, and fishing operations.
- Imports, operations, and sales of newspapers and periodicals, other than the advertising revenues.
- Exports and related international transportation.

There are no specific rules relating to refunds to non-residents.

There are no refunds of the excess in practice. If the amount paid exceeds the VAT payable, the credit can be offset against the VAT payable until the end of the second financial year following the birth of this credit. After that, it becomes a loss, which is deductible under corporate tax.

### *Real property tax*

The real property tax differs according whether it is build or an unbuild property and whether it is located in N'Djamena or elsewhere.

The tax rate on build property is 12% in N'Djamena and 11% elsewhere.

The tax rate on unbuild property is 21% in N'Djamena and 20% elsewhere.

The calculation base is the potential revenues of that property. The potential revenues correspond to 4/5 of the rental value, the rental value being 10% of the market value. For rural unbuild property, the market value is fixed to 50,000 CFA francs (XAF) per hectare.

### *Accommodation tax*

The person occupying a building (owner or renter) has to pay the following amount as accommodation tax:

| | N'Djamena | Elsewhere |
|---|---|---|
| For construction in local material | 3,000 | 1,500 |
| For solid constructions | 10,000 | 5,000 |
| For R+ solid constructions and each supplementary level | 10,000 | 5,000 |

### *Transfer tax*

Fixed or proportional transfer duties must be paid on the transfer of ownership of estates, personal property, and real property. Transfer duties are also due on contributions to companies and divisions of property.

### *Customs duties*

The tax base of customs duties corresponds with the customs valuation, namely the selling price of the goods plus cost of delivery to Chad (costs of insurance, transportation, etc.).

The rates of customs duties depend on the nature of the goods and range from 5% to 30%. These rates can be summarised as follows:

- Goods of first need (basic necessities): 5%.
- Raw materials and goods of equipment: 10%.
- Intermediate and miscellaneous goods: 20%.
- Consumer goods: 30%.

### *Excise duty*
Excise duty applies to goods of great consumption: cigarettes, drinks (water, beers and wines), cosmetics, and luxury products. Excise duty rates depend on the nature of the goods and range from 5% to 25% of the value of the good.

This value differs depending on the origin of the good. If the good has been manufactured in the Economic and Monetary Community of Central Africa (CEMAC) zone, the value corresponds with the selling price charged by the manufacturer. If the good is imported into the CEMAC zone, the value is the sum of the freight value plus insurance costs and custom duties.

The rates are as follows:

- Water: 5%.
- Beer under 6.5% alcohol: 15%.
- Tobacco, perfume, jewellery, electronic devices (except computers and telephones etc.), private vehicle with an engine capacity above 1600 $cm^3$, weapons: 20%.
- Other alcoholic drinks: 25%.

### *Stamp duties*
Stamp duties must be paid on each civil or judicial document intended to be used as evidence. Stamp duty is generally XAF 1,000 per page.

### *Registration duty*
The registration duty applies to certain deeds listed by the general tax code. The assessment basis depends on the nature of transactions, and the rate varies from 1% to 15%.

### *Business licence tax*
Any natural person or corporate body carrying on a trade, industry, or profession in Chad shall be liable to a business licence tax. The business licence tax is paid annually and is assessed as follows:

- A determined duty based on 0.1% of the first XAF 2 billion of turnover; above that, only 1/10 of the turnover is taxed.
- 10% of the rental value of the premises.
- 10% of the determined duty for the Social Security Fund.
- 7% of the determined duty for the consular commercial chamber.
- XAF 480 per year for the rural intervention fund.

### *Social security contributions*
The monthly contribution to Chad’s Social Security Fund is 16.5% of total salaries for the employer (upper limit: XAF 82,500 per month) and of 3.5% for the employee (upper limit: XAF 17,500 per month), withheld by the employer.

### *Payroll tax*
Employers in Chad are required to make monthly contributions of 7.5% of the total amount of salaries and fringe benefits paid to permanent employees.

### *Apprenticeship tax*
Employers in Chad are required to make monthly contributions of 1.2% of the total amount of salaries and fringe benefits of their employees (permanent and temporary) to the National Professional Training Fund (FONAP).

## Branch income

In Chad, there is a presumption of distribution of profits realized by branches. These profits are deemed distributed to their headquarters and are therefore subject to tax on income from capital gains at the rate of 20%.

However, this presumption of distribution is simple. Branches can provide evidence that the profits they have made have not actually been transferred but remained in the accounts of the branch.

## Income determination

Subject to international conventions, taxable income is the revenue made by enterprises after deduction of the expenses incurred for the operation of the business.

Taxable income is the net income, determined after considering all operations performed by the enterprise. It includes gains made through the disposal of assets.

### Inventory valuation

Stocks shall be valued at cost price; however, if the market price is lower than the cost price, the undertaking shall make provisions for depreciation of inventory.

### Capital gains

Capital gains are taxed at 20%.

### Dividend income

Dividends are taxed at 20%.

### Foreign income

Income from other countries is not liable to tax in Chad.

## Deductions

Expenses are deductible under the following conditions:

- They must lead to a reduction of the assets.
- They must be incurred in the interest of the enterprise.
- They must be regularly included in the accounts of the entity and justified by receipts.
- They must be related to the present fiscal year or a former fiscal year.
- They must not be considered as non-deductible by the law.

### Depreciation

According to accountancy principles, depreciation is calculated based on the probable length of use of the asset. The straight-line system of depreciation is applicable, and rates vary according to the nature of the business activity concerned and the normal useful life of the assets involved.

From an accountancy point of view, it is possible to depreciate whatever amount seems corresponding to the above mentioned principles. However, from a tax point of view, depreciation (i.e. enabling a deduction of the depreciated amount from the taxable income) is only possible under one condition and within certain limits.

Deduction of depreciation is only possible under the condition that the depreciation has been entered into the statement of accounts. Therefore, only a legal entity in Chad owning the assets is able to depreciate its assets.

In addition, a 1997 order sets a yearly limit of depreciation. As a consequence, if depreciation in the statement of accounts is higher than the depreciation authorized, the difference is not deductible and has to be reinstated in the taxable income.



The starting point for depreciation is the day of first use. If this date is not the first day of the financial year, the first year's depreciation is reduced pro-rata.

It should be noted that, despite the above, goods that are leased are depreciated at the rate that they are paid for.

Depreciation of goods that are made available for free to managers and supervisors of the business are deductible if the corresponding benefit in kind is declared.

The sum of depreciation applied to the acquisition or creation of an asset cannot, at the end of each financial year, be less than the amount of depreciation calculated on the linear system and spread out over the normal usage period.

Depreciation in loss-making years may be carried forward to the first profitable financial year, and to subsequent years if necessary.

Chadian tax legislation has established a list of maximum rates of depreciation allowance applicable to certain assets:

| Assets | Rate per year (%) |
|---|---|
| Construction | |
| Commercial and industrial buildings, garages, workshops, sheds | 5 |
| Transformation cabin | 5 |
| Waterfalls and dam installations | 5 |
| Factories | 5 |
| Dwellings | 5 |
| Lime and plaster ovens | 10 |
| Electric ovens | 10 |
| Temporary buildings or buildings that can be dismantled | 20 |
| Handling material | |
| Elevator vehicles | 20 |
| Big cranes | 10 |
| Motorized cranes | 10 |
| Furniture, equipment and installations | |
| Equipment, facilities, installations | 10 |
| Office furniture | 10 |
| Office equipment | 15 |
| Hardware | 33.33 |
| Photocopy equipment | 33.33 |
| Telecommunication equipment | 33.33 |
| Hotels, cafés, restaurants | |
| Glassware, crockery, kitchen utensils | 50 |

| Assets | Rate per year (%) |
|---|---|
| Linen | 33.33 |
| Silverware | 20 |
| Decorative fitting-out | 20 |
| Carpets, curtains, stained items | 20 |
| Refrigerators, air conditioners | 25 |
| Stoves | 20 |
| Plastic equipment | |
| Moulds | 33.33 |
| Heater or sterilizers | 20 |
| Lozenge production machine | 20 |
| Injection presses | 20 |
| Vacuum machines | 20 |
| Metalizing machines | 20 |
| Soldering or welding and cutting machines | 20 |
| Compression press | 10 |
| Gel producing machines, coil production machine | 20 |
| Transfer presses | 10 |
| Equipment subject to chemicals' action | |
| Leaching machines, diffusers | 20 |
| Recycling devices | 20 |
| Cooking devices | 20 |
| Fixed devices and equipment | |
| Vapour boiler | 10 |
| Cement vat | 5 |
| Electric power line in permanent material | 15 |
| Paper and cotton machine | 10 |
| Oil refining equipment | 10 |
| Hydraulic presses | 10 |
| Compression presses | 10 |
| Heavy oil engines | 10 |
| Oil tanks | 10 |
| Heavy high power transformers | 10 |
| Vapour Turbine and machines | 10 |
| Electric power line in provisional material | 20 |
| Transmission and commutation equipment | 10 |
| Network equipment | 10 |
| Movable equipment | |
| Pétrins mécanique (mechanical), mixer | 15 |
| Excavators | 15 |
| Tuns and tanks of brewery, distillation or verification | 10 |
| Wood cutting devices | 20 |
| Purification and drawing devices | 10 |
| Lamination and spin drying devices | 10 |
| Light machine tools, lathes, mortising machines, planning machines, drills | 20 |
| Factory material including machine tools | 20 |

| Assets | Rate per year (%) |
|---|---|
| Pneumatic drills | 20 |
| Hand tools so called small tools | 100 |
| Transport material | |
| Carts | 25 |
| Naval and air equipment | 20 |
| Transport barrels (beer, wine) | 20 |
| Containers | 20 |
| Motor vehicles | |
| Light motor vehicles used in town | 25 |
| Light rented or driving school motor vehicles | 33.33 |
| Heavy motor vehicles used in the bush | 33.33 |
| Tractors | 20 |
| Tractors used by foresters | 33.33 |



### *Interest expense*
Interests paid for the depositing of funds by a shareholder are deductible within the base rate of the Central Bank plus two points, calculated on the basis of the share capital.

### *Charitable contributions*
Donations and liberalities are deductible within a 0.5% limit of the annual turnover, net of tax, when they are duly justified. However, a decision from the Minister of Finances is required.

### *Non-deductible expenses*
The following expenses are not deductible:

- Provisions for laying off employees.
- Provisions for self insurance.
- Income taxes.
- Tax and customs penalties.
- Insurance premiums paid for a third-party.

### *Other expenses not entirely deductible*
The following expenses are not fully deductible:

- Foreign social security contributions are deductible only within 15% of the base salary of the expatriates when related to a compulsory retirement plan. Nonetheless, Chad's social security contributions are fully deductible.
- Restaurants, hotels, receptions, and related costs are deductible within a 0.5% limit of the turnover, net of tax.
- Travel expenses for expatriates and their families for vacation are deductible, limited to one trip per year.

### *Net operating losses*
Losses arising from the normal business activities of the company are deductible and may be carried forward for up to three years.

Carryback of losses is not permitted.

### Payments to foreign affiliates

There is a specific regulation relating to head office and foreign technical assistance costs that are subject to a 10% limitation of deductibility.

The scope of the 10% limitation covers study expenses, technical assistance, and other expenses, including commercial and industrial royalties, paid to the head office of an enterprise established outside Chad and outside the CEMAC zone.

Duly justified, these costs are only deductible within 10% of the intermediary fiscal profit (accounting profits plus non-allowable charges/costs) prior to their deduction.

## Group taxation

There is specific taxation of groups within the CEMAC area.

Where a joint stock company and a private limited company own either registered stock in a joint stock company or shares in a private limited company, the net proceeds of the share in the second company paid to the first during the financial year shall be deducted from the total net profit of the latter, less a percentage for costs and charges. This percentage is fixed at 10% of the total amount of the proceeds. This system shall apply when all of the following conditions are met:

- The stocks or shares owned by the parent establishment represent at least 25% of the capital of the subsidiary firm.
- The parent and subsidiary firms have their registered office in a CEMAC state (Cameroon, Central African Republic, Chad, Gabon, Equatorial Guinea, and Republic of Congo).
- The stocks or shares allotted at the time of issue are still registered in the name of the participating company which undertakes to retain them for at least two consecutive years in registered form.

### Transfer pricing regime

The Tax Code acknowledges that dependant or controlled companies may transfer benefits indirectly to their company abroad it is dependant of or to the company abroad it is controlled by.

In order to calculate the real benefit, the indirectly transferred benefits (by means of increase of purchase price or decrease of sales price to the controlling company or by any other means) are incorporated into the result established by the accounts.

If the tax administration does not have enough precise elements to determine the benefit, it will establish the taxable benefit by way of comparison to companies normally operated in Chad.

The Tax Code provides further, in accordance with CEMAC regulation, that interest paid to shareholders on sums which they lend over and above their share capital is deductible at the rate for loans allowed by the central bank increased by two percentage points. This deduction is only possible if the amounts lent do not exceed 50 % of the share capital.

### Thin capitalisation rules

Chad applies Organisation for the Harmonization of Business Law in Africa (OHADA) regulations with regards to thin capitalisation rules.

In cases where the equity capital gets, due to the recorded losses in the summarising financial statement, below 50% of the share capital, a shareholder consultation has to be organised within four months to decide upon a potential anticipated dissolution of the company.



If the dissolution is excluded, the company has to reconstitute its equity capital up until it equals 50% of the share capital within the two years following the date of the end of the loss-making financial year.

Otherwise, provided it stays above the legally required share capital minimum, the company has to reduce its share capital of an amount at least equal to the losses that it has not been able to charge against reserves.

In cases where no decision has been taken regarding dissolution, any interested person may claim dissolution of the company in front of a court. Any interested person is allowed to bring a legal action if the reconstitution of the equity capital has not taken place within the legal timeline.

This action ceases to exist the day the cause for dissolution ceases to exist or if the court has ruled on the grounds.

## *Tax credits and incentives*

Chad does not offer any tax incentives.

## *Withholding taxes*

### *Withholding tax (WHT) on commerce of retail goods*

A 4% WHT rate applies to natural persons and legal entities that purchase or sell wholesale or retail goods. This WHT also applies to imports.

According to the 2004 Finance Act, companies with more than one shareholder that regularly pay their taxes may apply for a suspension of payment of WHT (renewable every three months).

### *WHT on capital gains*

WHT on capital gains is 20% and applies to residents and non-residents.

### *WHT on income of non-residents*

WHT on income of non-residents is 25%. It applies to income of any legal or natural person which is not resident in Chad.

### *WHT on personal income*

WHT on personal income is withheld by the employer every month.

WHT on income from public procurement contracts financed from outside of the country and income from petroleum projects.

Chad's lowest WHT rate on income is of 12.5%. It applies in either of the following two cases:

- On income of agents, consultancy firms, and corporations executing a contract within the framework of public procurement contracts financed from outside of the country.
- On income of companies working within the petroleum projects.

### *WHT on interests of bonds, certificates, and notes*
Bonds and notes are subject to a WHT of 20% of the interests for registered bonds and 30% of the interests for bearer participation certificates.

### *WHT on rent*
WHT on rent is 15% for residents and 20% for non-residents.

### *Tax treaties*
Chad has one tax treaty with the member states of CEMAC (Cameroon, Gabon, Equatorial Guinea, Congo, Chad, and Central African Republic).

## *Tax administration*

### *Returns*
Corporate tax returns are due on 15 April.

### *Payment of tax*
Certain taxes are considered instalment payments of corporate tax. Once the amount of corporate tax is known, these payments are deductible from the amount and only the balance has to be paid. These taxes include the minimum corporate tax, the quarterly instalment payments, and the 4% discharge for retail goods, if applicable.

#### Minimum corporate tax (monthly)
The minimum corporate tax payment must be made prior to the 15th day of the month following the month of achievement of the turnover.

If this instalment payment exceeds the annual corporate tax, the remainder is lost.

#### One third instalment payments (paid three times quarterly)
Corporations which fulfil the following conditions are subject to quarterly instalment payments:

- Liable to corporate tax.
- Made a profit during the prior fiscal year.
- The amount of the corporate tax of the prior fiscal year is superior to at least XAF 100,000.

The quarterly instalment payments are equal to one-third of the difference between the corporate tax due during the prior fiscal year and the minimum income tax paid during the same period.

The payment must take place before the 10th day of April, July, and October.

# Chile



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## Significant developments

Pursuant to Law No. 20,455, published on 31 July 2010, several amendments to legal provisions were enacted for purposes of financing the plan for reconstruction of the country after the earthquake.

Law No. 20,455 provides a temporary increase in the First Category tax (i.e. corporate income tax) from current 17% to 20% for income received or accrued during calendar year 2011. The rate will be 18.5% for income received or accrued during calendar year 2012. Finally, income received or accrued during calendar year 2013 and subsequent years will again be subject to a 17% tax. The monthly income tax prepayments must be adjusted accordingly.

Law No. 20,455 also established that the transitory reduced stamp tax rate introduced under Law No. 20,326 is now a permanent amendment to the stamp tax law. As of 1 July 2010, stamp tax rates are now half of the prior rates (e.g. 0.6% maximum tax rate instead of the prior 1.2%).

## Taxes on corporate income

### First Category tax

The basic tax on income of a Chilean legal entity domiciled or resident in Chile and engaged in commerce, mining, fishing, or industry is the First Category tax, which is assessed at a rate of 20% on the entity's worldwide income during calendar year 2011. Prior to 2011, the rate was 17%. The rate will be 18.5% for income received or accrued during calendar year 2012. Income received or accrued during calendar year 2013 and subsequent years will again be subject to a 17% tax.

Non-domiciled and non-resident shareholders and partners are subject to an 'additional' withholding tax (WHT) of 35% on their Chilean-source distributions or remittances, with a credit granted for the First Category tax paid on the underlying profits. This results in an effective tax rate of 35%.

## Corporate residence

Companies incorporated in Chile are considered to be domiciled in the country.

## Other taxes

### Value-added tax (VAT)

VAT is payable on transfers and services at a rate of 19%. In general terms, this tax is levied over the price of the following goods and services:

- Sales and other contracts used to transfer ownership of tangible goods, or real estate owned by a construction company, provided that said operations are customary. The law assumes that all sales made within the ordinary course of business are customary.
- Services that are commercial, industrial, or financial, or that are connected to mining, construction, insurance, advertising, data processing, and other commercial operations.
- Imports, customary or not.

Normally, the sale of fixed assets is not subject to VAT, unless the assets are sold before the end of their useful lives or within four years from the date of acquisition. The sale of immovable property as fixed assets is subject to VAT only when the sale takes place within 12 months from the date of acquisition.

VAT works on a credit-debit system. The tax borne by a company or business in the acquisition of goods or services is called the 'VAT credit'. The VAT charged on the goods and services sold to customers is called the 'VAT Debit'. As a general rule, the seller or service provider is obliged to withhold and pay the VAT. The tax amount is added to the invoice for goods or services, as the final consumer is the economic taxpayer.

Exceptionally, when a seller or service provider is not domiciled in Chile or when, for other reasons, it is difficult for the Chilean Internal Revenue Service (IRS) to supervise the correct payment of VAT, the responsibility to withhold and pay the tax is transferred to the buyer or beneficiary of the service.

The tax is paid every month by deducting the VAT credit from the VAT debit. The balance due to tax authorities (when the debit is larger than the credit) must be paid no later than the 12th of the following month.

If on a given month the VAT credit is larger than the VAT debit, the balance may be kept and carried forward in the following months.

### Customs duties

The rate of custom duty is, in general, 6%.

Chile has an extended network of Free Trade Agreements (e.g. with China, United States, Mexico, Japan, European Union, Canada, Panama, Central America, and South Korea). Therefore, reduced or non-existing customs duties rates are available.

Duties on goods are imposed on the cost, insurance, and freight (CIF) price, without deducting special discounts.

In general, Chile has a very open economy and there are no significant barriers to foreign trade.

### Excise taxes

Alcoholic and non-alcoholic beverages and certain luxury items, such as jewels, are subject to additional sales taxes ranging from 13% to 50%.

A variable gasoline tax is also levied on the difference between a fixed amount and the sales price of gasoline and diesel oil.

### *Real estate tax*

Real Estate Tax is levied over an official valuation of real estate at an annual rate of 1.2% in case of non-farming real estate, and 1% for farming real estate. Some real estate is exempt from this tax.



Law No. 20,455, for purposes of financing the plan for reconstruction of the country after the earthquake, provides a temporary increase in the Real State Tax rate of 0.275% per year for non-farming real state with an official valuation equal or superior to 96,000,000 Chilean pesos (CLP) (approximately USD 205,000) during 2011 and 2012.

### *Stamp tax*

Stamp tax is payable mainly on documents that evidence money lending operations, and its rate varies depending on the document being executed.

Pursuant to Law No. 20.455, a transitory reduced stamp tax rate introduced under Law No. 20,326 is now a permanent amendment to the stamp tax law. As of 1 July 2010, stamp tax rates are now half of the prior rates (e.g. 0.6% maximum tax rate instead of the prior 1.2%).

This permanent amendment entered into force retroactively to 1 July 2010 (the Law was published in 31 July 2010). Hence, every transaction that took place between 1 July 2010 and 31 July 2010 is subject to the tax refund procedure set forth in Revenue Ruling No. 39/2010 issued by the Chilean IRS.

## *Branch income*

Branches of foreign corporations that are operating in Chile are taxed on their Chilean-source income. Branches are subject to the First Category tax, which is assessed at a rate of 20%.

Branches are also subject to a 35% ‘additional’ tax on amounts remitted or withdrawn during a given calendar year, less a credit for the First Category tax paid, which is payable in April of the year following the distribution. Thus, the tax burden for a branch is 35%.

## *Income determination*

For purposes of the First Category tax, as a general rule, corporate revenue must be determined on an accrual basis.

### *Inventory valuation*

Inventories must be valued in accordance with monetary correction provisions, basically by adjusting raw material content and direct labour to replacement cost (which is generally the most recent cost), but excluding indirect costs. No conformity is required between book and tax reporting for income determination. Last in first out (LIFO) is not allowed.

### Capital gains

Capital gains are subject to normal taxation unless special provisions, such as those pertaining to gains on the sale of shares or monetary correction on capital repayments, establish exemptions.

Under domestic laws, in certain circumstances, the capital gains derived from the following securities will be subject to a preferential tax treatment:

- Stock of listed local companies.
- Investment fund quotas, listed on an authorized stock exchange.
- Mutual funds quotas, if the fund invests in stock trade values.
- Investment funds quotas with no stock exchange participation or mutual funds, where at least a 90% of the investment portfolio is in a stock market.

### Dividend income

Dividends received from Chilean corporations are exempt from the First Category tax.

### Stock dividends

Stock dividends are not taxed.

### Foreign income

Resident corporations are subject to taxes on their worldwide income. In general, foreign income and dividends received by a domestic corporation are subject to Chilean taxation in the financial year when received (i.e. on a cash basis). A tax credit for taxes paid abroad is granted, subject to the regulations of the Income Tax Law.

Branches of foreign corporations are taxed on their income without regard to the results of the head office.

## Deductions

Net taxable income of a taxpayer is arrived at by deducting from gross income the expenses incurred to generate the income that have not been already deducted from gross revenue as costs.

As a general rule, expenses are not deductible for income tax purpose if they are not incurred to generate taxable income.

### Depreciation and depletion

Depreciation rates are calculated based on the estimated useful life of the assets. The normal periods of depreciation for new assets under normal conditions are as follows: heavy machinery, 15 years; trucks, seven years; factory buildings, in general, 20 years to 40 years. At the request of the Foreign Investment Committee or the taxpayer, the IRS may reduce the normal useful life.

Annual depreciation is taken by the straight-line method. However, taxpayers may recover capitalised costs by using the accelerated depreciation method for up to one third of the normal useful life with respect to new or imported fixed assets, provided that the normal period of depreciation is at least three years.

Accelerated depreciation may be used only to reduce the taxable basis of the First Category tax. For the purpose of the tax applicable to distributions of dividends, accelerated depreciation is not considered.

No conformity is required between book and tax depreciation.

For tax purposes, depletion for natural mineral resources is allowed on a unit-of-production basis.



### *Bad Debts*
In general, bad debts are deductible only if they are a consequence of operations related to the business purpose, if they have been opportunely written off into accounting, and the company has prudentially exhausted all reasonable means to collect them.

Determination of whether the company has prudentially exhausted all reasonable means to collect the bad debts varies according to the total amount of the debts. Therefore, a simple estimation or general provision for bad debts is not allowable.

### *Charitable contributions*
Charitable contributions may be deducted provided they are made to the institutions named by varied Laws (i.e. primary and secondary educational institutions; universities, professional or technical educational institutions, National Fire Brigade, National Solidarity Fund, etc.).

In case of charitable contribution, the total annual tax deduction for this purpose is limited. The deductible amount for this purpose may not exceed 5% of the company's net taxable income.

### *Taxes*
Taxes imposed by Chilean laws are deductible, provided they are related to the normal activities of the company. However, income taxes and special contributions for promotion or improvement are not deductible.

### *Net operating losses*
An indefinite carryforward of losses is allowed. Consistent with monetary correction, losses are carried forward, adjusted by a cost-of-living increase. No carrybacks are allowed, except in a case where a taxpayer has retained tax profits and has a subsequent tax loss.

### *Payments to foreign affiliates*
The deductibility of payments made abroad for the use of trademarks, patents, formulas, and consulting and similar services is limited to a maximum of 4% of the income derived from sales and services in the corresponding year, unless the royalty is subject to income tax of greater than 30% in the country of the beneficiary.

Transfer pricing regulations are in line with general Organisation for Economic Co-operation and Development (OECD) principles.

## *Group taxation*

Consolidated returns are not allowed in Chile.

### *Transfer pricing*
Special provisions of the Income Tax Law regulate the prices charged between related companies located in Chile and companies located in other jurisdictions.

The rules contained in the Income Tax Law on transfer pricing matters apply to both operations between a branch and its head office, and operations between a foreign company and a Chilean company in which the former participates (directly or indirectly) in the conduction, control, or capital.

These rules allow the IRS to challenge the prices paid by the Chilean company branch to its head office or to a foreign related company when the prices agreed are not adjusted to those applicable in operations between unrelated parties.

In order to contest the prices, the IRS may take into account a reasonable profit, bearing in mind the characteristics of the operation, or else the production costs plus a reasonable profit margin.

The same rules will apply with regard to prices paid or owed for goods or services provided by the head office, or by any of its branches or related companies, when those prices are not adjusted to the normal market prices charged in operations between non-related parties.

If the branch (or the local company) only has operations with related companies, the IRS will be allowed to challenge those prices taking into consideration the values of the respective goods or services in the international market.

Although domestic legislation regulating transfer pricing aspects of related-party transactions is broad and general, the fact that Chile became an OECD member in 2010 has been of great relevance from a tax perspective in the Chilean local market. The IRS has made public its intention to ensure its assessment policies and general practices are adequate and consistent with international OECD approaches to corporate restructuring, general tax planning, and in particular transfer pricing.

To date, new transfer pricing legislation has not been approved in Chile. However, based on public communications made by key tax officials in the local media, a new tax bill is due to be tabled before the parliament, and it is expected that this bill will introduce the main principles and pricing methodologies established by the OECD Guidelines.

### *Thin capitalisation*

Thin capitalisation rules apply in case of related party loans at a 3-to-1 debt to equity ratio. In this regard, the total annual amount of such loans is deemed to exceed the 3-to-1 ratio if the monthly average value of the sum of all related party loans and financial liabilities that the debtor has at the end of the taxable year in which the loan was granted exceeds three times the debtor´s adjusted tax equity.

## *Tax credits and incentives*

### *Investment incentives*

The principal investment incentives are the following:

- Tax benefits and other incentives for companies operating in the northernmost and southernmost parts of the country.
- Tax benefits to forestry companies, contracts for oil operation, and nuclear material operations.

### *Inbound investment incentives*

The principal incentives to encourage foreign capital contributions are statutory guarantees covering the repatriation of capital, remittance of profits, non-discrimination toward foreign investment, and access to the foreign exchange market for remittance purposes. In general, foreign investors are subject to the same legislation as national investors. A guaranteed income tax rate of 42% may be granted for ten years or, provided the capital investment project exceeds USD 50 million, 20 years for the development of industrial or extractive projects.

The overall rate is comprised of the corporate tax on profits and WHT on dividend or branch profit distributions. The tax rate on dividend or profit distributions is the difference between 42% and the underlying tax paid at a corporate level. The option to be subject to an overall effective tax rate of 42% without change for ten or 20 years is usually not exercised by foreign investors, because the current combined effective tax rate on profits and dividend distribution is 35% under the general tax regime.

Under the Foreign Investment Contract, a foreign investor may petition for tax stability with respect to VAT and customs duty regimes. With respect to customs duties, however, stability is granted only for the importation of certain machinery and equipment not available in Chile.

### *Export incentives*

The principal incentives for exports can be summarised as follows:

- Taxes paid in the importation or acquisitions of goods required in the export activity are reimbursed.
- VAT on exports is zero-rated.
- Chile has signed free-trade agreements with Australia, Bolivia, Canada, Central America (i.e. Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua), China, Colombia, the European Union (EU), Mexico, Panama, Peru, Republic of South Korea, Turkey, and the United States. All these agreements provide for reduced customs duties.

### *Foreign tax credit*

In order to avoid double taxation, the Chilean Tax Law recognizes a tax credit mechanism in which the tax effectively paid abroad may be deducted from the taxes to be paid in Chile.

In order to regulate this matter, the Chilean Tax Law distinguishes between those countries with which there is a double taxation treaty (DTT) in force with Chile and those that do not have a DTT in force with Chile.

## *Withholding taxes*

Dividends paid to a non-resident recipient are subject to a 35% withholding of ‘additional’ tax, with a credit available that is equivalent to the income tax effectively paid at the corporate level, corresponding with the First Category tax paid by the corporation. This credit is added to the amount that is distributed to form the taxable base for the ‘additional’ tax. Consequently, the tax burden for a non-resident recipient of dividends, including taxes at the company level, is 35%.

Branches are subject to a 35% ‘additional’ tax on amounts remitted or withdrawn, less the First Category tax credit. *See the Branch income section for more information.*

In the case of a foreign investor that has applied for the 42% tax invariability, the effective tax burden is also 42%.

Interest paid to non-residents is subject to additional WHT at a general 35% rate. Interest on loans granted by foreign banking or financial institutions is subject to a sole 4% additional WHT. Thin capitalisation rules requesting a 3:1 debt: equity ratio become applicable when the debt generating interest subject to the 4% rate is secured by related entities.

Royalties paid to non-residents are subject to additional WHT at a 30% rate. Royalty payments in connection to software are subject to additional WHT at a 15% rate. Such rate is increased in case the beneficiary of the payment is resident in a tax haven or in case the payment is made to a related entity.

### *Tax treaties*

Chile has in force double taxation treaties with the following countries: Argentina, Belgium, Brazil, Canada, Colombia, Croatia, Denmark, Ecuador, France, Ireland, Malaysia, Mexico, New Zealand, Norway, Paraguay, Peru, Poland, Portugal, Republic of South Korea, Spain, Sweden, Switzerland, Thailand, and the United Kingdom.

Please note that Chile has signed double taxation treaties with Russia, Australia, and the United States which are not yet in force.

The following table shows the higher and lower rates on WHT applicable by Chile and the countries with which DTTs exist. The application of one or the other rate will depend on the specific provisions of each treaty.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Belgium | 15 | 5/15 | 5/10 |
| Brazil | 10/15 | 15 | 15 |
| Canada | 5/15 | 10/15 | 10 |
| Colombia | 0/7 | 5/15 | 10 |
| Croatia | 5/15 | 5/15 | 5/10 |
| Denmark | 5/15 | 5/15 | 5/10 |
| Ecuador | 5/15 | 5/15 | 10 |
| France | 15 | 5/15 | 5/10 |
| Ireland | 5/15 | 5/15 | 5/10 |
| Malaysia | 5/15 | 15 | 10 |
| Mexico | 5/10 | 5/10/15 | 10 |
| New Zealand | 15 | 10/15 | 10 |
| Norway | 5/15 | 5/15 | 5/10 |
| Paraguay | 10 | 10/15 | 15 |
| Peru | 10/15 | 15 | 15 |
| Poland | 5/15 | 5/15 | 5/10 |
| Portugal | 10/15 | 5/10/15 | 5/10 |
| South Korea | 5/10 | 5/15 | 5/10 |
| Spain | 5/10 | 5/15 | 5/10 |
| Switzerland | 15 | 5/15 | 5/10 |
| Sweden | 5/10 | 5/15 | 5/10 |
| Thailand | 10 | 10/15 | 10/15 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| United Kingdom | 5/15 | 5/15 | 5/10 |



## Tax administration

### Returns

The tax year coincides with the calendar year. The tax system is one of self-assessment by the taxpayer, with occasional auditing by the tax authorities. Tax returns must be filed with the IRS before 30 April of each year with respect to the income of the previous calendar year.

Note that there are many other sworn statements with different deadlines, from March until June of each year.

### Payment of tax

Taxes are payable when the annual tax return is submitted in April of each year. Taxpayers, in general, are subject to monthly advance payments on account of their yearly income taxes. The difference between the advance payments and the final tax bill is payable in cash at the time the tax return is filed. If prepayments exceed the final tax bill, the excess is reimbursed by the Treasury.

# China, People's Republic of

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## Significant developments

### China/Singapore tax treaty

On 26 July 2010, the State Administration of Taxation (SAT) issued a Departmental Interpretation Notes (DIN) for the tax treaty concluded between China and Singapore. It is the first time the SAT introduced a set of technical views, interpretation, and practice guidelines for the implementation of a tax treaty in such a comprehensive manner. More importantly, this set of interpretation is also applicable to other tax treaties concluded by China if the provisions of the relevant articles in those tax treaties are the same as those in the China/Singapore tax treaty. Thus, it is likely to have a wide impact to tax residents of other countries/regions which have entered into tax treaties with China.

### Urban construction and maintenance tax and educational surcharge

Urban construction and maintenance tax and educational surcharge are two types of surcharges imposed at a certain rate on the amount of China's indirect taxes (i.e. business tax, value-added tax, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of the above mentioned indirect taxes are also the taxpayers of urban construction and maintenance tax and educational surcharge. Foreign investment enterprises and foreign enterprises were temporarily exempted from these two surcharges before. On 18 October 2010, the State Council released a circular to resume the collection of these two surcharges from foreign investment enterprises and foreign enterprises effective from 1 December 2010.

### Local educational surcharge

Local educational surcharge is another type of surcharge that is levied at 2% on the same tax basis as that for urban construction and maintenance tax and educational surcharge. It was not levied in many places in China. On 7 November 2010, the Ministry of Finance released a circular requesting all the local governments to unify/resume the collection of local educational surcharge. However, as the circular does not specify the effective date, the current local practice varies.

## Taxes on corporate income

Tax resident enterprises (TRE) are subject to corporate income tax on their worldwide income. A non-TRE that has no establishment or place in China is taxed only on its China-source income. A non-TRE with an establishment or place in China shall pay CIT on income derived by such establishment or place from sources in China as well as income derived from outside China which effectively is connected with such establishment or place.

Under the CIT law, the standard tax rate is 25%. There is no local or provincial income tax in China.

A lower CIT rate is available for the following sectors/industries:

- Qualified new/high tech enterprises are eligible for a reduced CIT rate of 15%. An enterprise has to fulfil a set of prescribed criteria and be subject to an assessment in order to qualify as a new/high tech enterprise.
- Integrated circuit (IC) production enterprises with a total investment exceeding CNY 8 billion, or which produce integrated circuits with a line-width of less than 0.25 micrometre, are eligible for a reduced CIT rate of 15%.
- Key software production enterprises are eligible for a reduced CIT rate of 10%. An enterprise has to fulfil a set of prescribed criteria and be subject to an assessment in order to qualify as a key software production enterprise.
- From 1 January 2009 to 31 December 2013, qualified technology-advanced service enterprises in 21 cities (e.g. Beijing, Shanghai, Tianjian, Guangzhou, and Shenzhen) are eligible for a reduced CIT rate of 15%. This incentive is only available to certain technology-advanced service sector members, and an enterprise has to fulfil a set of prescribed criteria and be subject to an assessment in order to qualify as a technology-advanced service enterprise.
- Qualified small and thin-profit enterprises are eligible for a reduced CIT rate of 20%. An enterprise has to fulfil certain conditions in order to qualify as a small and thin-profit enterprise.

## *Corporate residence*

Enterprises established in China are always TREs. A foreign enterprise with a place of effective management in China is also regarded as a TRE.

An 'establishment or place' is defined in the CIT regulations as an establishment or place in China engaging in production and business operations, including the following:

- Management organisations, business organisations, and representative offices.
- Factories, farms, and places where natural resources are exploited.
- Places where labour services are provided.
- Places where contractor projects, such as construction, installation, assembly, repair, and exploration are undertaken.
- Other establishments or places where production and business activities are undertaken.
- Business agents who regularly sign contracts, store and deliver goods, etc. on behalf of the non-TRE.

## *Other taxes*

China has a turnover tax system consisting of the following three taxes: value-added tax (VAT), business tax, and consumption tax.

### *Value-added tax (VAT)*

The sales or importation of goods and the provision of repairs, replacement, and processing services are subject to VAT. VAT is charged at a standard rate of 17%, and the rate for small-scale taxpayer is 3%. The sales of certain necessity goods may be subject to VAT at a reduced rate of 13%, as specified in the VAT regulations.

The VAT system is a consumption-based VAT system, which means that input VAT on fixed assets is fully recoverable except for situations specified in the VAT regulations.

Export of goods from China may be entitled to a refund of VAT incurred on materials purchased domestically. The refund rates range from 0% to 17%. There is a prescribed formula for determining the amount of refund, under which many products do not obtain the full refund of input VAT credit and suffer different degree of export VAT costs.

### *Business tax*

A business tax is imposed on services, transfer of intangible assets, and immovable property taking place within China. Services taking place within China refers to situations where the service provider, the service recipient, or both are in China. This may make services even being rendered outside China subject to business tax in China. Business tax rates are 3% or 5%, except for the leisure and entertainment industry, which may be subject to a rate of up to 20%. Business tax is not recoverable but is deductible for CIT purposes.

### *Consumption tax*

A consumption tax is imposed on 14 categories of goods, including cigarettes, alcoholic beverages, and certain luxury and environmental unfriendly items. The tax liability is computed based on the sales amount and/or the sales volume depending on the goods concerned. It is not recoverable but is deductible as an expense for CIT purposes.

### *Urban construction and maintenance tax*

Urban construction and maintenance tax is imposed at a certain rate on the amount of China's indirect taxes (i.e. business tax, VAT, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of indirect taxes are also the taxpayers of urban construction and maintenance tax. It is charged at three different rates depending on the taxpayer's location, 7% for urban areas, 5% for county areas, and 1% for other areas. Foreign investment enterprises and foreign enterprises were temporarily exempted from urban construction and maintenance tax until 1 December 2010.

### *Educational surcharge*

Educational surcharge is imposed at 3% on the amount of China's indirect taxes (i.e. business tax, VAT, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of indirect taxes are also the taxpayers of educational surcharge. Note that foreign investment enterprises and foreign enterprises were temporarily exempted from educational surcharge until 1 December 2010.

### *Local educational surcharge*

Local educational surcharge is levied at 2% on the amount of China's indirect taxes (i.e. business tax, VAT, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of indirect taxes are also the taxpayers of local educational surcharge. It was not levied in many places in China. On 7 November 2010, the Ministry of Finance released a circular requesting all the local governments to unify/resume the collection of local educational surcharge. However, as the circular does not specify the effective date, the current local practice varies.

### *Real estate tax*

A real estate tax, which is based on the value of the property or rental received, is assessed on land and buildings used for business purpose or leased. The tax rate is 1.2% of the original value of buildings. A tax reduction of 10% to 30% is commonly offered by local governments. Alternatively, tax may be assessed at 12% of the rental value. Real estate tax is deductible for CIT purposes.

### *Land appreciation tax*

A land appreciation tax is levied on the gain from the disposal of properties at progressive rates from 30% to 60%. Land appreciation tax is deductible for CIT purposes.

### *Customs duties*

In general, a customs duty is charged in either specific or *ad valorem* terms. For specific duty, a lump sum amount is charged based on a quantitative amount of the goods (e.g. CNY 100 per unit or per kg). For *ad valorem* duty, the customs value of the goods is multiplied by an *ad valorem* duty rate to arrive at the amount of duty payable. The applicable duty rate generally is determined based on the origin of the goods.

An exemption from customs duty applies to machinery and equipment imported by a foreign investment enterprise within the amount of its total investment, for its own use if the project falls within the encouraged category of the 'Catalogue for the Guidance of Foreign Investment Industries', and the imported machinery or equipment is not within the list of commodities that are not exempted from customs duty.

A customs duty and VAT exemption may be allowed on importation of raw materials for contract processing or import manufacturing. Goods may be imported into, and exported out of, designated Free Trade Zones and Bonded Logistics Zones without liability to customs duty or VAT.

### *Stamp tax*

All enterprises and individuals, who execute or receive 'specified documentation', including 11 types of contracts and a few specified documents, are subject to stamp tax. The stamp duty rates vary between 0.005% on loan contracts to 0.1% for property leasing and property insurance contracts. A flat amount of CNY 5 applies to certification evidencing business licences and patents, trademarks, or similar rights.

### *Motor vehicle acquisition tax*

A motor vehicle acquisition tax at a rate of 10% of the taxable consideration will be levied on any purchase and importation of cars, motorcycles, trams, trailers, carts, and certain types of trucks.

### *Deed tax*

A deed tax, generally at rates from 3% to 5%, may be levied on the purchase or sale, gift or exchange of ownership of land use rights or real properties. The transferee/assignee is the taxpayer.

### *Vehicle and vessel tax*

A vehicle and vessel tax is a tax that is levied on all vehicles and vessels registered within China. A fixed amount is levied on either a yearly or quarterly basis. Transport vehicles generally are taxed on a fixed amount according to their own weight, with passenger cars, buses, and motorcycles being taxed on a fixed unit amount. Vessels are taxed on a fixed amount, according to the deadweight tonnage.

### *Urban and township land-use tax*

An urban and township land-use tax is levied on taxpayers who utilise land within the area of city, country, township, and mining districts. It is computed annually based on the space of area actually occupied by a taxpayer multiplied by a fixed amount per square metre that is determined by the local governments.

### *Resource tax*

A resource tax may be levied, generally on a tonnage or volume basis, at rates specified by the Ministry of Finance in consultation with relevant ministries of the State Council on natural resources including crude oil, natural gas, coal, other raw non-metallic metals, raw ferrous metals, non-ferrous metallic minerals and salt (including solid and liquid salt). In lieu of a resource tax, mine area usage fees are collected from joint ventures exploiting crude oil or natural gas.

Resource tax is now undergoing reform. As a result, enterprises and individuals exploiting crude oil and natural gas in Xinjiang Autonomous Region and the western region are now subject to resource tax at 5% on sales turnover.

## *Branch income*

Under the CIT law, a branch of a non-TRE in China is taxed at the branch level. If there is more than one branch, they may elect to file their tax at the main office in China on a consolidated basis. There is no further tax upon remittance of branch profits.

## *Income determination*

Taxable income is defined as "gross income in a tax year after deduction of non-taxable income, tax exempt income, various deductions, and allowable losses brought forward from previous years". The accrual method of accounting should be used.

Gross income refers to monetary and non-monetary income derived by an enterprise from various sources, including, but not limited to, the sales of goods, provision of services, transfer of property, dividends, interest, rentals, royalties, and donations.

Non-taxable income refers to fiscal appropriation, governmental administration charges, governmental funds, and other income specified by the central government.

### *Inventory valuation*

Inventory must be valued according to costs. In computing the cost of inventories, the enterprise may choose one of the following methods: first in first out (FIFO), weighted average, or specific identification.

### *Unrealised gain or loss due to changes in fair value*

An unrealised gain or loss due to changes in the fair value of financial assets, financial liabilities, and investment properties held by an enterprise is not taxable/deductible for CIT purpose. The gain/loss is taxable/deductible only when the asset/liability actually is disposed or realised.

### *Capital gains*

Capital gains are treated in the same way as ordinary income of a revenue-nature for a TRE.

### *Dividend income*
An exemption exists for CIT on dividend derived by a TRE from the direct investment into another TRE except for where the dividend is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

### *Interest, rental, royalty income, and income from stock transactions*
Interest, rental, and royalty income, as well as income from stock transactions, are treated as ordinary income.

### *Partnership income*
Partnerships registered in China are not subject to CIT. The income of a partnership is taxable at the partners' level.

### *Unrealised exchange gains*
Unrealised exchange gain (loss) from the year-end translation of assets (liabilities) denominated in foreign currency generally is taxable (deductible).

### *Foreign income*
The worldwide income of a TRE and its branches both within and outside China is taxable. There are no provisions in the CIT law which allow foreign income directly earned by the TRE to be deferred for tax purposes. The CIT law contains a controlled foreign company (CFC) rule under which the unremitted earning of a foreign company controlled by Chinese enterprises may be taxable in China *(see the Group taxation section for more information)*. A foreign tax credit is allowed for foreign income taxes paid on foreign-source income.

## *Deductions*

Generally, an enterprise is allowed to deduct reasonable expenditures which actually have been incurred and are related to the generation of income.

### *Depreciation of fixed assets*
Fixed assets with useful lives of more than 12 months must be capitalised and depreciated in accordance with the CIT regulations. Generally, depreciation is calculated by the straight-line method. Shorter tax depreciation life or accelerated depreciation may be allowed due to advancement of technology or suffering from constant vibration or severe corrosion. Production-nature biological assets, such as livestock held for breeding and commercial timber, also have to be capitalised and depreciated using the straight-line method.

Under the straight-line method, the cost of an item, less its residual value, is depreciated over the useful life of the asset. Residual value should be reasonably determined based on the nature and usage of the asset. The CIT law provides minimum useful lives for the following assets:

| Assets | Years |
|---|---|
| Buildings and structures | 20 |
| Aircrafts, trains, vessels, machinery, mechanisms, and other production equipment | 10 |
| Appliances, tools, and furniture etc. related to production and business operations | 5 |
| Means of transport other than aircrafts, trains, and vessels | 4 |

| Assets | Years |
|---|---|
| Electronic equipment | 3 |
| Production-nature biological assets in the nature of forestry | 10 |
| Production-nature biological asset in the nature of livestock | 3 |

### *Amortisation of intangibles and goodwill*
A deduction is allowed for amortisation of intangible assets, such as, but not limited to, patents, trademarks, copyrights, and land use rights. Generally, intangible assets have to be amortised over a period of not less than ten years. For an intangible asset obtained through capital contribution or assignment, it can be amortised according to the useful life prescribed in the laws or agreed in the contracts, if any. However, acquired goodwill is not deductible until the invested enterprise is entirely transferred or liquidated.

### *Organisational and start-up expenses*
Organisational and start-up expenses are tax deductible fully in the first year of operation.

### *Research and development (R&D) expense*
For R&D expenses incurred for new technology, new products, or new craftsmanship, an extra 50% of the actual expenses incurred are also tax-deductible as an incentive.

### *Asset loss*
Asset loss (including bad debt loss) may be deductible in the tax year during which such loss is incurred, provided that supporting documents are submitted to the in-charge tax bureau during annual income tax reconciliation filing.

### *Interest expenses*
Interest on loans generally is tax-deductible. For interest expenses on borrowings from non-financial institutions by a non-financial institution, the portion that does not exceed the commercial rate is deductible. The tax deduction of interest paid to related parties is subject to the thin capitalisation rule under the CIT law *(see the Group taxation section for more information)*.

### *Reserves and provisions*
Provisions for asset impairment reserves (e.g. bad debt provisions) and risk reserves generally are not tax-deductible unless otherwise prescribed in the tax rules. Financial institutions and insurance companies may deduct certain provisions and reserves subject to the caps specified in the relevant tax circulars.

### *Contingent liabilities*
The CIT law does not specifically address the deductibility of contingent liabilities. According to the general principle of the CIT law, contingent liabilities are liabilities that an enterprise has not actually incurred and thus shall not be tax-deductible.

### *Charitable donations*
Charitable donations are tax-deductible up to 12% of the annual accounting profit.

### *Wages and staff welfare expenses*
Reasonable wages and salaries of employees incurred by an enterprise are tax-deductible. Directors' fees are also tax-deductible.

Basic social security contributions, including basic pension insurance, basic medical insurance, unemployment insurance, injury insurance, maternity insurance, and housing funds, that are made by an enterprise in accordance with the scope and criteria as prescribed by the state or provincial governments are deductible.

Commercial insurance premiums paid for investors or employees shall not be tax-deductible unless it is paid for safety insurance for workers conducting special types of work.

Staff welfare expenses, labour union fees, and staff education expenses are tax-deductible up to 14%, 2%, and 2.5% of the total salary expenses, respectively.

### *Entertainment expenses*

Entertainment expenses are tax-deductible to the lesser of 60% of the costs actually incurred and 0.5% of the sales or business income of that year. The excess amount must not be carried forward to and deducted in the following tax years.

### *Advertising expenses and business promotion expenses*

Advertising expenses and business promotion expenses are deductible up to 15% of the sales (business) income of that year unless otherwise prescribed in the tax regulations. Any excess amount is allowed to be carried forward and deductible in the following tax years. Advertising expenses and business promotion expenses incurred by the tobacco industry are entirely not tax-deductible.

### *Other non-deductible expenses*

In addition, the following expenditures are non-tax deductible expenditures: CIT payments; tax surcharges; penalties, fines, and losses arising from confiscation of property; non-charitable donations; and sponsorship expenditures which are non-advertising and non-charitable in nature.

### *Net operating losses*

Tax losses can be carried forward for no longer than five years starting from the year subsequent to the year in which the loss was incurred. Carryback of losses is not permitted.

### *Payments to affiliates*

Management fees for stewardship are not deductible, but services fees paid for genuine services provided by affiliates in China or overseas and charged at arm's length should be deductible. Other payments to affiliates, such as royalties, are also tax-deductible provided that the charges are at arm's length.

## *Group taxation*

Group taxation is not permitted under the CIT law unless otherwise prescribed by the State Council.

### *Transfer pricing regime*

All enterprises are required to conduct transactions with related parties on an arm's-length basis. The Chinese tax authorities are empowered to make adjustments to transactions between related parties which are not conducted at arm's length and resulting in the reduction of taxable income of the enterprise or its related parties using the following appropriate methods: comparable uncontrolled price method, resale price method, cost plus method, transactional net margin method, profit split method, and other methods which are consistent with the arm's-length principle. China also adopts stringent requirements on the disclosure of related party transactions in the filing of the annual tax return. In addition, there is also a requirement to prepare contemporaneous transfer pricing documentation if the amount of related parties' transactions with an enterprise exceeds a certain prescribed threshold.

The CIT law also contains transfer pricing provisions relating to cost sharing arrangements and advance pricing arrangements. In addition, it also contains a few tax avoidance rules such as a CFC rule, a thin capitalisation rule, and general anti-avoidance rules.

### *Thin capitalisation rule*

The CIT law has a thin capitalisation rule disallowing interest expense arising from excessive related party loans. The safe harbour debt/equity ratio for enterprises in the financial industry is 5:1 and for enterprises in other industries is 2:1. However, if there is sufficient evidence to show that the financing arrangement is at arm's length, these interests may still be fully deductible even if the ratios are exceeded.

### *Controlled foreign company (CFC) rule*

Under the CFC rule, the undistributed profits of CFCs located in low-tax jurisdictions with an effective income tax rate of less than 12.5% may be taxed as a deemed distribution to the TRE shareholders. The Chinese tax authorities have published a list of countries (i.e. a 'white list') that they do not regard to be low-tax jurisdictions.

## *Tax credits and incentives*

The CIT law adopts the 'Predominantly Industry-oriented, Limited Geography-based' tax incentive policy. Key emphasis is placed on 'industry-oriented' incentives aiming at directing investments into those industry sectors and projects encouraged and supported by the state. The tax incentive policies mainly include the following and are applicable to both domestic and foreign investments.

### *Tax reduction and exemption*

CIT may be reduced or exempted on income derived from the following projects:

| Projects/industries | CIT incentive | Valid period |
|---|---|---|
| Agriculture, forestry, animal-husbandry, and fishery projects | Exemption or 50% reduction | All years, as long as it is engaged in these projects |
| Specified basic infrastructure projects | 3 + 3 years tax holiday (2) | Starting from the first income-generating year |
| Environment protection projects and energy/ water conservative projects | 3 + 3 years tax holiday (2) | Starting from the first income-generating year |
| Qualified new/high tech enterprises established in Shenzhen, Zhuhai, Shantou, Xiamen, Hainan, and Pudong New Area of Shanghai after 1 January 2008 | 2 + 3 years tax holiday (1) | Starting from the first income-generating year |
| Newly established software production enterprises | 2 + 3 years tax holiday (1) | Starting from the first profit-making year |
| Integrated circuits design enterprises | 2 + 3 years tax holiday (1) | Starting from the first profit-making year |

| Projects/industries | CIT incentive | Valid period |
|---|---|---|
| Integrated circuits production enterprises with a total investment exceeding CNY 8 billion or which produce integrated circuits with a line-width of less than 0.25um, provided that its operation period exceeds 15 years | 5 + 5 years tax holiday (3) | Starting from the first profit-making year |
| Integrated circuits production enterprises which produce integrated circuits with a line-width of less than 0.8um | 2 + 3 years tax holiday (1) | Starting from the first profit-making year |
| Qualified energy-saving service enterprises | 3+3 years tax holiday(2) | Starting from the first income-generating year |

Notes

1. '2 + 3 years tax holiday' refers to two years of exemption from CIT followed by three years of 50% reduction of CIT.
2. '3 + 3 years tax holiday' refers to three years of exemption plus three years of 50% reduction of CIT.
3. '5 + 5 years tax holiday' refers to five years of exemption plus five years of 50% reduction of CIT.

For income derived from the transfer of technology in a tax year, the portion that does not exceed CNY 5 million shall be exempted from CIT; and the portion that exceeds CNY 5 million shall be allowed a 50% reduction of CIT.

A CIT exemption applies to the dividend derived by a TRE from the direct investment into another TRE except where the dividend is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

A CIT exemption also applies to the income derived by recognised non-profit-making organisations engaging in non-profit-making activities.

### *Reduced tax rate*

The CIT rate may be reduced under certain conditions for different industries *(see the Taxes on corporate income section for more information).*

### *Reduction of revenue*

Where an enterprise uses resources specified by the state as its major raw materials to produce non-restricted and non-prohibited products, only 90% of the income derived is taxable.

### *Offset of certain venture capital investment*

For a venture capital enterprise that makes an equity investment in a non-listed small to medium-sized new/high tech enterprise for more than two years, 70% of its investment amount may be used to offset against the taxable income of the venture capital enterprise in the year after the holding period has reached two years. Any portion that is not utilised in that year can be carried forward and deducted in the following years.

### *Investment tax credit*

Enterprises purchasing and using equipment specified by the state for environmental protection, energy and water conservation, or production safety purposes are eligible for a tax credit of 10% of the investment in such equipment. Any unutilised amount can be carried forward and creditable in the following five years.

### *Other incentives*

There are also tax incentives in relation to the deduction of expenses and cost (e.g. 50% additional R&D deduction, shorter tax depreciation period, and accelerated depreciation). *See the Deductions section for more information.*

### *Foreign tax credit*

A TRE is allowed to claim foreign tax credit in relation to foreign income tax already paid overseas in respect of income derived from sources outside China based on a country-basket principle. The creditable foreign tax also includes foreign income tax paid by qualified CFCs. However, the creditable amount may not exceed the amount of income tax otherwise payable in China in respect of the foreign sourced income. In addition, there is a five-year carryforward period for any unutilised foreign tax.

## *Withholding taxes*

Foreign enterprises without establishments or places of business in China shall be subject to a unilaterally concessionary rate of withholding tax (WHT) at 10% on gross income from dividends, interest, lease of property, royalties, and other China-source passive income unless reduced under a tax treaty. Nevertheless, dividends distributed by a foreign investment enterprise out of its pre-2008 profit are still exempted from WHT.

WHT rates under China's tax treaties with other countries/nations are as follows (as of 1 June 2011):

| Recipient | Dividends (%) | Interest (%) (1) | Royalties (%) (2) |
|---|---|---|---|
| Albania | 10 | 10 | 10 |
| Algeria | 5/10 (3a) | 7 | 10 |
| Armenia | 5/10 (3a) | 10 | 10 |
| Australia | 15 | 10 | 10 |
| Austria | 7/10 (3b) | 7/10 (4a) | 6/10 |
| Azerbaijan | 10 | 10 | 10 |
| Bahrain | 5 | 10 | 10 |
| Bangladesh | 10 | 10 | 10 |
| Barbados | 5/10 (3a) | 10 | 10 |
| Belarus | 10 | 10 | 10 |
| Belgium | 10 | 10 | 6/10 |
| Brazil | 15 | 15 | 15/25 (5a) |
| Brunei | 5 | 10 | 10 |
| Bulgaria | 10 | 10 | 7/10 |
| Canada | 10/15 (3f) | 10 | 10 |
| Croatia | 5 | 10 | 10 |
| Cuba | 5/10 (3a) | 7.5 | 5 |
| Cyprus | 10 | 10 | 10 |
| Czech Republic | 10 | 10 | 10 |
| Denmark | 10 | 10 | 7/10 |
| Egypt | 8 | 10 | 8 |
| Estonia | 5/10 (3a) | 10 | 10 |
| Ethiopia (6) | 5 | 7 | 5 |
| Finland | 5/10 (3a) | 10 | 7/10 |

| Recipient | Dividends (%) | Interest (%) (1) | Royalties (%) (2) |
|---|---|---|---|
| France | 10 | 10 | 6/10 |
| Georgia | 0/5/10 (3c) | 10 | 5 |
| Germany | 10 | 10 | 7/10 |
| Greece | 5/10 (3a) | 10 | 10 |
| Hong Kong Special Administrative Region | 5/10 (3d) | 7 | 7 |
| Hungary | 10 | 10 | 10 |
| Iceland | 5/10 (3a) | 10 | 7/10 |
| India | 10 | 10 | 10 |
| Indonesia | 10 | 10 | 10 |
| Iran | 10 | 10 | 10 |
| Ireland, Rep. of | 5/10 (3b) | 10 | 6/10 |
| Israel | 10 | 7/10 (4a) | 7/10 |
| Italy | 10 | 10 | 7/10 |
| Jamaica | 5 | 7.5 | 10 |
| Japan | 10 | 10 | 10 |
| Kazakstan | 10 | 10 | 10 |
| Korea, Rep. of | 5/10 (3a) | 10 | 10 |
| Kuwait | 5 | 5 | 10 |
| Kyrgizastan | 10 | 10 | 10 |
| Laos | 5 | 5 (in Laos) | 5 (in Laos) |
| | | 10 (in Mainland China) | 10 (in Mainland China) |
| Latvia | 5/10 (3a) | 10 | 10 |
| Lithuania | 5/10 (3a) | 10 | 10 |
| Luxembourg | 5/10 (3a) | 10 | 6/10 |
| Macao Special Administrative Region | 5/10 (3a) | 7 | 7 |
| Macedonia | 5 | 10 | 10 |
| Malaysia | 10 | 10 | 15 (5b), 10 |
| Malta | 10 | 10 | 10 |
| Mauritius | 5 | 10 | 10 |
| Mexico | 5 | 10 | 10 |
| Moldova | 5/10 (3a) | 10 | 10 |
| Mongolia | 5 | 10 | 10 |
| Morocco | 10 | 10 | 10 |
| Nepal | 10 | 10 | 15 |
| Netherlands | 10 | 10 | 6/10 |
| New Zealand | 15 | 10 | 10 |
| Nigeria | 7.5 | 7.5 | 7.5 |
| Norway | 15 | 10 | 10 |
| Oman | 5 | 10 | 10 |
| Pakistan | 10 | 10 | 12.5 |
| Papua New Guinea | 15 | 10 | 10 |
| Philippines | 10/15 (3g) | 10 | 15 (5b), 10 |
| Poland | 10 | 10 | 7/10 |
| Portugal | 10 | 10 | 10 |
| Qatar | 10 | 10 | 10 |

# China, People's Republic of

| Recipient | Dividends (%) | Interest (%) (1) | Royalties (%) (2) |
|---|---|---|---|
| Romania | 10 | 10 | 7 |
| Russia | 10 | 10 | 10 |
| Saudi Arabia | 5 | 10 | 10 |
| Seychelles | 5 | 10 | 10 |
| Singapore | 5/10 (3a) | 7/10 (4a) | 6/10 |
| Slovak Republic | 10 | 10 | 10 |
| Slovenia | 5 | 10 | 10 |
| South Africa | 5 | 10 | 7/10 |
| Spain | 10 | 10 | 6/10 |
| Sri Lanka | 10 | 10 | 10 |
| Sudan | 5 | 10 | 10 |
| Sweden | 5/10 (3a) | 10 | 7/10 |
| Switzerland | 10 | 10 | 6/10 |
| Syria (6) | 5/10 (3a) | 10 | 10 |
| Tajikistan | 5/10 (3a) | 8 | 8 |
| Thailand | 15/20(3a) | 10 | 15 |
| Trinidad and Tobago | 5/10 (3e) | 10 | 10 |
| Tunisia | 8 | 10 | 5/10 (5c) |
| Turkey | 10 | 10 | 10 |
| Turkmenistan | 5/10 (3a) | 10 | 10 |
| Ukraine | 5/10 (3a) | 10 | 10 |
| United Arab Emirates | 7 | 7 | 10 |
| United Kingdom | 10 | 10 | 7/10 |
| United States | 10 | 10 | 7/10 |
| Uzbekistan | 10 | 10 | 10 |
| Venezuela | 5/10 (3h) | 5/10 (4a) | 10 |
| Vietnam | 10 | 10 | 10 |
| Yugoslavia | 5 | 10 | 10 |
| Zambia (6) | 5 | 10 | 5 |

Source: State Administration of Taxation, China

Notes

- This table is a summary only and does not reproduce all the provisions relevant in determining the application of WHT in each tax treaty/arrangement.
- The former Czechoslovak Socialist Republic is divided into Czech Republic and Slovak Republic.
- The former Yugoslavia is divided into Bosnia, Croatia, Macedonia, Serbia, Slovenia, and Yugoslavia.
- There is no tax treaty signed between China and Bosnia and Serbia.

1. 0% is due on interest paid to government bodies except for Australia, Brunei, Cyprus, Israel, Slovenia, and Spain. Reference should be made to the individual tax treaties.
2. The lower rate on royalties applies for the use of or right to use any industrial, commercial, or scientific equipment.
3. The following notes apply to dividend WHT:
    a. The lower rate applies where the beneficial owner of the dividend is a company (not a partnership) that directly owns at least 25% of the capital of the paying company.
    b. The lower rate applies where the beneficial owner of the dividend is a company that directly owns at least 25% of the voting shares of the paying company.
    c. The lowest rate (i.e. 0%) applies where the beneficial owner is a company that owns directly or indirectly at least 50% of the capital of the paying company and the investment exceeding EUR 2 million. The lower rate (i.e. 5%) applies where the beneficial owner is a company that directly or indirectly owns at least 10% of the capital of the paying company and the investment exceeding EUR 100,000.
    d. The lower rate applies where the beneficial owner of the dividend is a company that directly owns at least 25% of the capital of the paying company.

   e. The lower rate applies where the beneficial owner of the dividend is a company that directly or indirectly owns at least 25% of the capital of the paying company.
   f. The lower rate applies where the beneficial owner of the dividend is a company that owns at least 10% of the voting stock of the paying company.
   g. The lower rate applies where the beneficial owner of the dividend is a company that directly owns at least 10% of the capital of the paying company.
   h. The lower rate applies where the beneficial owner is a company (other than a partnership) which directly owns at least 10% of the capital of the paying company.
4. The following notes apply to interest WHT:
   a. The lower rate applies to interest payable to banks or financial institutions.
5. The following notes apply to royalties WHT:
   a. The higher rate applies to trademarks.
   b. The higher rate applies to copyright of literary, artistic, or scientific work, including cinematograph films or tapes for television or broadcasting.
   c. The lower rate applies to royalties paid for technical or economic studies or for technical assistance.
6. These tax treaties have not yet entered into force as of 1 June 2011.

In addition to the above tax treaties, China has also entered into tax information exchange agreements with the following countries:

- Argentina.
- Bahamas.
- Bermuda.
- BVI.
- Guernsey.
- Jersey.
- Isle of Man.

## Tax administration

### Returns

The tax year commences on 1 January and ends on 31 December. Enterprises are required to file their annual income tax return within five months after the end of the tax year, together with an audit certificate of a registered public accountant in China. Information on related party transactions must be filed with the annual income tax return.

### Payment of tax

Enterprises are required to file and pay provisional income taxes on a quarterly or monthly basis within 15 days following the end of each month/quarter. Three options are available to the taxpayer in computing the provisional tax: (i) actual profits of the month/quarter, (ii) average monthly or quarterly taxable income of the preceding year, or (iii) other formulas approved by the local tax authorities.

Settlement of tax payment is due, in conjunction with the annual income tax return, within five months after the end of the tax year.

### Statute of limitations

For unintentional errors (e.g. calculation errors) committed by the taxpayer in its tax filing, the statute of limitation is three years and extended to five years if the amount of tax underpaid is CNY 100,000 or more. For transfer pricing adjustments, the statute of limitation is ten years. There is no statute of limitation for tax evasion, refusal to pay tax, or defrauding of tax payment.

### *Audit cycle*
There is no fixed audit cycle in China. Tax audit targets are selected pursuant to certain criteria.

### *Recent focus of Chinese tax authorities*
Since 2009, the Chinese tax authorities have strengthened their tax administration on transfer pricing and income derived by non-TREs. The SAT has released a number of tax circulars addressing the tax administration of transfer pricing, foreign contractors and service providers, WHT on passive income, etc.

In particular, the Chinese tax authorities have geared up their efforts in recent years to scrutinise investment structures involving intermediate holding companies incorporated in low tax jurisdictions. One of their focuses is on the indirect equity transfer of Chinese companies by non-TRE. The income derived by a non-TRE from the disposal of a non-Chinese company is not taxable under China's domestic income tax law. However, if the Chinese tax authorities are of the view that the non-TRE transferor has used an abusive arrangement to indirectly transfer the equity of the Chinese company (i.e. interposing and disposing of the special purpose vehicle for no reasonable commercial purpose, but just for avoidance of China withholding income tax), it may re-characterize the equity transfer based on the 'substance over form' principle and disregard the existence of the special purpose vehicle. Once the special purpose vehicle is disregarded, the transfer would be effectively a transfer of the underlying Chinese company's equity, and the transfer gain would be China source and subject to China withholding income tax.

In addition, the SAT has also released circulars relating to the claiming of treaty benefits by non-TREs and interpretation of certain articles and terms in the tax treaties, such as dividends, royalties, beneficial ownership, etc. Aggressive tax planning (including, but not limited to, tax-avoidance and treaty-abusive arrangements) not supported by reasonable commercial purposes and substance will be subject to scrutiny by the Chinese tax authorities.

On 26 July 2010, the SAT issued a Departmental Interpretation Note (DIN) for the tax treaty concluded between China and Singapore. It is the first time the SAT has introduced a set of technical views, interpretation, and practice guidelines for the implementation of a tax treaty in such a comprehensive manner. More importantly, this set of interpretation is also applicable to other tax treaties concluded by China if the provisions of the relevant articles in those tax treaties are the same as those in the China/ Singapore tax treaty. Thus, it is likely to have a wide impact to tax residents of other countries/regions which have entered into tax treaties with China.

### *General anti-avoidance rules (GAAR)*
There is a GAAR provision in the CIT law allowing the Chinese tax authorities to make adjustments to taxable revenue or taxable income where business arrangements, structures, or transactions are entered into without reasonable commercial purpose. The Chinese tax authorities may initiate GAAR investigation if they suspect that an enterprise undertakes any of the following arrangements: abuse of preferential tax treatments, abuse of tax treaties, abuse of corporate structure, use of tax havens for tax avoidance purposes, or other arrangements that do not have a reasonable commercial purpose.

## Other issues

### Choice of business entity

Foreign companies, enterprises, or individuals may, subject to approval from the Ministry of Commerce or other relevant ministries, establish equity joint ventures, contractual joint ventures, wholly foreign-owned enterprises, or representative offices in China. Certain foreign financial institutions, including banks and insurance companies, may, subject to approval, set up branches in China. As of 1 March 2010, foreign investors are allowed to establish foreign invested partnerships in China.



### Exchange controls

Foreign exchange transactions are administered by the State Administration of Foreign Exchange (SAFE) and its branches. The regulatory administration on foreign exchange transactions of an enterprise depends on whether the transaction is a current account item or a capital account item. Current account items refer to ordinary transactions within the context of international receipts and payments, including, but not limited to, balance of payments from trade, labour services, and unilateral transfers. Capital account items refer to items of increase or decrease in debt and equity due to inflow or outflow of capital within the context of international receipts and payments, including, but not limited to, direct investment, all forms of loans, and investment in securities. If a transaction falls under the category of capital account items, generally prior approval from the SAFE should be obtained. Generally, a payment that falls under the category of a current account may be remitted to overseas if supported with proper contracts, invoices, and tax payment/exemption certificates.

### Intellectual properties

Patents, trademarks, and copyrights are governed by separate laws and administered by separate governmental bodies. The government encourages the development and transfer of intellectual properties. The transfer of technology and technical services are currently exempted from business tax.

### Mergers & acquisitions (M&A) activities

Both Chinese domestic and foreign investors increasingly are using M&A transactions to establish or expand their Chinese operations.

The Ministry of Finance and the SAT jointly released a tax circular that addresses the CIT treatments for six forms of restructuring transactions, namely, change in legal form, debt restructuring, equity acquisition, assets acquisition, merger, and spin-off. The general principle is that enterprises undergoing corporate restructuring should recognise the gain/loss from the transfer of relevant assets/equity at fair value when the transaction takes place. However, if certain prescribed conditions are satisfied, the parties involved could opt for special tax treatments, which are essentially tax deferral tax treatment. In other words, recognition of gain/loss of the transferor from transfer of assets/equity can be deferred with respect to the equity-payment portion; and the transferee may take over the transferor's tax basis of the acquired assets/equity. Such special tax treatments are only available to a very few specific types of cross-border transactions.

# Columbia

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## Significant developments

Colombia has signed double taxation treaties (DTTs) with Spain, Chile, Switzerland, Canada, and Mexico, the first two of which are in force as of 30 April 2010, while the others are still being finalised or awaiting the ratification process.

The equity tax originally due to expire in 2010 was rolled over into 2011 (accruing only once on 1 January 2011) at rates substantially higher than those that applied from 2007 through 2010, and the taxable base was reduced to net equity above 1 billion Colombian pesos (COP) (approximately USD 540,000). Additionally, a 25% surcharge to the ordinary equity tax was established, so that the equity tax that was 4.8% under the new rates was effectively 6% (for net equities exceeding COP 5 billion) and the equity tax that was 2.4% under the new rates was effectively 3% (for net equities between COP 3 billion and COP 5 billion).

The so-called 30% fixed asset super-deduction, which was enacted as an investment incentive, has been reduced to 0%.

As of 2011, law 1429 established that small companies (not exceeding USD 1,400,000 in total assets or 50 employees) initiating activities after the enactment of this law will be subject to income tax in the following way: 0% of the statutory income tax rate for the first two years, 25% of the statutory income tax rate for the third year, 50% of the statutory income tax rate for the fourth year, and 75% of the statutory income tax rate for the fifth year.

The stamp tax rate was reduced to 0% for documents executed as of 1 January 2010.

As of 2011, the tax reform introduced a rule over which the foreign tax credit on dividend income is enhanced to include a third-tier of credit availability, subject to specific ownership requirements.

The new tax bill established that the financial transactions tax will be reduced to 0.2% for year 2014 and 2015, to 0.1% for years 2016 and 2017, and to 0% for year 2018 and onwards.

## Taxes on corporate income

National companies (i.e. incorporated in Colombia under Colombian law) are taxed on worldwide income. Foreign companies and local branches of foreign companies are taxed on their Colombian-source income only. The current general corporate income tax (CIT) rate is 33%, which is a flat rate applied on taxable income. Taxable income is generally defined as the excess of all operating and non-operating revenue over deductible costs and expenses.

### *Minimum presumptive tax*



Corporate income taxpayers are required to pay a minimum amount of income tax, which is determined based on the so-called presumptive income method. Under this method, presumptive taxable income is measured as 3% of net assets (or tax equity) as of 31 December of the prior tax year as reported by the tax payer on the corresponding CIT return. The CIT rate is then applied to the greater of regular taxable income (revenue less allowable costs and expenses) or presumptive taxable income (exempting certain business activities).

In order to determine the taxable base for presumptive income purposes, it is necessary to subtract from the total amount of net assets, which is the base to calculate presumptive income, the following amounts:

- The net asset value of the shares owned in national companies.
- The net asset value of the assets affected by force majeure.
- The net asset value of assets associated with operations in unproductive periods.

Each year, taxpayers must compare the value resulting from the application of the foregoing two systems. The income tax for the taxable year will be calculated on the higher value resulting from this comparison. If presumptive income is higher than the ordinary net income, the difference constitutes an excess of presumptive income, which can be carried forward (adjusted for inflation) to any of the following five taxable years and offset against the net income determined by the taxpayer.

### *Stability Agreement Regime*

In an effort to continue to attract local and foreign investments, a 2005 law created a Stability Agreement Regime whereby taxpayers can, upon satisfaction of several requirements, agree with the government on a contract that any future adverse tax changes will not apply. However, to the extent changes are for the benefit of the taxpayer (i.e. income tax rate reduction), they will apply. In order to obtain a legal stability contract, an investor has to satisfy certain requirements, which include the payment of a premium of 0.5% or 1% on an investment commitment, the definition of which is a new investment or enhancement of an existing investment which is worth COP 3,862,500,000 or more.

## *Corporate residence*

Corporate residence is determined by the place of incorporation of any given company.

For income tax purposes, companies incorporated under foreign laws and which have their main domicile abroad are considered ‘foreign companies’, whereas any company incorporated in Colombia under Colombian law qualifies as a ‘national company’ even if fully owned by foreign shareholders.

### *Permanent establishment (PE)*

The concept of PE is not included under Colombian internal legislation for CIT laws. This concept is only relevant in the context of DTTs, and therefore, its applicability varies between one DTT to another one.

The concept of PE, in the case of the DTTs, follows the Organisation for Economic Co-operation and Development (OECD) criteria. In the case of Spain and Chile, the concept of PE therefore means a fixed place of business throughout which an entity carries out its activity, whether partially or in its whole.

Regarding the above, each DTT has exemptions for the incorporation of a PE.

## *Other taxes*

### *Value-added tax (VAT)*

The Colombian VAT taxes the sale in the country of any items of tangible personal property that are not fixed assets and are not covered by an exemption, the provision of services within the national territory (certain services supplied outside Colombia but imported also attract VAT), and the importation of tangible personal property that is not covered by an exemption.

The Colombian VAT is based on a credit-debit system throughout the entire chain of a business. However, certain products are only taxed at the manufacturer level (one-phase VAT). For purposes of VAT calculation, the VAT taxpayer may credit the VAT (input) paid to vendors (certain limitations apply) against any VAT (output) collected from customers.

The general VAT rate is 16%. However, certain services and goods are taxed at 10% (i.e. coffee, rice) and 20% (i.e. mobile phone services). Luxury goods attract higher rates within the range between 20% and 35%. Wines and other alcoholic beverages are not considered as luxury goods, but the applicable VAT rate is higher (ranging between 20% and 25%) than the general rate.

Under current law, there are VAT exemptions available for the following items, among others:

- Equipment and materials for the construction, installation, assembly, and operation of environmental monitoring and control systems.
- Imports of raw materials and supplies made under the so-called Vallejo Plan for further processing and incorporation into products that are to be subsequently exported *(see the Tax credits and incentives section for more information on the Vallejo Plan)*.
- Temporary importation of heavy machinery and equipment for basic industries (mining, hydrocarbons, heavy chemistry, the iron and steel industry, metallurgy, power generation and transmission, and the water industry).
- Importation of machinery and equipment, which is not produced in the country, for recycling and processing of waste and refuse.
- Regular imports by major exporters of industrial equipment, which is not produced in the country, for the transformation of raw material.
- Freight transportation.
- Public transportation of passengers in the national territory by water or land.
- Transportation of gas and hydrocarbons.
- Interest and other financial income from credit operations.
- Financial leasing.
- Medical care services.
- Public utilities.
- Internet services for low to mid-income residential customers.

A non-resident supplier of VAT-subject services does not require VAT registration. Rather, it is the locally-based recipient that must apply a reverse-charge. No VAT fiscal representation is allowed.

As of 2011, no VAT filings are required for periods where no inputs or outputs exist. An amnesty is granted for taxpayers who failed to file such VAT returns in the past, such that they will not be subject to late filing penalties if making the delinquent filings within six months following the enactment of the law.



### *Customs duties*
Imports, according to customs rules, consist of the entry of goods to the 'national customs territory' from the rest of the world, or from a free trade zone (FTZ), with the purpose of remaining permanently or temporarily in it for the achievement of a specific purpose.

The importation processes before the Colombian Internal Revenue and Customs Service (DIAN) can only be carried out by users registered in the Customs Information System, either Customs Agencies (previously called Customs Intermediation Companies) or Permanent Customs Users (UAPs). The latter may file their own customs declarations, as long as the value of the imported goods exceeds the sum of USD 1,000; otherwise, they must do it through the Customs Agencies.

According to the Harmonized System of Designation and Coding of Goods approved by the World Trade Organization (WTO), imported goods are classified into subentries composed of six digits. Also, two digits are added which are for exclusive use of the CAN, and two final digits which correspond to the digits for use of Colombia. The custom subentry, which is the ten digit result, is exposed in the Colombian Customs Tariff, which is governed by Decree 4589 of 2006, which also reflects the applicable tariff of each duty. VAT, which is also part of the customs duties, is regulated in the Colombian Tax Code.

The general VAT rate for the importation of goods is 16% and the general rate for custom duties is 5%.

### *Excise taxes*
There are some excise taxes for the consumption of beer and its derivates, wine, liquor and its derivates, and cigarettes and similar products.

The excise taxes are of municipal in nature. Therefore, the tax rates and applicable laws vary from one municipality to another.

### *Equity tax*
For taxable years 2007 through 2010, corporate income taxpayers were subject to an equity tax based on net equity held as of 1 January 2007, provided it amounted to COP 3 billion or more, at the annual rate of 1.2%. Net equity is generally defined as gross assets less allowable liabilities as reported on the CIT return.

The life of the equity tax was extended to 2011 for those taxpayers who held an amount of tax equity that was equal to or greater than COP 3 billion but less than COP 5 billion as of 1 January 2011, with the tax rate being 2.4%. Where the tax equity was equal to or greater than COP 5 billion, a 4.8% rate applied.

In order to collect funds to deal with the 2010 flooding disaster, the Government reduced the equity taxable base for 2011 to net equity above COP 1 billion (approximately USD 540,000). For taxpayers with net equity between COP 1 billion and COP 2 billion, the rate was 1%, and for taxpayers with net equity between COP 2 billion and COP 3 billion, the rate was 1.4%.

Additionally, a surtax of an additional 25% was established on net equity above COP 3 billion. This meant that the equity tax rate that was 4.8% was effectively 6% (for net equities exceeding COP 5 billion) and the equity tax rate that was 2.4% was effectively 3% (for net equities between COP 3 billion and COP 5 billion).

The 2011 equity tax is payable in eight equal instalments starting in 2011 through 2014. The 2011 equity tax is not deductible for CIT purposes and cannot be offset against any tax receivables.

It is important to establish that the applicable rate covers all of the net equity of the taxpayer. If, for example, a taxpayer has a taxable equity of COP 10 billion, the applicable rate will be 4.8% over the whole equity.

In addition to the above, it is important to mention that the taxable base for this tax is the amount of the net assets of the taxpayer as of 1 January 2010, excluding the net asset value of the shares held in Colombian companies. The date of accrual of the tax is 1 January 2011.

This tax is not deductible or creditable for income tax purposes, and it cannot be offset against any other taxes either. However, the law authorises taxpayers to charge this tax against the asset revaluation account, without affecting the income statement for the year.

### *Stamp tax*
The stamp tax rate was reduced to 0% for documents executed as of 1 January 2010.

### *Financial transactions tax*
The financial transactions tax is a permanent tax on financial transactions, the collection of which is the responsibility of regulated financial institutions and the Central Bank (Banco de la República).

The tax rate is 0.4%, and the taxable event is the carrying out of financial transactions that involve the disposal of resources deposited in checking or savings accounts as well as in deposit accounts with Banco de la República, and the issuance of cashier’s checks.

25% of the total tax paid is deductible for CIT purposes, regardless of whether or not the transactions have a causal nexus with the income producing activity of the taxpayer.

The law establishes a series of operations and transactions that are exempted from this tax.

The new tax bill established that the financial transactions tax will be reduced to 0.2% for year 2014 and 2015, to 0.1% for years 2016 and 2017, and to 0% for year 2018 and onwards. Currently 25% of this tax is deductible for CIT purposes; however, 50% of this tax will be deductible from 2013 onwards. Planning strategies such as payment to third parties using overdrafts, repos, buy/sell back transactions, or portfolio investments that did not trigger this tax, are not permitted.

### Property tax

The property tax is a municipal tax which is imposed on real property located in urban, suburban, or rural areas. It is levied on both improved and unimproved real estate. Therefore, the property taxpayers are the owners or holders of real property.

The taxable base of this tax is the current cadastral value of the property, as adjusted for inflation. In some cities, such as Bogotá, the taxable base is the value of the property as appraised by the taxpayer directly.

Property tax rates depend upon the nature and usage of the property, and generally range between 0.4%and 1.2%.

This tax is fully deductible for CIT purposes provided the same has a causal nexus with the income producing activity of the taxpayer (for example, where the tax is paid on rental property).

### Industry and trade tax

The industry and trade tax is a municipal tax that is imposed on revenue obtained from the exercise of industrial, commercial, or service activities in any Colombian municipal jurisdiction. It can be viewed as a special form of a turnover tax.

The industry and trade tax rates are determined by each municipality, and as a rule they range between 0.2% and 1%. All of this tax can be deducted for CIT purposes when effectively paid.

## Branch income

Branch income is taxed at the same rate as corporate income, which is 33%. A 7% remittance tax on branch profits was eliminated in 2007 but still applies to retained profits incurred prior to 2007.

## Income determination

### Inventory valuation

The value of inventories, which includes all expenses and direct and indirect charges necessary to put in a position to use or sale, must be determined using one of the following methods: first in first out (FIFO), last in first out (LIFO), specific identification, or weighted average. Special rules may authorize the use of other methods of recognized technical value.

### Capital gains

The general capital gains tax rate is 33%.

### Dividend income

The so-called double income taxation on corporate earnings was eliminated from the Colombian tax system many years ago. This means that shareholders of Colombian companies are, as a rule, not required to pay any income taxes on dividend distributions, but only to the extent that dividends are paid out from earnings that were taxed at corporate level prior to distribution. When the dividends are paid out from earnings that went untaxed at the corporate level, a foreign shareholder is required to pay income taxes on the dividends at 33% via a withholding tax (WHT) collected by the distributing company. Certain DTTs offer limited or full relief for the 33% income tax on dividends.

### *Interest income*

Interest income derived from activities in Colombia is considered part of the CIT base for Colombian entities; however, if interest is paid to a non-resident that is not compelled to file CIT in Colombia, a WHT is accrued over the payment or deposit at a rate of 33%, if the loan term does not exceed of one year, or 14%, if the loan term does exceed of one year.

Note that there are some special conditions derived from DTTs which decrease the WHT rate.

### *Royalties*

Royalties paid in favour of a Colombian entity are subject to taxes in Colombia; consequently, such royalty payments are part of the CIT base. If royalties are paid in favour of a non-resident (i.e. in favour of an entity that is not compelled to file CIT in Colombia), WHT is accrued over the payment or deposit at a rate of 33%.

### *Foreign income*

The following cases, among others, qualify as foreign-source income:

- Income obtained from external debt, if it complies with some requirements provided by law. Interest produced by this external debt is not taxed via CIT, and there is no WHT liability.

  Additionally, the expense derived from this concept will be 100% deductible.
- Income derived from technical services of repair and maintenance of equipment carried out abroad.

## *Deductions*

In Colombia, the customary costs and expenses of a business are generally acceptable as deductible expenditure for income tax purposes provided they are necessary, reasonable, and have been realised during the relevant tax year under the accrual method of accounting. Examples of common (and not so common) deductions include the items below.

### *Depreciation*

As a general rule, the acquisition cost of tangible fixed assets is fully depreciable for income tax purposes. The normal estimated useful lives are as follows:

| Asset | Useful life (years) |
|---|---|
| Buildings and pipelines | 20 |
| Machinery and equipment, office furniture, and fixtures | 10 |
| Vehicles and computer equipment | 5 |

The acceptable methods for the depreciation are:

- Straight-line: The straight-line method is the easiest and most commonly used method of depreciation by companies; it is calculated by dividing the value of the asset by the asset's useful life.
- Declining balance: The reducing balance method allows one to consider a certain depreciation percentage to depreciate the alignment machine rate annually. This method takes into consideration an accelerated rate of depreciation. This is useful for those assets in which a higher value is lost during the beginning years of usage.
- Any other method of recognised value in accordance with the opinion of the tax authorities.

Depreciation rates can be increased by 25% for each additional eight-hour shift of asset use (and pro rata for fractions thereof). When tax depreciation exceeds book depreciation, the taxpayer is required to establish a reserve equivalent to 70% of the difference. Recapture of depreciation on the sale of depreciated property is taxed at 33%.

### *Depletion*
Depletion is available under certain specific circumstances.

### *Amortisation of intangible assets*
Taxpayers can amortise, for income tax purposes, the cost of any acquired intangible asset over a period of five years, at a minimum, unless the taxpayer is able to prove that the amortisation period should be less because of the specific nature or conditions of the business.

### *Interest expenses*
Taxpayers are generally entitled to deduct any interest paid to financial institutions or to third parties.

### *Expenses incurred abroad*
As a general rule, the deduction of expenses incurred abroad which are not subject to WHT are limited to 15% of the taxpayer's net income. However, these expenses are fully deductible when they have to be capitalised under Colombian generally agreed accounting principles (GAAP).

### *Special deductible items*
Colombian income tax laws have established certain special deductible items, which include the following:

- 100% of the industry and trade tax and real property tax actual payments and 25% of the financial transactions tax actual payments are deductible.
- 100% of acquisition costs are available as a tax amortisation or depreciation base.
- 125% of the investments made in certain scientific and/or technological projects or in professional training projects of governmental, public, or private institutions of higher education are deductible. This deduction cannot exceed 20% of the taxpayer's net income as determined before subtracting the amount of the investment.
- 100% of the investments made for the control and improvement of the environment are deductible. This deduction cannot exceed 20% of the taxpayer's net income as determined before subtracting the amount of the investment.

### *Net operating losses*
Net tax losses (adjusted for inflation) incurred in 2007 or thereafter may be carried forward without limitation. There is no loss carryback provision. Certain limitations apply to the offset of losses transferred on merger reorganisations.

### *Payments to foreign related parties*
#### Royalties and similar charges
Royalties and the costs of exploitation or acquisition of all kinds of intangible property that are charged by foreign related parties are allowable as CIT deductions, provided that the corresponding WHT is collected at generally 33% (10% in the case of most DTTs). Other types of payments are subject to the general rules for expenses incurred abroad.

#### Management overhead expenses
Management overhead expenses paid to a foreign related party (e.g. the parent company) are deductible provided they meet the arm's-length test under transfer pricing regulations and provided the management services are real and are specifically related to the income producing activity of the local subsidiary which pays them. These expenses must also be carefully documented such that the local subsidiary can provide evidence to the authority of the fact that they are specifically related to its Colombian operations: to the planning and direction of the operations, the setting and implementation of management controls, the measurement of progress made toward specific business goals, the related financial results, etc. Where these services are supplied inside Colombia, a 33% WHT is also required to ensure deductibility.

#### Interest
Interest and related financial costs (including foreign exchange losses) paid to foreign related parties are deductible provided they meet the arm's-length test under transfer pricing regulations. Furthermore, interest and the related financial costs paid on short-term financing relating to imports of merchandise and raw materials directly supplied by foreign related parties are also deductible for income tax purposes. Interest paid to non-resident triggers WHT over the payment or deposit at a rate of 33%, if the loan term does not exceed of one year, or 14%, if the loan term does exceed of one year. However, only financial institutions registered with the Colombian Central Bank are permitted to extend loans into Colombia.

## *Group taxation*

Group taxation or group consolidation is not allowed for CIT purposes in Colombia.

### *Transfer pricing*
In Colombia, transfer pricing rules are applicable to the transactions performed by local taxpayers with foreign related parties. Thus, for CIT purposes, Colombian taxpayers must determine their income, costs, expenses, assets, and liabilities on the basis of prices and profit margins used in comparable transactions entered into with or between independent or unrelated parties.

In general terms, the rules related to comparability criteria, supporting documents, and advanced pricing agreements (APAs) follow international transfer pricing standards. However, they introduce a wide definition of 'related companies' for transfer pricing purposes, including subordination and individual or joint control exercised by a foreign parent company or by individuals located in Colombia or abroad.

The law presumes that transactions with foreign non-domiciled entities located in the so-called ‘tax havens’ are transactions performed with related parties and are subject to transfer pricing rules. However, the Colombian government has not yet issued the list of tax havens for these purposes, nor further regulations applicable to the payments made to such jurisdictions. Therefore, the Colombian tax rules related to tax havens are not yet applicable.



If (i) the gross equity (assets) of the local taxpayer on 31 December of each year is equal to, or higher than, the equivalent to 100,000 Tax Value Units (COP 2,513,200,000 or approximately USD 1,400,000) or (ii) the gross income obtained by the local taxpayer in a given year is equal to, or higher than, the equivalent to 61,000 Tax Value Units (COP 1,533,052,000 or approximately USD 852,000), it shall be required to prepare transfer pricing supporting documents (i.e. a transfer pricing study) and to file with the tax authority an informative return in connection with the transactions performed, during the corresponding year, with the foreign related parties.

If the local taxpayer does not file the supporting documents, it may be subject to fines equivalent to 1% of the total value of the transactions performed with related parties. This fine would not exceed the equivalent to 39,000 Tax Value Units (COP 980,148,000 or approximately USD 545,000).

### *Thin capitalisation*
There are no thin capitalisation rules applicable in Colombia.

## *Tax credits and incentives*

### *CIT exemptions*
As items of exempt income, the law has established the following:

- Income obtained by publishing companies from the publication of scientific and cultural books, until year 2013.
- The principal and interest (as well as related commissions and fees) paid pursuant to public foreign debt operations.
- Income from the sale of electric power generated from wind, biomass, or agricultural waste, for a period of 15 years, provided the seller issues and negotiates Greenhouse Gas Reduction Certificates.
- Income obtained from slow yield crops and plantations, including cocoa, rubber, palm oil, citrus, and other fruits.
- Income obtained from river transportation services with shallow draft vessels and barges, for a period of 15 years, starting in 2003.
- Income obtained from hotel services offered in new hotels that are built within 15 years counted from 2003, for a term of 30 years, until 2032.
- Income obtained from hotel services offered in refurbished or enlarged hotel facilities, where the related work is started within 15 years counted from 2003, for a term of 30 years.
- Income obtained from ecotourism services, for 20 years starting in 2003.
- Income obtained from investment in new forestry plantations, sawmills, and plantations of timber-yielding trees.
- Income obtained from new medicinal and software products developed in Colombia and protected under new patents registered with the authorities, with a high content of national research and technology, until 2013.

- As of 2011, the gain in trading derivatives that are qualified as securities will not be subject to CIT, provided that the underlying asset is stock traded in the Colombian stock exchange, indexes, or participations in funds tracking such stock.

### *Special CIT rate for free trade zones (FTZs)*
FTZ industrial users enjoy a special CIT rate. The so-called FTZ industrial goods users and industrial service users pay CIT at a reduced rate of 15% on income earned from their FTZ operations.

Note that capital gains are still taxed at the standard CIT rate of 33%.

### *Reduction to the statutory CIT rate for small companies*
Small companies (not exceeding USD 1.4 million in total assets or 50 employees) initiating activities after 1 January 2011 are subject to CIT at the following reduced rates: 0% of the statutory CIT rate for the first two years, 25% of the statutory CIT rate for the third year, 50% of the statutory CIT rate for the fourth year, and 75% of the statutory CIT rate for the fifth year.

### *Reduction of payroll fees for small companies*
Small companies (not exceeding USD 1.4 million in total assets or 50 employees) initiating activities after 1 January 2011 are subject to payroll fees at the following reduced rates: 0% of the payroll fees for the first two years, 25% of the payroll fees for the third year, 50% of the payroll fees for the fourth year, and 75% of the payroll fees for the fifth year.

### *Tax credit on payroll fees paid*
A tax credit is granted to employers hiring employees under 28 years old; women above 40 years old; low-income workers earning less than 1.5 times the minimum monthly wage (approximately USD 420); and disabled, reintegrated (from armed conflict), or displaced (as victims of armed conflict) workers, subject to certain requisites and time limitations (two to three years).

### *Interest amnesty*
An amnesty of 50% of interest derived from tax obligations of fiscal year 2008 and previous years is granted, provided that the tax and applicable penalties are settled by the taxpayer.

### *Vallejo Plan for raw materials*
The Vallejo Plan allows for the total or partial suspension of customs duties upon receipt, within the national customs territory, of specific goods destined to be totally or partially exported within a certain period of time, after having undergone transformation, manufacture, or repair, including the materials needed for these operations. Under the Vallejo Plan, machinery, equipment, and spare parts may also be imported, to be used partially or entirely in the production and sale of goods and services destined for export. The goods so imported remain under restrictions of sale.

### *Foreign tax credit*
Foreign income taxes are creditable, subject to certain limitations. Generally, the amount of the credit cannot exceed the Colombian CIT rate. DTT's provide for more comprehensive credit systems as well.

As of 2011, the tax reform introduced a rule over which the foreign tax credit on dividend income is enhanced to include a third-tier of credit availability subject to specific ownership requirements.

A third-tier of credit means that before the tax reform, Colombian entities could only claim as a tax credit the taxes paid by a company in which it had a direct investment. However, as from the enactment of this reform, Colombian entities can claim a tax credit not only for taxes paid by a company in which it has a direct investment, but also for taxes paid by a company in which it has an indirect investment.

As an example, Colombian entity (A) used to be able to take as a tax credit only the taxes paid by a company (B) in which the company (A) had a direct investment, but not the taxes paid by a company (C) in which the company (B) had an investment. However, as of January 2011, the company (A) can take both the taxes paid by the companies (B) and (C), as long as some specific requirements are met.

## *Withholding taxes*

The Colombian tax system provides for WHT as a general mechanism of advance tax collection. Under the law, as a general rule, all corporate entities are required to collect or withhold taxes from payments made to third parties. The WHT collection agents must collect the applicable WHT amounts, deposit the withheld amounts with the authority, file monthly WHT returns, and issue WHT certificates to the payees. The payees who are also CIT return filers credit the withheld taxes against the annual CIT liability computed on their returns.

As noted above, foreign non-resident persons are taxed on their Colombian-source income only. Generally, the full tax liability accruing on payments made to foreign non-resident persons is satisfied via the collection of the applicable WHT. The WHT rate on payments made to foreign non-resident persons for taxable dividends, royalties, and taxable interest is 33%. On payments made for consulting, technical assistance, and technical services the WHT rate is 10% (whether supplied inside or outside Colombia). On payments made for software licences, the WHT rate is 26.4%.

On other types of payments which give rise to Colombian source income, the general WHT rate is 14%, with the foreign non-resident payee being required to file a CIT return in Colombia to report the final CIT liability, at 33% of net income (and being entitled to a refund where the final liability is less than the amount withheld at the 14% rate or being required to pay the deficit should the case be the opposite).

As of 2011, WHT returns do not need to be filed where there are no taxes to declare or pay. An amnesty is granted for taxpayers who failed to file such returns in the past, such that they will not be subject to late failing penalties if making the delinquent filings within six months following the enactment of the law.

### *Offsetting of WHT*

WHT returns filed on a non-payment basis will be treated as not filed, except if the filer has a refundable tax credit balance over USD 1,065,000 to offset the outstanding payment. A six-month deadline applies for the taxpayer to apply the offsetting of the credit balance. Otherwise, late filing penalties will apply.

### *Self-withholding on some exports*

The tax reform granted an authorisation to the Government to establish up to a 10% self-WHT on exports for the mining, oil, and gas industry. The self-withholding would be creditable against the CIT liability.

### Exempt interest

As of 2011, the interest payments abroad on loans or cross-border leasing agreements, formerly not subject to WHT if the debtor's activities were deemed of interest for the economic and social development of the country, are now subject to a 14% WHT, if the loan term exceeds one year. If the loan or cross-border agreement has a term not exceeding one year, a 33% WHT is triggered.

A grandfather rule was provided for loans and leasing agreements executed before 31 December 2010.

### Summary chart

| Type of payment | WHT rate (%) |
|---|---|
| Dividends | 33 |
| Royalties | 33 |
| Taxable interest | 33 |
| Royalties on software licences | 26.4 |
| Technical assistance, consulting, and technical services | 10 |
| Other types of payments | 14 |

## Tax administration

### Tax returns

For income tax purposes, the taxable period is the calendar year, with no exceptions being admissible.

Income tax return filing due dates are set by the government every year. Usually they fall in the month of April; but for the case of the large taxpayers, the filing due dates are usually in February.

### Payment of tax

For CIT purposes, corporate taxpayers are divided into 'large taxpayers' and 'other taxpayers'. Large taxpayers pay their estimated outstanding CIT liability (outstanding after deducting applicable WHT from the estimated final liability) in five instalments over the year in which they file their annual CIT return. The due date varies according to the last digits of its NIT (Number of Tax Identification).

Other tax payers pay their estimated outstanding CIT liability in two instalments over the year in which they file their annual CIT return. The due date varies according to the last digit of its NIT.

### Statute of limitations

The statute of limitations is generally two years following the actual filing of the return (a longer or shorter statute of limitations applies in certain cases).

A method to reduce the statute of limitations was due to expire in 2010 but was rolled over into years 2011 and 2012. This benefit enables one to reduce the statute of limitations of a CIT return if the CIT liability increases by a given number of times inflation with respect to the former year. The ordinary 2-years statute of limitations may be reduced to: 18 months if the CIT liability increases by five times inflation, 12 months if the CIT liability increases by seven times inflation, and 6 months if the CIT liability increases by 12 times inflation.

## Other issues

### Choice of business entity

The most common type of company used in Colombia since the beginning of 2009 has been the so-called simplified stock company or simplified corporation, known as a SAS (sociedad por acciones simplificada). Besides SAS, foreign investors also use branch offices of an offshore entity as their investment vehicles in Colombia.



As a general rule, from a high-level perspective, there are no mayor differences between a branch office and a subsidiary (such as a SAS), as far as Colombian taxation is concerned, other than the taxation regarding dividends or profits.

However, the following is a chart explaining the main differences between a branch and a subsidiary in Colombia.

| Tax | Subsidiary in Colombia | Branch of a foreign entity |
|---|---|---|
| CIT | Colombian companies are subject to CIT on their worldwide income at a rate of 33%.<br><br>The CIT base applicable to Colombian companies is, as a general rule, the ordinary net taxable income determined by subtracting from the gross income of the corresponding taxpayer the cost and expenses allowed by the tax laws; however, Colombian law establishes a minimum taxable base called 'presumptive income' which is equivalent to 3% of the net equity (i.e. the result of subtracting the liabilities from assets) of the taxpayer on 31 December of the previous taxable year.<br><br>The CIT of a taxpayer must be determined based on the presumptive income if the ordinary taxable income of the corresponding year, determined according to the ordinary or normal rules, is lower than the presumptive income.<br><br>In addition, please bear in mind that related party liability is not allowed, except when a DTT applies. | Branches of foreign companies are taxed only on their Colombian-source income. The rate at which branches pay income taxes is the general CIT rate of 33%.<br><br>The presumptive income rule applicable to Colombian companies is applicable to the branches of foreign entities as well. |

| Tax | Subsidiary in Colombia | Branch of a foreign entity |
|---|---|---|
| Income tax on dividends or profits | Dividends received by foreign non-domiciled entities (which would be the case of the foreign shareholders of the local company) are not subject to income tax withholding, provided that such dividends correspond to profits subject to income tax at a corporate level. If such dividends correspond to profits that would have been subject to taxation if distributed to a Colombian resident (profits not taxed at the corporate level), they shall be subject to a 33% income tax withholding on the amount paid.<br><br>In addition, please bear in mind that Colombia has DTTs with Spain and Chile that are currently in application. Under these treaties, the dividends or profits shall not be levied in Colombia or will be levied with a lower WHT rate.<br><br>The taxes applicable to dividends received by foreign non-domiciled entities must be withheld on the basis of the total amounts distributed or accrued.<br><br>Please be advised that foreign non-domiciled entities are not required to file Income Tax returns in Colombia if their entire income was subject to the withholdings provided in articles 407 to 411 of the Colombia Tax Code (which refer to dividends, among other concepts). Therefore, if the entire income obtained by the foreign shareholders of the local company corresponds to dividends remitted by the company, and the applicable withholdings are duly performed, they would not be required to file Income Tax returns for the relevant periods. | In the case of profits obtained through a branch, please note that such profits are not considered as dividends and Colombian law does not provide for an income or remittance tax applicable to the transfer of profits from a branch to its main office. Therefore, if the profit obtained by a branch is not subject to income tax in Colombia at the branch level, the profit may be remitted abroad to the home office without the payment of any additional tax in Colombia. |
| WHT | As a means to collect income taxes in advance, the Colombian law establishes a system of tax withholdings that requires every person making payments to a taxpayer to withhold a certain percentage depending on the concept being paid. For those who must file an income tax return, all amounts withheld are a prepayment of the final tax liability and, as such, are credited on their return.<br><br>The withholding agent must file every month a WHT return.<br><br>Please bear in mind that technical services, technical assistance services, and consultant services rendered by a foreign non-domiciled entity are subject to 10% income tax withholding, regardless of the place in which the service is rendered, in Colombia or abroad. | Applies exactly the same WHT described for a subsidiary as for the branch of a foreign entity. |

In conclusion, as per Colombian law, there are no substantial differences between the fiscal treatment of a subsidiary or a branch, apart from the tax implications for the payment of dividends and territorial source of taxation.

All the taxes discussed in this summary would apply equally to a branch operation or a subsidiary operation. However, from a commercial perspective, and specifically from the perspective of corporate liability, operating through a branch office means that the head office is exposed to direct liability for all the obligations of the branch, tax obligations included. Operating through a subsidiary means that only the subsidiary is liable for its obligations as a general rule, that is to say that the shareholders are not liable for company obligations. Of corporations, the advisable choice would be a SAS, which is very flexible in nature, easy to incorporate, and can be held by one single shareholder (regular corporations require a minimum of five shareholders).

# Congo, Democratic Republic of

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## Significant developments

There have been no significant corporate tax developments in the Democratic Republic of Congo (DRC) during the past year.

## Taxes on corporate income

Corporate income tax (CIT), known as impôt sur les bénéfices et profits in the Democratic Republic of Congo, is paid on profits realised by a company which carries out any operational activity in the country.

The Democratic Republic of Congo taxes resident corporations on a territorial basis.

Foreign-sourced profits (e.g. dividends received from a foreign subsidiary, for instance) are exempt from corporate tax.

The CIT rate is currently 40% (30% for mining companies), with a minimum tax of 0.1% of the yearly turnover. Note that the minimum tax cannot be less than 2,500 US dollars (USD). Also note that turnover includes all profits and interest received, in essence any credits on the income statement which have the nature of income or gain.

## Corporate residence

Non-resident companies that carry out an activity in the Democratic Republic of Congo are taxable on profits they realise through permanent establishments or fixed establishments located in the Democratic Republic of Congo.

### Permanent establishment (PE)

A non-resident company is deemed as having a PE in the Democratic Republic of Congo in either of the following cases:

- It has a material place of business (e.g. head office, branch) or any other fixed or permanent installations producing revenues in the DRC.
- Without having a material place of business, it carries out a professional activity under its own name during a period of at least six months, insofar as such an activity cannot be considered as a technical assistance to a local company.

## Other taxes

### Tax on rental income

Rental income related to buildings, houses, offices, premises, warehouses, etc. is taxed in the Democratic Republic of Congo at the rate of 22%.

In order to secure the payment of this tax, the tax code has put into practice a withholding tax (WHT) system. The tenant is liable to withhold 20% of the rentals paid and to remit this tax to the authorities.

## Branch income

Tax rates on branch profits are the same as on corporate profits. However, the costs incurred abroad by the head office of the branch are not deductible in the Democratic Republic of Congo, and the branch is liable for taxation of deemed distributed profits on top of the CIT. On profits realised, a branch will pay both the 40% CIT and a 20% tax based on 50% of the net profits after deduction of CIT.

## Income determination

Taxable income consists of profits from any industrial, commercial, agricultural, or real estate operations entered into by the taxpayer in the Democratic Republic of Congo, as well as any increases of assets invested as a result of such activities and any increases derived from capital gains either realised or not, of any nature and origin.

To arrive at taxable income, the taxpayer may deduct all costs actually incurred in the production of income of the company during the year, such as:

- Rents actually paid and rental expenses linked to buildings or parts of buildings used in the exercise of the activity and any overheads derived from their maintenance, lighting, etc.
- Overheads costs, from maintenance of furniture and equipment used in connection with the company's activities.
- Wages, salaries, bonuses, and allowances of employees and workers used in the operation, as well as benefits in kind if these have been added to remunerations paid.
- Depreciation of fixed assets used in the company's operations.
- Interest costs on funds borrowed from third parties and invested in the company's operations and similar type expenses, such as annuities or fees related to the operation.

Please note if the borrower is a private limited company (Société Privée à Responsabilité Limitée or SPRL) and if the lender is one of its shareholders, the interests on loan paid are not deductible from the CIT basis.

## Deductions

Professional expenses directly related to the acquisition of income are tax-deductible.

The following are examples of expenses which may not be deducted to arrive at taxable income:

- Expenses of a personal nature, such as accommodation, school fees, leave indemnities, and any other expenses not necessarily incurred in the business.
- Income tax.
- Legal or administrative fines of any nature.
- Expenses linked to rental properties as a landlord as well as related depreciation expenses.
- Any kind of provisions (e.g. for taxes, for bad debts).

### *Net operating losses*

Tax losses can be carried forward for the next five years following the tax loss year; however, the losses must be deducted from the first year of tax profits of the company.

There is no carryback loss regime in the Democratic Republic of Congo.

A company may get audited up to five years after submission of a tax return. In practice, there is a tax audit every year.

### *Payments to foreign affiliates*

In respect of payments made by a local company to a foreign company for services (e.g. management services, technical assistance services), such expenses are deductible provided that:

- the services rendered can be clearly identified
- the services cannot be rendered by a local company, and
- the amount paid for the service is not overstated and is commensurate to the nature of the service itself.

Technical assistance/management services must be clearly formalised in an agreement, including the modalities of calculation of the corresponding fees payable.

## *Group taxation*

There is no group taxation regime per the DRC tax legislation.

### *Transfer pricing*

Transfer pricing rules are limited to the following provisions:

- Interests on loans are not considered as deductible expenses for the borrower, provided that it is an SPRL (Private limited company) and that the lender is a shareholder.
- Where a local company is directly or indirectly controlled by a foreign company, any abnormal advantage given to the latter is considered as an indirect distribution of profits and is then added back to the profits of the local company.
- In respect of payments made by a local company to a foreign company, for services (management services, technical assistance services), the Tax Code provides that such expenses may be deductible if (i) the services rendered can be clearly identified, (ii) the services cannot be rendered by a local company, and (iii) the amount paid for the service is not overstated and is commensurate to the nature of the service itself.

### *Thin capitalisation*

There are no thin capitalisation rules in the DRC tax legislation.

## *Tax credits and incentives*

The Investments Code allows for a certain number of tax, customs, and general order measures designed to favour direct investments. The preferential tax treatment measures of the Investments Code apply to direct investments and/or to entities that carry them out.

The regime of the Investments Code does not apply to numerous sectors, notably:

- Mining and hydrocarbon.
- Banking and insurance.
- Trade.

In order to take advantage of the provisions of the Investments Code, the following conditions must be fulfilled by the investor:

- The investor must be a Congolese legal entity.
- The investment must be at least USD 200,000.
- The investing company must comply with the rules and regulations relating to environment.
- The investing company must undertake to train local personnel in technical and executive duties.
- The investing company must undertake to create an added value of 35% of its initial investment (within a stipulated time period to be agreed).

The application file is examined by the National Agency for the Promotion of Investments in the Democratic Republic of Congo (ANAPI) and then sent to the Minister of Finance, who decides on the grant of the advantages foreseen in the Investments Code to the applicant, by the way of a Ministerial Order.

### *Tax holiday*
The Investments Code grants appointed investors an exemption of corporate tax during the investment period, which is determined by the location of the investments: three years in Kinshasa, four years in Lubumbashi or Kolwezi, and five years in Katanga.

## *Withholding taxes*

The following payments are subject to a WHT in the Democratic Republic of Congo:

- Dividends paid by a local company to its shareholders.
- Royalties.
- Interest on funds borrowed for business purposes. Note that if the interest is paid to a local company, the WHT does not apply since the interest is included in the taxable income of the company charging such interest.

The Democratic Republic of Congo has not entered into a double tax treaty with any other nation, so it is impossible to get any WHT reimbursed.

### *WHT rate and payments*
The rate of WHT is 20%, which is based on the gross amount of sums paid.

If the payee does not withhold the tax from the amount invoiced and pays the tax of 20% directly, then the tax authorities consider that the basis of the 20% tax is composed of the amount invoiced plus the amount of the tax.

Consequently, in the case that the DRC company takes in charge the corresponding WHT, the WHT rate will be 25% (20/80) and the amount of tax will not be tax-deductible.

For royalties, the WHT is charged on the net amount of the royalties paid. The tax authorities consider that the net amount of royalties is calculated by deducting 30% from the royalties invoiced (i.e. the taxable basis will be 70% of the royalties invoiced).

Mining companies are, under certain conditions, exempt from WHT on interest paid and are subject to just a 10% WHT on dividends paid to their shareholders.

## *Tax administration*

### *Returns*

The yearly CIT return is due by 31 March of the following year.

### *Payment of taxes*

Final payment of CIT is required when submitting the yearly tax return, which is due by 31 March of the following year.

CIT is payable in local currency through a DRC bank account by a wire transfer to the bank account of the Public Treasury. Consequently, in order to operate in the Democratic Republic of Congo, the opening of a bank account in a DRC bank is mandatory. Moreover, the tax authorities require the bank account number of the applicant in order to grant a taxpayer number.

The collection of CIT is on an instalment basis or by way of prepayments (depending on taxpayer type).

#### Instalments of corporate tax

Instalments, in respect of CIT, apply to taxpayers who come under the supervision of two specific kinds of tax departments: the Directorate General (DGE), the department of the tax authorities in charge of the most important taxpayers, and the Centre des Impôts (CDI), tax centres.

These taxpayers have to pay two instalments each representing 40% of the CIT paid during the previous fiscal year (including the amounts assessed by the tax authorities). This, therefore, totals 80% of the CIT actually paid in the previous year. The first instalment must be paid before 1 August, and the second instalment before 1 December. Both payments are offset against the final CIT due for the fiscal year. The balance is paid when the tax return is submitted.

#### Prepayments of corporate tax (Précompte BIC)

Prepayments of CIT are to be paid by taxpayers (excluding those under the supervision of DGE and the CDI) in respect of import and export activities by wholesalers and on the settlement of invoices relating to provisions of services or for building works.

Prepayments of CIT are withheld at source and collected by:

- the customs authorities, L'Office des Douanes et Accises (OFIDA), for imported and exported goods
- local manufacturers, wholesalers or semi-wholesalers, and beneficiaries for services rendered, and
- customers or contracting authority for building works on the settlement of the invoices.

Amounts withheld at source must be remitted monthly to the tax authorities and are creditable against the final CIT to be paid at the end of the fiscal year by the importer, exporter, service provider, etc.

The prepayment rate is 1%, which is based on the invoice value.

# Congo, Republic of

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## Significant developments

Further to the promulgation of the 2011 Finance Act on 29 December 2010, the following new tax measures for companies have been introduced and are effective as of 1 January 2011.

- The corporate income tax rate is now at 35% (previously 36%).
- A favourable taxation regime has been implemented for headquarters operations of foreign companies.
- Pre-existing tax regulations have been codified. They relate to Congolese registered companies that earn at least 70% of their income from activities with oil sector companies and are subject to the simplified tax regime. These companies can revert to the general taxation regime during the fiscal year following which their total income from oil sector companies became less than 70%.
- Non-resident companies are now obligated to appoint a tax representative in the Republic of Congo.
- Insurance contracts may now be registered free of charge.
- Legal regularisation of the date for declaration and monthly payment of tax on insurance contracts has been set to the fifteenth day of every month.
- Registration of contracts of sub-contractors in the public works sector shall be at a fixed rate of EUR 155.44.
- Registration of private commercial contracts shall be at the rate of 1% of the amount of the transaction, due within three months from the date of signature.
- The value-added tax (VAT) deduction principle for taxpayers not exclusively carrying out transactions giving right to VAT has been revised.
- The excise duty is now at the rate of 25%, (previously 24%).
- The National Fund for Housing tax is now at 1% (previously 2%).

## Taxes on corporate income

The majority of corporate income tax (CIT) provisions in the Congolese General Tax Code arise from the implementation, under Congolese law, of Central African Economic and Monetary Community (CEMAC) Regulation No. 02/01/UEAC-050-CM-06, which revised the Act No. 3/72-153-UDEAC dated 22 December 1972.

### Tax rates

The standard CIT rate in the Republic of Congo is 35%, with certain exceptions. Prior to 1 January 2011, the standard CIT rate was 36%.

The minimum tax payable is 1% of the annual turnover and cannot be less than 1,524.49 euros (EUR) (EUR 762.25 if annual turnover is less than EUR 15,244.90).

A 2% minimum tax is payable by companies showing losses during two consecutive fiscal years. The 2% rate is applied to the sum of gross turnovers and products and benefits realised by the company in the most recent year in which it earned a profit. The 2% tax is not deductible for CIT purposes. However, in a company's first profit-making year after incurring the losses, half of the 2% tax is deductible.

A 20% withholding tax (WHT) is imposed on income sourced in the Republic of Congo that is derived by foreign companies not necessarily engaged in activities in the Republic of Congo.

### *Industry specific rates*

The CIT rate for agricultural companies is 25%.

A tax rate of 30% applies for:

- property companies
- revenues resulting from leasing or occupation of built or empty lands received by public establishments and non-profit making organisations
- revenues resulting from capital assets that are not subject to tax on securities received by public establishments, non-profit-making organisation, or communities.

A tax rate of 35% is applied on a deemed profit equal to 22% of the total gross remuneration (i.e. an effective tax rate of 7.70% of the taxable turnover made in the Republic of Congo) derived from services rendered by:

- foreign companies that qualify for this simplified tax regime
- local companies and branches that realise more than 70% of their annual turnover with oil companies and oil services companies (in this case, the deemed profit tax is regarded as an advance payment of CIT levied at the rate of 35% on net profits).

Note that these companies would revert to the general taxation regime the year after which the turnover realised with oil and gas sector companies became less than 70%.

### *Headquarters operations of foreign companies*

The headquarters operations of foreign enterprises taxation regime is subject to prior approval by the tax authorities.

If enacted, headquarters operations of foreign enterprises and international groups will be granted a favourable tax status in the Republic of Congo. For those that qualify, corporate income tax is charged on a deemed profit equivalent to a prescribed percentage of headquarters expenses. The percentage of which is currently unknown.

To qualify, the headquarters must be registered under the form of a public limited company or branch and must act solely for the benefit of the group in the area of management, control, or coordination.

### *Global flat taxation*

The global flat tax was previously at the rate of 8% and is now at 10%. It is calculated on the annual turnover of small and medium size enterprises taxable under the flat rate regime, whose turnover does not exceed EUR 60,980.

# Congo, Republic of

## Corporate residence

### Resident companies

Congolese registered companies are taxed on the territoriality principle. As a result, Congolese companies engaged in business outside of the Republic of Congo are not taxed in the Republic of Congo on the related profits.

### Non-resident companies

In the absence of a tax treaty stating otherwise, a non-resident company is liable for CIT on income realised in the Republic of Congo or derived from or resulting from work / services of any nature supplied or used in the Republic of Congo.

## Other taxes

### Value-added tax (VAT)

Under the provisions of the VAT Law No. 12-97 dated 12 May 1997, all economic activities conducted in the Republic of Congo are subject to VAT, regardless of their purpose, profitability, or the legal status of the business performing them, and irrespective of whether these activities are habitual, occasional, or originate in the Republic of Congo or from a foreign country. Therefore, any person, natural or legal, engaged in an industrial, commercial, or professional activity is subject to VAT unless specifically exempt by law.

Section 8 of the VAT law states a service is considered as provided in the Republic of Congo when the service is used or exploited in the Republic of Congo.

The Congolese VAT rate is 18%. In addition to VAT, there is a sales tax (surtax) calculated at the rate of 5%, applied to the amount of VAT, which must be invoiced and paid at the same time as the VAT. Therefore, the VAT rate is globally 18.9%. The surtax is not deductible (final cost).

In principle, an entrepreneur is entitled to credit the VAT paid on purchases of goods, equipment, and services for use in business (input VAT) against the total of the tax charges to one's customers for deliveries made and services rendered (output VAT).

Taxpayers not exclusively carrying out transactions giving rise to a VAT deduction shall deduct VAT proportionally on the portion of the income pertaining to taxable transactions and not a flat rate as was previously the case.

A VAT return must be filed on a monthly basis before the fifteenth of every month.

### Business tax and accessory taxes

The business tax ('patente', in French) is a tax collected by local communities. This tax, paid during the first three months of every year, includes both a fixed and variable fee depending on the specifications of the profession. The principal amount of the tax is increased with 'additional centimes', 'communal centimes', and 'contributions to the National Investment Fund' (accessory taxes).

Business tax is paid by traders and professionals. It is imposed on most commercial, industrial, and professional enterprises (including branches of foreign enterprises), although some traders are exempt. The business tax is charged on the actual or deemed annual rental value of the tangible assets of the enterprise, on the power of the machines, and on the average number of employees.

Any new taxpayer undertaking an activity requiring a trading licence must declare it in writing to the tax administration within 15 days following the start of the business. For the first tax year, the business tax is paid on the basis of the date on which the business started (i.e. the tax is due from the first day of the quarter during which the business started).

### Computer royalty

The 2003 Finances Act instituted a computer royalty, to cover expenses incurred by the Customs Administration on computer data processing, applicable without exception or exemption to all importation and exportation of goods. The royalty applies on the customs taxable value of any imported or exported goods in the Republic of Congo. The rate is fixed at 2%, as per the 2010 Finances Act.

### Oil and gas

Specific rules and caps apply for the upstream (production) oil and gas industry.

### Customs duties

When applicable, import duties are payable at rates ranging from 5% to 30% on the customs value of imported goods. Customs value is calculated on the cost, insurance, and freight level (CIF).

### Customs duties rates

| Group | Rates (%) |
|---|---|
| Basic necessities | 5% |
| Raw materials and capital goods | 10% |
| Intermediate and miscellaneous goods | 20% |
| Consumer goods | 30% |

### Additional entry taxes

Additional entry taxes apply on the importation of goods, such as:

- CEMAC integration tax: 1% on CIF value.
- Statistic tax: 0.20% on CIF value.
- Organisation for the Harmonisation of Business Law in Africa (OHADA) contribution: 0.05% on CIF value.
- Economic Community of Central African States (CEEAC) contribution: 0.04% on CIF value.

### Rent tax

Rent tax is payable annually on the rental of built property. It also applies on non-built property for business purposes. The rent tax is imposed on the occupant of the premises (whether the occupant is the owner, a tenant, or a subtenant).

The rent tax, which is equal to one-twelfth of the rents due within a year, is due annually on or before 28 February. For new lease agreements, the rent tax is due within three months of the effective date of the lease agreement and is calculated as a proportion of the rents due until the end of the year.

The rent tax is paid by the tenant on behalf of the owner, or by the subtenant on behalf of the tenant. The tenant / subtenant has the legal obligation to pay this tax on behalf of the lessor. Tenant and subtenants make a once-a-year deduction between 1 January and 30 April of the same year from all the rents due to the owner.

A 50% fine, assessed on the amount of the tax, is due for any late payment of the rent tax.

### *Registration fees and stamp duties*

Lease agreement registration fees amount to 5% of the value of the annual rent paid during the tax year, including premises charges if any (Article 18 of the Congolese General Tax Code, Part II, Book I). 'Additional centimes' also apply at a 5% rate of the registration fees. Stamp duties and registration fees should be paid for the total duration of the lease agreement. In the case where the lease agreement is renewed, stamp duties and registration fees should be paid for the renewable period.

Stamp duty ranges from 200 CFA francs BEAC (XAF) to XAF 20,000 on certain documents.

Examples of documents that are subject to stamp duty include:

- Letters of agreement and other letters, which are prepared for use as evidence of act, fact, or condition of civil nature.
- Notarial deeds and their copies.
- Visas and flight tickets.

The following fees for the registration of contracts are due within three months from date of signature:

- Private commercial contracts (as opposed to public commercial contracts) at the rate of 1% on the estimated amount of the transaction.
- Purchase orders for public contracts at the rate of 2% for contracts with a value exceeding EUR 15,240.
- Subcontracts in building construction and public work sector at a fixed fee of EUR 155.44.
- Insurance contracts are registered free of charge.

Prior to the Finance Act of 2011, tax on insurance contracts were registered during the first thirty days of a quarter, being either 30 January, 30 April, 30 July, or 30 October. Now, insurance contracts shall be registered and tax on insurance paid on the fifteen day of the month following the insurance subscription.

Transfer of company shares are subject to a 5% registration fee.

### *Land tax on built properties*

Land tax is payable annually on built properties and is due from the owner. However, properties built for the purpose of accommodation are exempt for ten years, and properties built for business purposes are exempt for five years. The effective rate is determined every year by the local council.

The land tax is levied on the rental value after a deduction of 25% (decline, maintenance, and repair expenses) for properties built for business purposes. The land tax is levied on the cadastral value after a deduction of 25% (decline, maintenance, and repair expenses) for properties built for accommodation purposes.

### *Land tax on non-built properties*

Land tax is payable annually on non-built properties and is due from the owner. However, properties intended for plantations and breeding are temporarily exempt for a three to ten year range. The effective rate is determined every year by the local council.

The land tax is levied on 50% of the cadastral value, determined every year by the Ministry of Finances. The land tax is arbitrarily assessed by hectares in rural areas according to the nature of the plantations.



## Branch income

Tax rates on branch profits are the same as for domestic corporations. No tax is withheld on transfers of profits to the head office.

## Income determination

### Determination of income

Taxable income is based on financial statements prepared according to generally accepted principles and the standard statements of the Organisation for Harmonisation of Business Law in Africa (OHADA) treaty.

Business expenses are generally deductible, unless specifically excluded by law.

### Capital gains

Capital gains are treated as ordinary business income and are taxed at the standard CIT rate of 35%. However, a capital gain realised on the disposal of a fixed asset in the course of trading is excluded from income for a period of three years if the taxpayer reinvests the gain in new fixed assets for the business.

If the business is totally or partially transferred or discontinued, only half of the net capital gain is taxed if the event occurs less than five years after the start-up or purchase of the business and only one-third of the gain is taxed if the event occurs five years or more after the business is started or purchased. However, the total gain is taxed if the business is not carried-on in any form.

### Dividends

Dividends paid by a Congolese company are subject to a 20% withholding tax (WHT) on securities income (Impôt sur les Revenus des Valeurs Mobilières or IRVM) unless a different rate applies under an international tax treaty (France, CEMAC, Organisation Commune Africaine et Malgache (OCAM)). This IRVM is regarded as an advance payment for the final calculation of CIT.

Dividends are treated as ordinary business income and are taxed at the standard CIT rate of 35% for resident corporations.

After three years, profits credited to the non-compulsory reserve are considered to be dividends and are accordingly subject to the 20% WHT on dividends.

### Inter-company dividends

Dividends received from a Congolese company (DivCo) by a commercial company incorporated in the Republic of Congo (HoldCo) are exempt from CIT and subject to a final 20% WHT if the following conditions are met:

- HoldCo and DivCo are incorporated in the CEMAC
- HoldCo holds 25% of the capital of DivCo
- HoldCo holds the shares for at least two years from the date of purchase.

However, 10% of dividends that are deemed to represent the share of cost and expenses are included in the taxable profits of HoldCo and liable for the CIT.

If the above conditions are not met, dividends received from a Congolese company by another Congolese company are subject to a 20% WHT, which is an advance payment of the recipient's CIT.

## *Deductions*

Generally, a deduction is allowed for all expenditures incurred to obtain, collect, and maintain business profits. To be deductible, expenses should be incurred necessarily for the normal purposes of the business and be supported by suitable evidence.

### *Depreciation and depletion*

In general, all types of fixed assets, except land, are depreciable for tax purposes as long as they can be shown to have been acquired for business purposes of the corporation. Depreciation must be calculated on the original purchase price. The straight-line method is used, and the Congolese General Tax Code sets forth maximum rates of depreciation. Goods costing less than EUR 152.44 per item may be written-off at purchase as expenses.

Depreciation recorded when the company is in a loss position may be carried forward without limitation and deducted from the first available taxable profits, provided it was appropriately disclosed in the annual corporate income tax return.

Recoverable and identifiable packaging is regarded as fixed assets. They are recorded in a fixed asset account at the time of purchase. This packaging is regarded as returnable packaging when the supplier intends to act as the sole owner of the packaging.

Unrecoverable packaging is recorded as an expense and deductible for tax purposes.

Exceptional accelerated depreciation may be authorised in certain circumstances for heavy equipment with a value of more than EUR 60,979.60. This special accelerated depreciation does not apply to private vehicles owned by the enterprises.

### *Exceptional depreciation method*

The exceptional depreciation method is an accelerated depreciation method.

Companies may elect the accelerated depreciation method for heavy materials and equipments that:

- are purchased new for a value higher than EUR 60,979.60
- have a useful life of at least three years
- are used for manufacturing, processing, transport and handling
- are bound to an intensive use.

The application for the accelerated depreciation must be submitted to the head office of taxes within three months of the purchase of the assets to be depreciated. The option is granted upon approval of the ministry in charge of finances. According to the implementation instructions adopted by the head office of taxes on 24 January 2003, if the administration fails to respond to the application for accelerated depreciation within three months, the application is tacitly granted.

According to the implementation instructions adopted by the head office of taxes on 24 January 2003, a 40% deduction may be taken in the year of acquisition of the previously mentioned assets, increased with the normal rate calculated on the residual value after application of the accelerated depreciation. These assets are depreciated on a straight-line basis thereafter.

### *Net operating losses*

For tax purposes, losses may be carried forward to offset profits earned in the three succeeding fiscal years. Carry back losses are not permissible.

In accordance with Article 114 of the Congolese General Tax Code, Part 1, depreciation recorded when the company is in a loss position may be carried forward without limitation.

### *Payments to foreign affiliates*

Allowable deductions include sums paid abroad to foreign companies for:

- actual services, notably overhead for the operations made for the benefit of a company based in the Republic of Congo, including: costs of studies; technical, financial, and accounting assistance; commissions and fees; and interests
- use of patents, licenses, trademarks, drawings, manufacturing processes, patterns, and similar rights to the extent the payer proves they correspond to actual operations, and they are neither abnormal nor excessive.

Subject to the provisions of tax treaties (France, CEMAC, and OCAM), the deduction is allowed within a limit of 20% of taxable profits before deduction of the expenses in question.

In the event of losses, the rate is applied on the results of the last profit period, which is not statutory limited. In the absence of profits during the period out of statutory limitation, the sums paid are not allowed as tax deductions.

When the sums are not allowed, as a whole or in part, in the deductible expenses, they are deemed to be paid benefits and are subject to tax on the dividends at the rate of 20%.

Royalties for the transfer or concession of patents, trademarks, drawings, and other similar titles are deductible to the extent the payer proves they are still valid. When these royalties benefit an enterprise contributing in the management or share capital of an enterprise in the Republic of Congo, they are deemed to be paid benefits and are subject to tax on the dividends at the rate of 20%.

Commission or brokerages, relating to goods purchased on behalf of enterprises based in Congo, are allowable tax deductions up to 5% of the purchase amount made by the central purchasing office, the head office, or the intermediaries. The reductions shall benefit enterprises based in the Republic of Congo. An original supplier’s invoice must be attached to the intermediary’s invoice.

The payer shall prove that:

- the purchases necessitated the interventions of a broker or intermediary
- the commissions provided better supply conditions compared with the actual situations on the market
- the commissions are not excessive compared with the nature of the services.

### *Taxes*
Taxes, other than income taxes, are usually deductible. Examples of deductible taxes include: customs duties, excise duties, payroll taxes, business license tax, registration taxes, and unrecoverable VAT.

Corporate income tax itself is not deductible, nor is the special tax on company-owned cars.

Taxes withheld on remuneration, paid to third parties (third parties taxes), and remitted to the tax office by a Congolese enterprise are not deductible.

### *Interest paid to shareholders*
Interests are deductible subject to two conditions.

1. General limit – regardless of the form under which a legal entity is registered, the deduction is allowed with an interest rate limited to the rate of the advances in current accounts on states funds of the Bank of the States of Central Africa (BEAC) raised by two points. Currently, the ceiling for the deduction of interests is 7.25%.
2. For private limited companies and public limited companies, the deduction is allowed according to the status of control over the management of the enterprise.
   - For shareholders who have control over the company de facto or de jure, the deduction is allowed only to the extent that the sums paid do not exceed, for the shareholders as a whole, half of the paid-up capital and are within the limit sets forth in the 'General limit'.
   - For other shareholders, the General limit applies.

## *Group taxation*

There is no tax provision in the Republic of Congo for group taxation.

## *Tax credits and incentives*

The current investment regime in the Republic of Congo was set out by Law No. 6-2003 of 18 January 2003, which established the investment charter. The charter's application, Decree No. 2004-30 of 18 February 2004 established modes of business registration.

1. Scope – the following may be registered under the investment charter:
   - Businesses wishing to pursue an activity in the Republic of Congo, except for activities such as brokerage, trade, import and production of arms, and import or processing of toxic waste and by products.
   - Under certain conditions, commercial activities linked to collection, storage, distribution, and export of locally produced products, except alcoholic beverages and tobacco.
   - New activities (as opposed to pre-existing activities).
   - Forestry businesses benefiting from a forestry permit called the forestry development unit.
   - New companies coming from the redemption of a registered company.
2. Conditions of eligibility for the investment charter – to be eligible, a company must satisfy the conditions below:

- Be registered with the Trade and Personal Credit Registry in the Republic of Congo.
- Create permanent employment, to be carried out over a minimum of 280 days per year.
- Maintain company share capital equal to or greater than 20% of investments.
- Primarily use local principal materials necessary for the production of the finished or semi-finished product, when available, with equal conditions concerning price, quality, and time of delivery to outside, in the case of industry.
- Primarily use local business services, when available, with equal conditions concerning quality, price, and time of realisation regarding payments to external businesses, for the case of service businesses.
- Be registered at the Congolese National Welfare Fund.
- Open an account at a local bank or any other financial, savings, or credit establishment.
- Primarily use a local workforce, when available, with the same expertise as the foreign workforce.

3. Registration procedure – entitlement to the benefits prescribed by the charter is subject to obtaining a registration agreement, provided by the National Investment Commission.
4. Fiscal and customs benefits set out by the Investment Charter – these benefits vary according to privileged regimes, motivation measures, and in a general manner.

***Privileged regimes***

The charter sets out three privileged regimes:

- General regime (G).
- Special regime (S).
- Preferential development zone regime.

***General regime (G)***

The general regime applies to businesses that fulfil the aforementioned general requirements, and carry out investments greater than or equal to EUR 152,450.

Special advantages are conferred according to the period of activity of the registered business.

During the set-up period and the first three exploitation tax years, the company receives several benefits.

- In customs matters, the company benefits from the provisions of the CEMAC customs code relative to asset improvement mechanisms for export activity and from the suspension of customs duty in the form of temporary admission or franchise for natural resource research activities.
- In fiscal matters, the company benefits from the 50% reduction of registration fees for business foundation, increases in capital, company mergers, and transfer of company stocks and shares.

For the three first exploitation tax years and until the first year of sale or first service, the following fiscal benefits are added with the aforementioned reduction of registration duties:

- Total exemption from the tax on company earnings.
  - Companies that are subject to CIT because of their size or activity will be exempt from CIT.

    - Businesses that are subject to personal income tax because of their size or activity will be exempt from personal income tax.
- The authorisation to proceed to accelerated depreciation.
- The authorisation to carry forward losses for the first three tax years.
- The application of zero-rate VAT on exported products.

### *Special regime (S)*
The special regime applies to businesses that fulfil the aforementioned general requirements and carry out investments between EUR 45,734 and EUR 152,450.

In addition to the advantages of the aforementioned (G) regime, businesses registered under the (S) regime benefit during the set-up period and the first three exploitation tax years from the moderation of registration duties for the incorporation of the business, increases in capital, company mergers, and transfer of company stocks and shares.

This moderation of registration duties is granted exclusively by decree of the Minister in charge of the Economy and Finances upon a decision of the National Investment Commission.

### *Preferential development zone regime*
All exporting businesses registered under the investment charter are eligible for the preferential development zone system, including free-trade zones.

The institution, organisation, and function of the preferential development zone are fixed by a specific text.

### *Incentive measures*
Respect for the aforementioned general requirements set out by the charter is a prerequisite for benefiting from these motivation measures.

### *Export incentives*
This measure is reserved for businesses that export at least 20% of their production.

The benefits are:

- The provisions of the CEMAC customs code, relating to asset improvement mechanisms.
- Exemption from customs duties and taxes on manufactured products, except computing fees and statistic tax.
- Application of a zero-rate VAT on exported products.

Non-manufactured goods remain subject to the common law export system.

### *Incentive to reinvest earnings*
This measure is reserved for businesses that carry out new investments of at least one-third of existing assets.

The benefit conferred consists in a 50% reduction of the tax on company earnings for the three years following the realisation of the investment.

Notwithstanding, this benefit is granted upon the following conditions:

- The business declares to the permanent secretary of the National Investment Commission its investments, planned investment, and the state of existing capital assets.
- The National Investment Commission, on the report of checking teams, verifies if the new investments correspond to one-third of the preceding capital assets.
- All investments are realised within one year.
- Investments generate new employment.
- Investments increase capacity of production by at least 10%.
- The business has sound ethical concerns.

### *Incentives to set up in remote areas*

All new businesses registered under (G) or (S) regimes, which are located in a remote area, benefit from a reduction of 50% on the tax on company earnings in the fourth and fifth year following the first three tax years for which the business benefited from total exemption from the tax on earnings or personal income tax.

The business is considered as belonging to a remote area from the moment its production units are set-up and 90% of the production unit workforce is working in the remote location.

The appraisal of a zone's location results from the exclusive competency of the National Investment Commission.

### *Incentives for social and cultural investment*

All new businesses registered under (G) or (S) regimes, carrying out investments of a social and cultural character, may benefit from a fiscal reduction by ministerial decree of the Minister in charge of Finance and the Economy, upon the decision of the National Investment Commission.

These benefits may not, however, be added to those mentioned above and allocated to remote areas, even if the business concerned is set-up in such a location.

### *General measures*

For the duration of the privileged regime, and subject to current texts, the company shall enjoy fiscal stability in terms of local and state taxes.

Privileged regimes (G) and (S) are allocated only once and are not renewable. The business may receive fiscal and customs advantages pertaining to the set-up period.

Fiscal advantages concerning the exploitation period are applicable only after the set-up period.

The end of the set-up period is certified by decision of the Minister in charge of Economy and Finance after the adoption of the verification report by the National Investment Commission.

## *Withholding taxes*

The Republic of Congo is a member of CEMAC, established by the treaty signed on 16 March 1994 in N'Djamena (Chad) that became effective in June 1999. The organisation replaced what was then the Customs and Economic Union of Central Africa (UDEAC) and adopted its commitments. The CEMAC unites the following six states: Cameroon, Central African Republic, Republic of Congo, Gabon, Equatorial Guinea, and Chad.

# Congo, Republic of

The Republic of Congo has signed the following tax treaties.

### *The tax treaty of the Common Organisation for Africa and Madagascar (OCAM)*

The member states of this organisation adopted a tax cooperation agreement 29 January 1971, which was ratified by the Republic of Congo on 3 September 1971. The OCAM, which initially had 14 members, had 17 members when it was dissolved by the Conference of Heads of State in 1985. Those members were Cameroon, Central African Republic, Chad, Congo, Ivory Coast, Dahomey, Gabon, High Volta, Madagascar, Mauritius, Niger, Rwanda, Senegal, Togo, and the Democratic Republic of Congo. The Republic of Congo has not denounced the application of this tax treaty.

### *The tax treaty of the CEMAC Convention*

The Republic of Congo signed the UDEAC Convention of 13 December 1966, which was designed to avoid or to limit double taxation among the member states: Cameroon, Central African Republic, Congo, Gabon, Equatorial Guinea and Chad. This tax treaty remains significant to companies interested in affiliate creation in Central Africa countries.

### *The tax treaty between the Republic of Congo and the French Republic*

This tax treaty, which concluded on 27 November 1987, was designed to avoid double taxation and to prevent tax evasion related to income tax, inheritance tax, registration law, and stamp duty.

### *Services, dividends, attendance fees*

#### Services

The tax regime set forth for foreign suppliers is defined in Section 185 Ter of the Congolese General Tax Code, Part 1. According to the provisions of Section 185, as well as the wide interpretation made by the Congolese Tax Authorities, the services rendered by the foreign suppliers should be subject to a 20% WHT.

In addition, Section 185 Ter provides that companies, which have no tax residence in the Republic of Congo, are subject to a 20% WHT if they earn revenues realised in the Republic of Congo or coming from the Republic of Congo, and which come from works or services of any nature performed or used in the Republic of Congo.

The provisions of the Section 185 Ter do not apply to resident suppliers of a country that has signed an international tax treaty with the Republic of Congo, provided certain conditions are met.

#### Dividends

Dividends distributed by a Congolese company are subject to a 20% WHT unless a different rate applies under an international tax treaty (France, CEMAC, OCAM). The same rate applies for dividends distributed to a resident shareholder.

Under the tax treaty between France and Congo, the applicable WHT rate is 15%. There is no specific rate defined in the CEMAC and OCAM tax treaties.

#### Attendance fees

Attendance fees are subject to a 22% WHT unless a different rate applies under an international tax treaty (France, CEMAC, OCAM).

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### Payments to local independent contractors

Payments to local independent contractors (self-employed contractors – i.e. those not registered with the Congolese Trade Registry) are subject to a WHT at the rate of 5% from such payments to be remitted to the Public Treasury.

Late remittance of the WHT is subject to a late payment penalty of 50% within the first two months and 100% if the late payment exceeds two months.

### WHT rates summary

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations | 20 | 0 | 0 |
| Resident individuals | 20 | 0 | 0 |
| Non-resident corporations and individuals: (Non-treaty) | 20 | 20 | 20 |
| Treaty with: | | | |
| France | 15 | 0 | 15 |
| OCAM | 0 | 0 | 0 |
| CEMAC | 0 | 0 | 0 |

## Tax administration

### Tax returns

Taxable business profits are computed on the basis of normal accounting principles as modified by certain tax adjustments.

The annual corporate tax return is a specific form (Document Statistique et Fiscal or DSF) which should be prepared in accordance with OHADA accounting principles. The form cannot be completed electronically.

The books must be maintained in French and in XAF. This accounting system must follow the OHADA chart of account. All entries have to be booked under OHADA standard throughout the year.

The annual corporate tax return must be filed within four months following the end of the fiscal year of the company (i.e. before 1 May).

### Payment of tax

Resident companies are required to pay quarterly instalments of tax (15 February, 15 May, 15 August, and 15 November), and these quarterly instalments are generally calculated with reference to the most recent corporate tax return. Special calculations of instalments apply to new taxpayers.

Based on the self-assessment system, when submitting annual tax returns due by 1 May every year, taxpayers must pay the amount of tax calculated in the annual tax return to the extent this amount exceeds tax instalments paid during the year.

Non-resident companies and individuals shall appoint tax representatives in the Republic of Congo. The Congolese resident shall be considered as tax representative if the non-resident person fails to appoint a tax representative.

# Costa Rica

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## Significant developments

There have been no significant corporate tax developments in Costa Rica during the past year.

## Taxes on corporate income

Corporate income is taxed at a 30% rate. However, the law establishes special regulations for small companies whose gross income does not exceed 87,004,000 Costa Rican colónes (CRC). For this category, the following rates apply:

- 10% for companies with gross income up to CRC 43,253,000.
- 20% for companies with gross income of more than CRC 43,253,000, but not more than CRC 87,004,000.
- 30% for companies with gross income over CRC 87,004,000.

Please note that these income tax brackets are adjusted yearly, effective 1 October to 30 September of the following year. The tax brackets listed are for the 2011 fiscal year.

## Corporate residence

In most cases, the place where a company is incorporated is regarded by Costa Rican authorities as the corporate residence. However, any business that carries on industrial, agricultural, or commercial activity in Costa Rica is subject to income taxation on local income in the same way as a registered business, irrespective of the place of incorporation. Such corporations doing business in Costa Rica are subject to permanent establishment (PE) rules.

On the other hand, under the Costa Rican income tax law, income from transactions carried out abroad may be regarded as non-Costa Rican-source income and is not subject to income taxes.

## Other taxes

### Sales tax

A fixed sales tax rate of 13% is applied at all stages of the sale of merchandise or the invoicing of certain limited services. The tax is levied on (i) sales of merchandise within the national territory (except sales of land, buildings, exports, and certain basic necessity items, such as basic foodstuffs, certain medicines, and veterinary products); (ii) the value of services performed by restaurants, bars, motels, printing companies, social and recreational clubs, painting and repair shops, and others; and (iii) imports consisting of merchandise for personal use or consumption or to satisfy commercial needs.

### *Property tax*

Each local municipal government is in charge of real estate appraisal. The property tax to be applied throughout the Costa Rican territory is 0.25% of the appraised value, registered in the respective municipality where the tax liability originates. The first CRC 13,203,000 is exempt from property tax if the taxpayer is an individual who owns only one piece of property within the country. Tax will be levied on the amount in excess of CRC 14,229,000 for the year 2011.

### *Selective consumption tax*

The selective consumption tax may be applied at a rate of up to 100% and is levied on goods that are considered non-essential. The tax base is either the cost, insurance, and freight (CIF) price plus import duties for imported items or the sales value for items produced in Costa Rica. The tax is levied at only one stage in the sale of merchandise. Payment of the tax is required at the time of importation or, for articles produced in Costa Rica, within 15 days of the month of the sale.

### *Real estate transfer tax*

Real estate transfer is calculated as 1.5% of the selling price of the real estate or its tax value, whichever is greater.

### *Capital gains tax*

At present, there is no capital gains tax on the sale of real estate or securities when such sales are not a habitual activity. There is capital gains tax, at the regular rate, on the sale of depreciable assets when their sale price is higher than their adjusted basis (book value).

### *Franchise tax*

The payments realised abroad for the use of a franchise will be subject to remittances abroad, with a 25% withholding tax (WHT).

## *Branch income*

Branch income is subject to income tax at the rates applicable for corporate income taxes. There is a WHT of 15% on dividends distributed within the country and a 15% tax, in lieu of a dividend WHT, on profits transferred abroad.

## *Income determination*

### *Capital gains*

Capital gains and losses on the disposition of non-depreciable fixed assets or shares of other companies are excluded for income tax purposes if such dispositions are not a habitual activity.

### Inter-company dividends
Dividends between domestic subsidiaries and other domestic corporations are not subject to taxes. There are no ownership requirements to qualify for this exclusion.

### Stock dividends
Stock dividends are subject to income tax at 15% if the stock is not listed in an officially recognized stock exchange or 5% if the stock is registered in a stock exchange officially recognized by the Costa Rican government.

Dividends paid in the form of stock of the distributing company are allowed and exempt from taxes.

### Foreign income
Foreign-source income is not taxable.

## Deductions

### Depreciation and depletion
The straight-line and sum-of-the-years-digits methods of depreciation are allowed.

| Assets | Useful life (years) |
|---|---|
| Buildings | 2 to 6 |
| Machinery and equipment | 7 to 15 |
| Furniture and fixtures | 10 |
| Vehicles | 10 |
| Agricultural plantations | 10 to 50 |

The tax administration, at the request of the taxpayer, could adopt technically acceptable special depreciation methods in cases duly justified by the taxpayer. In addition, the tax administration could authorise, through general resolution, accelerated depreciation methods on new assets, acquired by corporations with monetary activities requiring constant technological updates, higher installed production capacity, and productive reconversion processes, in order to maintain and strengthen their competitive advantage.

### Taxes
With the exception of sales tax, selective consumption tax, specific taxes over consumption and special duties over them established by law, penalties and interest paid over any tax obligation, and the income tax itself, all other taxes are deductible expenses when determining taxable income.

### Net operating losses
Losses incurred by industrial and agricultural enterprises may be carried forward and deducted from the taxable profits for the following three years for industrial enterprises, and five years for agricultural enterprises. Loss carrybacks are not allowed.

### Payments to foreign affiliates
Corporations may claim deductions for royalties, technical and management service fees, and interest charges paid to foreign affiliates, provided that a tax of 25% for royalties, franchises, and other services, and a tax of 15% for interest is withheld.

However, the deductions for technical and management service fees may not exceed 10% of gross sales in the aggregate if paid to the parent company.



## Group taxation

There is no group taxation in Costa Rica.

## Tax credits and incentives

### Free zones

Entities established in free zones may enjoy exemption from import duties on goods, income tax, sales tax, export tax, selective consumption tax, real estate transfer tax, and WHT on payments abroad, as well as the discretionary use of foreign currency generated abroad. However, these incentives will be affected by the rules established by the World Trade Organization (WTO) in force in the year 2015.

### Drawback industries

Special benefits exist for industries that import semi-manufactured materials for assembly in Costa Rica and export finished products. Benefits consist of duty-free imports of raw materials for subsequent export as manufactured products. Machinery for these industries may also be imported duty-free.

### Tourism development

The Incentive Law for Tourism Development grants several tax benefits, such as exemption from import duties on certain tourism service-related goods and from property tax for companies dedicated to tourism, but only for those with a signed tourism agreement.

## Withholding taxes

### Payments to non-domiciled foreign corporations or individuals

Regarding payments to non-domiciled foreign corporations or individuals, taxes are withheld as follows:

- Dividends: 15%. Withholding depends on the origin or source of the retained earnings. Total or partial exemption will be authorised by the tax authorities to the extent that a foreign tax credit is totally or partially disallowed to the taxpayer in the taxpayer's country of residence. This exemption will not be allowed, however, if this type of income is not taxable to the taxpayer in the country of residence.
- Interest and other financial expenses: 15%. No tax is withheld if the recipient is a bank or a financial institution recognised as a first-class bank by the Central Bank of Costa Rica or a supplier of merchandise. Interest or financial expenses paid to parties other than those aforementioned are subject to a 15% WHT. An 8% WHT applies to interest on bearer documents issued by financial entities registered at the Central Bank's General Auditor's Office or stock exchange. No WHT applies to interest paid on securities issued by the Workmen's Bank or the Mortgage Housing Bank and its authorised institutions or on foreign currency securities issued by the state banks.
- Special tax on banks and non-resident financial entities. Banks or non-resident financial entities that are part of a local financial group are payers of this tax. The taxpayers mentioned in the 'interest and other financial expenses' section must pay,

in lieu of tax on remittances abroad, a local currency tax equivalent to USD 125,000 per annum. The tax period will run from 1 January to 31 December of each year.

- Royalties, patents, trademarks, franchises, and formulas: 25%.
- Technical service and management fees: 25%.
- Personal services from a Costa Rican source. Employees: 10%; directors: 15%; others: 30%, depending on the nature of the services rendered.
- Transportation and communication services: 8.5%.

### *Tax treaties*

Costa Rica is a full member of the Central American Common Market, which guarantees free trade among the countries of the area. It also has a free-trade bilateral treaty in force with Mexico (1994), the Dominican Republic (1998), Chile (1998), Canada and Panama, and the CAFTA-DR entered into force on 1 January 2009. These agreements aim to provide favourable conditions for the exchange of merchandise between contracting parties.

The only tax treaty in force between Costa Rica and the United States, effective since 12 February 1991, is a Tax Information Exchange Agreement, whereby both countries agree to exchange information, from and/or in relation to public and private entities and individuals, at the request of the party's corresponding authority, in relation to any tax relevant issue.

## *Tax administration*

### *Returns*

With certain exceptions, all corporations must file a tax return by 15 December on the basis of a fiscal year-end of 30 September. Entities with an operating period of less than four months may present a return together with the following year's tax return. Current legislation contemplates that other fiscal year-ends may be adopted with the prior approval of the tax authorities.

The tax system is one of self-assessment with occasional auditing by the tax authorities.

### *Payment of tax*

In March, June, and September all corporations and taxpayers must prepay instalments that total 75% of the average income taxes paid in the past three fiscal years, or the amount paid in the prior year, whichever is greater. Failure to pay on these dates results in the accrual of interest unless the taxpayer has requested, on a timely basis, that the tax authorities eliminate the corresponding payments. Any amount owed in excess of the instalments should be paid by 15 December.

# Croatia

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## Significant developments

Amendments to the Corporate Income Tax Act were introduced on 1 July 2010, and amendments to the Corporate Income Tax Ordinance were introduced on 4 November 2010.

The following significant tax law changes were introduced by these amendments.

### Profit tax

- Provisions on transfer pricing and interest deduction were introduced in business relationships between resident parties, if one party has beneficial tax status (i.e. pays taxes at lower rates) or an entitlement to carry forward tax losses from the previous years.
- An entitlement to carry forward tax losses in case of statutory changes of legal entities is prescribed in detail, limiting the entitlement where the legal predecessor was inactive and in case of a significant change in business activity or ownership structure.
- Provisions for unused holidays in accordance with the accounting regulations are allowed for tax purposes.
- The minimum value of long-term assets (assets used by the company for more than one year) is now increased to 3,500 Croatian kuna (HRK).

### Withholding tax (WHT)

In addition to the current WHT rate of 15%, an increased rate of 20% is introduced. The increased rate applies to all services paid to foreign entities whose place of seat or management is in a country with a profit tax rate below 12.5%. This provision does not apply to European Union (EU) member countries.

### Crisis tax

A special tax at the rate of 2% on earnings ranging from HRK 3,000 to HRK 6,000 was abolished as of July 2010. The remaining special tax at the rate of 4% on income over HRK 6,000 was also abolished as of 1 November 2010.

## Taxes on corporate income

### Profit tax

Profit tax is paid at a flat 20% rate by enterprises engaged in independent activities on a long-term basis for the purpose of deriving profit, branches of foreign enterprises, enterprises that control shares in capital (unless the object of investment itself pays profit tax), and natural persons who choose to pay profit tax instead of personal income tax.

The profit tax base is the difference between revenue and expenditures, adjusted for increasing and decreasing items. Croatian residents pay profit tax on profit derived in Croatia and abroad, and non-residents (e.g. branches) pay profit tax only on profits derived in Croatia. The tax base also includes gains arising from liquidation, sale, change of legal form, and division of the taxpayer where it is determined at the market rates.

Payments into voluntarily pension funds paid by an employer for an employee under certain conditions prescribed by Corporate Income Tax Act are also considered expenditures.

Expenditures are not considered to be expenditures if they are not related to the taxpayer's business activity.

The profit tax base is reduced by the following items:

- Income from dividend and profit sharing.
- Unrealised profits from value adjustments of shares (increase of financial asset value), if these were included as profit in the P&L account.
- Income from collected written-off claims that were included in the tax base in the previous tax periods, but not excluded from the tax base as recognised expenditure.
- The amount of depreciation not recognised in previous tax periods, up to the amount prescribed by the Corporate Income Tax Act.
- The amount of tax relief or tax exemption in line with special regulations (i.e. costs of education, costs of research and development (R&D), costs of a new employee's salary).

The profit tax base is increased by the following items:

- Unrealised losses from value adjustments of shares (decrease of financial asset value), if these were included as expenses in the P&L account.
- The amount of depreciation in excess of the amounts prescribed by the Corporate Income Tax Act.
- 70% of entertainment costs (food and drink, gifts with or without the printed firm logo or product brand, and expenses for vacation, sport, recreation and leisure-time, renting cars, vessels, airplanes, and holiday cottages). Entertainment costs do not include the costs of goods and merchandise adapted by a taxpayer for business entertainment purposes, labelled 'not for sale', and other promotional objects with the name of the firm or merchandise or other advertising objects (e.g. glasses, ashtrays, table cloths, mats, pencils, business diaries, cigarette lighters, tags) put to use in the selling area of the purchaser and given to consumers, provided that their value does not exceed HRK 80 per item.
- 30% of the costs, except insurance and interest costs, incurred in connection with owned or rented motor vehicles or other means of personal transportation (e.g. personal car, vessel, helicopter, airplane) used by managerial, supervisory, and other employees, provided that the use of means of personal transportation is not defined as salary.
- Asset shortfalls exceeding the amount prescribed by the Croatian Chamber of Economy or Croatian Chamber of Trades and Crafts, in accordance with the VAT Act and on the basis of which no personal income tax was paid.
- The costs of forced collection of tax and other levies.
- Fines imposed by competent bodies.
- Late payment interest charged between associated persons.

- Privileges and other economic benefits granted to natural or legal persons for the purpose of causing or preventing a certain event in favour of the company (generally related to commissions paid to parties acting on behalf of the taxpayer).
- Donations in excess of the amounts prescribed by the Corporate Income Tax Act.
- Expenditures identified during Tax Authority's audit, including VAT, surtax, and contributions related to hidden profit payments and withdrawals from shareholders, company members, and physical persons performing independent activities taxable by profit tax.
- Any other expenditure not directly related to profit earning, as well as other increases in the tax base, which were not included in the tax base.

### *Local taxes*

A legal entity that is liable to pay profit tax and is registered for the performance of the business activity may be subject to tax on trade name at the amount of up to HRK 2,000, depending on the decision of the municipality or city.

## *Corporate residence*

In terms of Corporate Income Tax Act, residents are legal or natural persons whose seat is recorded in the Register of Companies or other register in Croatia, or whose place of effective management and control of business is in Croatia. Residents are also entrepreneurs/natural persons with domicile or habitual residence in Croatia, whose business activity is recorded in a register or other records.

A non-resident is any person who does not satisfy one of the requirements referred to above.

### *Permanent establishment (PE)*

Definition of a business unit of a non-resident is based on the Organisation for Economic Co-operation and Development (OECD) guidelines, which provides that a non-resident's business unit is a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources or construction site or project for a period longer than six months, including agents acting in its name, having the right to conclude contracts or hold stock of products which it distributes on the Croatian market in the name of a foreign entrepreneur. The business unit of a non-resident also includes the performance of services (i.e. advisory and business consulting services) for the same or a related project, which lasts for more than three months in a 12-month period.

## *Other taxes*

### *Value-added tax (VAT)*

The general VAT rate is 23%.

VAT is a consumption tax and has a neutral effect on enterprises by operation of the input and output mechanism. Accordingly, the tax burden is borne by the final consumer.

#### VAT returns and payments

A VAT-registered entity must calculate its VAT liability or refund and submit a monthly (by the end of the following month) VAT return to the relevant Tax Authority Office or a quarterly VAT return (by the end of month following the quarter) if the taxpayer is classified as small (annual turnover below HRK 300,000). An annual VAT return must be submitted by 30 April of the following year.

Where the amount of input tax credits exceeds the entity's VAT liability, a taxpayer is entitled to a refund of the difference or may choose to use the difference as a VAT prepayment.

VAT paid to the customs office at the time of import can be credited to the taxpayer's VAT account and offset against any domestic VAT liability. A VAT entity must self-assess VAT on imported services provided by a foreign entity. This VAT can be reclaimed through the VAT return as described above.

### Determination of VAT taxpayers

VAT taxpayers are defined as entrepreneurs that deliver goods or perform services in Croatia. An 'entrepreneur' is a legal entity or a natural person that continuously and independently performs an activity for the purpose of deriving profit. In addition to those that may be regarded as 'normal' taxpayers, domestic enterprises receiving imported services from foreign enterprises and legal entities and individuals that issue invoices or receipts including VAT without authorisation are also liable to pay VAT.

A taxpayer is required to register for VAT where turnover in the previous year exceeded HRK 85,000. Voluntary registration is also possible.

Foreign entrepreneurs may also become VAT registered in Croatia through a tax representative. This will entitle them to reclaim input VAT incurred in Croatia.

In addition to foreign individuals, foreign legal entities are now also entitled to claim a VAT refund under reciprocity agreement terms.

### Determination of VAT base

The VAT base for goods and services supplied domestically is the consideration received. Where no consideration is provided, for instance where goods are exchanged, the VAT base is the market value of the good or service. The VAT base of imports is the customs value as prescribed by customs regulations, increased by customs duties, import duties, special taxes, and other fees paid during customs clearing.

### VAT-exempt supplies

VAT-exempt supplies are similar to those contained in the EU's Sixth Directive and include rental of residential property (with some exceptions); granting of credits and credit guarantees; transactions related to bank accounts, interest, winnings from special games of chance in casinos, slot machine clubs, and other forms of gambling; supplies of domestic and foreign legal tender, securities and shares, and supplies of gold by the central bank.

Other exemptions include the following:

- Services and deliveries of goods by public institutions in the field of culture, such as museums, galleries, archives, libraries, theatres, religious communities and institutions, primary and secondary schools, universities, and student catering and boarding institutions.
- Medical services, including services conducted by doctors, dentists, nurses, physiotherapists, and biochemistry laboratories engaged in private practices; services of medical care performed in healthcare institutions; and services performed by social care institutions and child and adolescent care institutions.

- Supplies (transfers) of real estate (land, buildings, parts of buildings, housing premises, and other structures) with the exception of newly built buildings.
- Temporary imports of goods which are exempt from customs duty.

**Zero-rated supplies**
The following supplies are zero-rated or 'VAT free' under the Croatian VAT legislation:

- Bread and milk, including baby food used as a substitute for mother's milk.
- Books of a scholarly, scientific, artistic, cultural, and educational character as well as school textbooks (primary, secondary, and tertiary education, including materials printed on paper and other media, such as CD-ROMs, video cassettes, and audio tapes).
- Certain medicines and surgical implants.
- Scientific journals.
- Services rendered by cinemas.

**Reduced-rate services**
There is a reduced rate of 10% for services related to the following:

- Organised stays (accommodation or accommodation with breakfast, full or half board, in all kinds of commercial hospitality facilities) and agency fees with respect to the abovementioned services.
- Daily and periodic newspapers and magazines (with the exception of those that consist entirely of advertisements or are used mainly for advertising purposes).

***Excise duties***
There are a number of excise duties levied on specific products. They are levied at a fixed amount and are payable by the producer or importer. VAT is applied first, after which the fixed amounts are added.

- Oil derivatives: Tax ranging from HRK 110 to HRK 3,600 per 1,000 litres.
- Tobacco products: Tax on cigarettes may reach up to HRK 180 per 1,000 pieces plus 30% proportional special (excise) tax from retail price; for cigars HRK 1,100 per 1,000 pieces; for cigarillos HRK 220 per 1,000 pieces; and HRK 234 per kilogram for tobacco (HRK 136 prior to 1 January 2011).
- Beer: HRK 40 per 1% volume fraction of the actual alcohol contained in one hectolitre of finished product.
- Soft drinks: HRK 40 per hectolitre for domestically produced brands and imported soft drinks. Some soft drinks, including mineral water and natural fruit juices, are exempt.
- Alcohol:
  - Excise duty on products with the volume of actual alcohol content at 15% and higher is paid in the amount of HRK 800 per hectolitre of finished product.
  - Excise duty on products with the volume of actual alcohol content of less than 15% is paid in the amount of HRK 500 per hectolitre of finished product.
  - Excise duty on ethyl alcohol is to be paid in the amount HRK 5,300 per hectolitre of pure alcohol.
- Imported coffee: HRK 5 to HRK 20 per kilogram.
- Passenger cars and motor cycles: from 13% to HRK 177,500 plus 63% of the amount exceeding HRK 500,000.
- Imported boats and aircrafts: from 5% to HRK 445,000 plus 16% of the amount exceeding HRK 4 million.

- Luxury products: 30% of the sales value of the product without VAT.
- Liability and comprehensive road vehicle insurance premiums: for obligatory motor vehicle insurance premium, 15% of the contractual amount; and for comprehensive motor vehicle insurance premium, 10% of the contractual amount.

### *Custom duties*
As Croatia is in the accession negotiations process with the European Union, customs regulations are largely in compliance with the EU customs standards. The general customs duty rate is 10%. However, it varies depending on the type and the origin of imported goods, as prescribed by the Customs Tariff. The Customs Tariff is based on the Harmonized Commodity Description and Coding System (HS Nomenclature).

### *Real estate tax*
The acquisition of real estate is subject to taxation. 'Real estate' includes agricultural, construction, and other land as well as residential, commercial, and other buildings. Transactions include the sale, exchange, and any other means of acquiring real estate for consideration.

Tax is charged at 5% of the market value of the real estate on the contract date and is paid by the acquirer.

### *Chamber of Commerce contribution*
Employers pay a mandatory contribution to the Croatian Chamber of Commerce. The amount varies between HRK 55 to HRK 5,500 depending on company size and 0.0056% of total income.

### *Stamp tax*
There are no stamp taxation provisions in Croatia.

## *Branch income*

Foreign corporations carrying on business in Croatia are taxed on their Croatian-source income at a 20% rate.

## *Income determination*

### *Inventory valuation*
Inventories are generally valued at the lower of their acquisition cost or net realisable value. Taking into consideration the accounting principles set out in the Accounting Act and the International Accounting Standards (IAS), a company can choose to adopt the most favourable method.

### *Capital gains*
Capital gains or losses are covered by the profit tax regime. They are either an increasing or decreasing item to the profit tax base.

### *Inter-company dividends*
Inter-company dividends are treated as income under the profit tax regime but are not included in the tax base.

## Deductions

### Depreciation
Most companies depreciate assets on a straight-line basis; this is because depreciation calculated this way, at the prescribed rates, is recognised for tax purposes. Companies are, however, free to use any depreciation method defined in the IAS and to estimate the useful lives of all fixed assets in accordance with their accounting policies.

Prescribed annual depreciation rates are as follows:

| Assets | Depreciation period (years) | Depreciation rate (%) |
|---|---|---|
| Buildings and ships of over 1,000 gross registered tonnage (GRT) | 20 | 5 |
| Basic herd and personal cars | 5 | 20 |
| Intangible assets, equipment, vehicles (except personal cars), and machinery | 4 | 25 |
| Computers, computer hardware and software, mobile telephones, and computer network accessories | 2 | 50 |
| Other non-mentioned assets | 10 | 10 |

However, depreciation expenses in excess of the amount allowed for tax purposes are taxable. The value adjustment of tangible fixed assets rarely occurs in practice, except in the case of financial assets and claims.

The Corporate Income Tax Act no longer allows taxpayers to wholly write off plant and equipment acquired or built during the tax period. Furthermore, by the newly introduced changes in the Corporate Income Tax Act, applicable from 1 July 2010, the cost of depreciation of assets which are not used for business purposes is not deductible.

Plant and equipment are taken to be acquired in the period in which it is installed or ready for use. Plant and equipment includes: tools of trade, information technology infrastructure including software, furniture and fittings, and motor vehicles (excluding vehicles for personal use).

If the taxpayer writes off a portion of a depreciable asset, the remaining undepreciated portion will be depreciated at the rate prescribed by law. According to the Corporate Income Tax Act, the taxpayer can double depreciation rates.

Land and forests (renewable resources) are not depreciated.

Financial assets, cultural monuments, and art work are not depreciated.

Depreciation of vessels, aircrafts, condominiums, and vacation houses can be tax deductible only if certain conditions are met.

### Goodwill
Goodwill paid on the acquisition of a business must be amortised over five years. It is usually the difference between the estimated statistical value of assets and liabilities and their book value.

However, the amortisation of goodwill arising from mergers and acquisitions is not recognised for taxation purposes.

### Net operating losses

Tax losses may be carried forward and utilised within five years following the year in which the losses were incurred and must be utilised in the order in which they occurred. The losses may not be transferred to any third entity except in the case of merger, de-merger, or acquisition. Tax losses cannot be carried back.

By the newly introduced changes in Croatian Corporate Income Tax from July 2010, utilisation of tax losses from previous years in case of statutory changes of legal entities is prescribed in detail, limiting the entitlement where the legal predecessor is inactive and in case of a significant change in business activity or ownerships structure.

### Payments to foreign affiliates

The treatment of payments made to foreign affiliates is dealt with through the mechanism of the profit tax base. The profit tax base is increased for any concealed profit payments made. The Tax Administration may audit the expenditure of non-resident taxpayers, examining expenditure on goods and services abroad as well as management, intellectual property, and other fees and payments that may have the character of a profit transfer. If the Tax Administration discovers that transactions have been used to conceal profit transfers, the difference between the declared price/fee and the average market price/fee will be added back into the taxpayer's tax base.

## Group taxation

There are no group taxation provisions in Croatia.

### Transfer pricing

Prices between a Croatian entity and its foreign related parties must be set at fair market value (the arm's length principle). By the changes of the Corporate Income Tax Act applicable from 1 July 2010, provisions on transfer pricing and interests are also introduced in transactions between resident related parties if one of the parties has:

- beneficial tax status (i.e. reduced tax rates) or
- entitlement to carry forward tax losses from previous years.

If the prices between related entities are different than those between non-related resident and non-resident entities, the tax base must be calculated with prices that would be charged between unrelated companies. In order to determine the market value of the related party's transaction, the following methods can be used:

- Comparable uncontrolled price.
- Resale price.
- Cost plus.
- Profit split.
- Net-profit.

### Thin capitalisation

Interest on loans from a shareholder or a member of a company holding at least 25% of shares or voting power of the taxpayer will not be recognised for tax purposes, if the amount of the loan exceeds four times the amount of the shareholder's share in the capital or their voting power. Interest on loans obtained from financial institutions is exempt from this provision. A third-party loan will be considered to be given by a shareholder if it is guaranteed by the shareholder.

## *Tax credits and incentives*

The Investment Incentive Act provides the following relief and incentives for taxpayers.

### *Investment incentives*

Investment incentives are usually organised as corporate tax credits applicable for up to ten years upon completion of various conditions.

General incentives apply for investors profit earned as a result of an investment under the following conditions:

| Investment amount (EUR) | Tax benefit rate (%) | Period (years) | Necessary to employ (employees) |
|---|---|---|---|
| From 300,000 to 1.5 million | 10 | 10 | 10 |
| More than 1.5 million | 7 | 10 | 30 |
| More than 4 million | 3 | 10 | 50 |
| More than 8 million | 0 | 10 | 75 |

Tax benefits cannot exceed investment amount.

### *Incentive for investment in significant projects*

A non-refundable money subsidy in an amount of up to 5% of justified costs related to investment in significant projects (maximum amount of up to EUR 1 million) may be granted to a company, providing that certain conditions are met.

A significant project investment consists of high economic activity, such as the construction of a new plant or industrial facility, initiation of a new economic activity, or new technology development, with investment in assets greater than EUR 15 million. At least 100 workplaces must be opened upon expiration of one year of investment.

### *Custom free zones*

Taxpayers in custom free zones can take advantage of incentives prescribed in the Investment Incentives Act. Taxpayers that were engaged in or participating in the building of infrastructure within a zone, in projects with a value exceeding HRK 1 million before July 2008, and that did not fully utilise the incentive prescribed by the Investment Incentive Act, are exempt from paying profit tax until the full amount has been used, but no later than 31 December 2016.

### *Employment incentives*

Taxpayers whose business activities are based on agriculture or fishing in areas under special state care and employing more than five persons on a permanent bases (certain limitations apply), will be exempted from the payment of profit tax until EU accession, up to 100%.

Taxpayers with business activities other than agriculture or fishing in areas under special state care and who employ more than five persons on a permanent basis (subject to certain limitations and depending on the area) will be exempt from tax, up to a certain amount of the profit tax rate, as prescribed by local legislation. Exemptions will be gradually decreased until year 2014 or 2017, when it will no longer be applicable.

Companies established in the territory of the City of Vukovar and employing more than five persons on a permanent basis will be exempted from the payment of any profit tax until EU accession.

Companies established in mountain regions that employed more than five persons on a permanent basis, enjoyed up to a 75% profit tax reduction in the period starting from 2008 until the end of 2010.

### *Research and development (R&D) incentives*

Registered scientific organisations, centres of scientific excellence, individual scientists, and groups of scientists are entitled to apply for the state subsidies and tax incentives for scientific research, basic research, applied R&D research.

Depending on the type of research (e.g. scientific, basic, applied research, or technical feasibility) and size of entrepreneur (i.e. small, medium, or large entrepreneur, according to the Accounting Act), the percentage of the costs covered by state subsidy can vary between 25% and 100%. Additionally, the profit tax base can be decreased (depending on the same criteria) by up to 150% of the amount of the costs covered by the state subsidy, where the profit tax liability decrease is granted up to the amount of the percentage of the costs covered by state subsidy.

### *Foreign tax credit*

If a domestic taxpayer has paid tax abroad on profit derived abroad, the tax paid will be included in its profit tax, up to the amount of tax paid abroad. The amount of paid tax abroad, which can be offset with the domestic tax, is calculated in the following way:

- The domestic tax rate is charged on the revenues/profit derived from abroad, and the result represents the highest amount of tax which can be offset with the domestic tax.

If the amount of paid tax abroad was charged at the rate lower than 20%, the actual amount of foreign tax paid can be offset with the domestic tax.

## *Withholding taxes*

Taxpayers who pay fees for the use of intellectual property rights (the right to reproduction, patents, licenses, copyrights, designs or models, manufacturing procedures, production formulas, blueprints, plans, industrial or scientific experience, and such other rights); fees for market research services, tax consulting services, legal, auditing, or such other services; or interest to foreign legal entities, natural persons excluded, shall, when making the payment, calculate and withhold tax at a rate of 15%.

In addition to the current withholding tax (WHT) rate of 15%, an increased rate of 20% applies to all services paid to foreign entities whose place of seat or management is in a country with a profit tax rate below 12.5%. This provision does not apply to EU member countries.

The following countries have a profit tax below 12.5%:

| | | |
|---|---|---|
| Andorra | Gibraltar | Netherlands Antilles |
| Anguilla | Grenada | Niue |
| Antigua and Barbuda | Guernsey | Panama |

| | | |
|---|---|---|
| Aruba | Isle of Man | Saint Kitts and Nevis |
| Bahamas | Jersey | Saint Lucia |
| Bahrain | Liberia | Saint Vincent and the Grenadines |
| Belize | Liechtenstein | Samoa |
| Bermuda | Marshall Islands | Seychelles |
| British Virgin Islands | Monaco | Turks and Caicos Islands |
| Cayman Islands | Montserrat | US Virgin Islands |
| Cook Islands | Nauru | Vanuatu |
| Dominica | | |

Note that tax is not withheld from interest payments on the following:

- Commodity loans for the purchase of goods used for carrying out a taxpayer's business activity.
- Loans granted by a non-resident bank or other financial institution.
- To holders of government or corporate bonds, who are non-resident legal persons.

The WHT rate on dividends is 0%, regardless of the period in which the dividends were received.

## *Tax administration*

### *Returns*

All profit tax taxpayers are obliged to submit an annual profit tax return to the tax authorities no later than four months after the end of the tax period for which profit tax is assessed.

The Ministry of Finance administers taxation matters through the Tax Administration and the Financial Police. These organisations have responsibilities and powers defined by law.

### *Payment of tax*

Every taxpayer is required to make monthly profit tax instalments (on the last day of each month) on the basis of the previous year's tax return.

In the first year of operation, taxpayers are not obliged to pay any profit tax advances.

Profit tax is assessed at the end of the calendar year, and the assessed amount, less any instalments made, is payable by the day of submission of the tax return.

# Curaçao

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## Significant developments

### Recent political developments

On 10 October 2010, the Netherlands Antilles dissolved, and Curaçao became an autonomous country within the Kingdom of the Netherlands. Prior to dissolution, the Netherland Antilles consisted of five islands: St. Maarten, Curaçao, Bonaire, Saba, and St. Eustatius.

While each of the islands will remain within the Kingdom of the Netherlands structure, the ties between the islands will be loosened. Defence and foreign affairs will remain within the province of the government of the Kingdom of the Netherlands. Also, the judiciary system will remain an integral part of the Kingdom of the Netherlands.

### Compliance with sound international fiscal standards

In recent years, Curaçao, as part of the former Netherlands Antilles, has complied with international standards as set forth by the Organisation for Economic Co-operation and Development (OECD) and the European Union (EU). There is, for example, no distinction in the fiscal treatment of offshore and onshore taxpayers. Well-known incentives such as a participation exemption comparable to that applied in the Netherlands and Luxemburg apply to all taxpayers, as well. Curaçao does not have bank secrecy laws, and the tax information exchange agreements (TIEAs) that in recent years have been concluded with several countries remain applicable to Curaçao.

### Tax treaties

Curaçao currently has tax treaties in effect with the Netherlands (including the Caribbean Netherlands), Aruba, St. Maarten, and Norway. A double tax agreement (DTA) has been negotiated with Jamaica but has not yet entered into force.

Furthermore, TIEAs have been signed with several countries, including Australia, Canada, Denmark, Mexico, Spain, Sweden, New Zealand, and the United States. As a result ,Curaçao, as part of the former Netherlands Antilles, has been moved to the white list of the OECD Global Forum.

### Transitional legislation

While the offshore tax regime was abolished in 2001, qualifying offshore companies incorporated before 1 January 2002 may continue to apply the old regime until 2019, provided that certain conditions are met under transitional legislation.

### Recent tax proposals

The Government has announced that it is planning to review the current tax system. It is looking for a shift from direct tax to indirect tax as well as to broaden the base of the income and corporate income tax, while lowering the tax rate. For the corporate income tax, the Government has introduced a proposal to lower the tax rate from 34.5% to 27.5% for the current year and aims for further reductions to possibly 20% in 2014.

## Taxes on corporate income

Resident corporations are taxed on worldwide income. Non-resident companies are taxed on the following Curaçao-source income:

- Income attributable to a permanent establishment (PE).
- Income from real property situated on Curaçao.
- Interest on loans secured by a mortgage on property situated on Curaçao.

Capital gains are not differentiated from operating income and are subject to the same applicable rates. Corporations are taxed on their income as reflected in their profit and loss account, less certain deductible items.

Companies are generally taxed at a flat rate of 34.5%.

Special minimum rates apply to the taxable income of certain companies:

| Type of company | Rate (%) |
|---|---|
| E-zone companies | 2 |
| New industries and hotels | 2 |
| Land development companies | 2 |

### Shipping business

Shipping companies are subject to the general profit tax rate of 34.5% but may apply for the tonnage regime. If applicable, their profit is calculated based on the rates provided in the table below. If a shipping company applies the tonnage regime, the actual profits or losses are not taken into account, regardless of whether they are regular profits or capital gains.

The calculated profit based on the table below is subject to the general tax rate of 34.5%.

| Over (tons) | Not over (tons) | Profit per net ton (ANG*) |
|---|---|---|
| 0 | 10,000 | 2.00 |
| 10,000 | 25,000 | 1.35 |
| 25,000 | | 0.60 |

* Antilles guilders

### Exempt companies

*Please see the Tax credits and incentives section for information on tax exempt companies.*

### Companies under transitional offshore rules

The transitional rules distinguish three types of offshore companies.

- Offshore companies which, on the last day of the financial year that ended before 1 January 2002, had all (or almost all) investments in or revenues from portfolio investments, royalties, holding companies, finance companies, or technical support subject to tax rates of 2.4% to 3% (while capital gains and losses were not taken into account) will be grandfathered through the last day of the financial year of the company that starts before 1 July 2019.

- Offshore companies which, on the last day of the financial year that ended before 1 January 2002, had all (or almost all) their profit subject to tax rates of 4.8% to 6% or, under certain circumstances, 2.4% to 3% and which had a valid ruling with the tax inspector (e.g. trading companies, banks, captives commissions, and fee-earning companies) on the aforementioned date or for which a request for (extension of) such a ruling had been filed on that date will be grandfathered through the last day of the financial year of the company that starts before 1 July 2019.
- Offshore companies that, on the last day of the financial year that ended before 1 January 2002, had invested all (or almost all) investments in or revenues from real estate property or rights connected thereto, located outside the Netherlands Antilles. These revenues were, under the old offshore regime, exempt from tax. For profit tax purposes, these companies will be grandfathered through the last day of the financial year of the company that starts before 1 July 2019.

Specific rules are applicable to companies that were incorporated after 30 June 1999 but before 31 December 2001. These companies may also qualify for the aforementioned transitional rules provided that these companies have been active in a meaningful way. In principle, a company will not be considered to have been active in a meaningful way if the assets of the companies consist predominantly of deposits or receivables on shareholders or affiliated parties.

The grandfathering period continues until 2019.

## Corporate residence

Corporate residence is, in principle, determined by the place of incorporation. However, other factors may also determine residence. For example, a foreign company with effective management on Curaçao is considered to be a resident. A company that has been established on Curaçao will always be considered a resident of Curaçao.

Offshore entities on Curaçao must have a local managing director. This function is easily provided by one of the many trust companies established on Curaçao.

### Permanent establishment (PE)

The definition of a PE on Curaçao is generally in line with the OECD model.

### Transfer of legal seat

Legislation has been enacted under which a Curaçao company is allowed to transfer its legal seat to another jurisdiction (if permitted under the laws of the outside jurisdiction) and a foreign company is allowed to migrate to Curaçao.

## Other taxes

### Turnover tax

A 5% turnover/sales tax is levied on the revenue derived from services and deliveries rendered by an entrepreneur or company on Curaçao.

A limited number of services and deliveries are exempt, such as:

- Exports.
- Electricity and water.
- Certain services to non-residents.

- Medical services.
- Services at the airport or in the harbour regarding imported or exported goods or goods in transit.
- Advisory and management services provided to or by offshore companies and offshore banks.



An entrepreneur liable to turnover/sales tax must file a declaration, with the Tax Inspectorate before the 16th day of the month following the month concerned, at the Tax Collector's office.

### Excise tax
Excise tax is due on gasoline; alcohol, with different tariffs for liquor and beer; as well as for tobacco.

### Land tax
A land tax is levied on real estate located on Curaçao at an annual rate of 0.3% on the value of the land.

### Transfer taxes
The transfer of immovable property located on Curaçao is subject to a 4% transfer duty.

## Branch income

### Branches operating on Curaçao
Tax rates on the profits of PEs are the same as for resident corporations.

There are specific rules for the PE of an insurance company. In that case, the company may elect to declare profit based on a percentage of premiums received by the PE, as well as premiums the company has received from insured residents and from insured risks on Curaçao. The insurance company may also elect to declare a profit that is in the same proportion to total profit of the company as the aforementioned premiums to total premiums.

No tax is withheld on transfers of profits to the head office.

### Branches of Curaçao-based companies
Curaçao has adopted a definition of a branch (permanent establishment/permanent representatives) that is in line with the definition in the OECD Model Double Taxation Convention on Income and Capital.

The profits of a PE in Aruba, St. Maarten, or the Netherlands, including the Caribbean Netherlands, are tax exempt on Curaçao based on the tax arrangement with the Kingdom of the Netherlands. In the case of a PE outside the Kingdom of the Netherlands (i.e. the Netherlands, Aruba, Curaçao, and St. Maarten), the income realised through the PE, after deduction of foreign taxes, is tax exempt. In the case of a foreign loss, this is not deductible.

Foreign real estate is always deemed to be part of a PE and, as such, is fully tax exempt.

## Income determination

### Inventory valuation

Both the last in first out (LIFO) and first in first out (FIFO) methods of inventory valuation are permitted, provided the chosen method conforms to sound commercial practice. Conformity of book and tax reporting is not required. However, occasions or situations for differences are very rare.

### Capital gains

Capital gains or losses are, in principle, considered ordinary income and subject to standard corporate rates. An exemption from profit tax is granted for advantages (dividends and capital gains) from a qualifying participation *(see Dividend income below)*.

Under the transitional regime for offshore companies (investment, holding, finance, and patent holding companies), capital gains and losses are tax exempt.

### Dividend income

In general, a full participation exemption applies to all local as well as foreign participations for dividends as well as for capital gains. However, it is now required that dividends be derived from an active participation (non-portfolio investment) or a participation that is subject to tax.

Expenses incurred in connection with a qualifying participation (including capital losses) are not deductible, unless it can be demonstrated that these are indirectly incurred to realise profits that are subject to tax on Curaçao.

#### Non-portfolio investment clause

A participation is deemed to be active if the gross income of that participation consists of not more than 50% of dividends, interest, or royalties received other than from an enterprise of that participation.

#### Subject-to-tax clause

A participation is deemed to be subject to tax if it is subject to a tax rate of at least 10%.

If at least one of these clauses has been met, the 100% participation exemption will apply. If none of these clauses are met, the participation exemption is limited to 70% of dividends. Consequently, the dividends would be subject to an effective tax rate of 10.35% (30% x 34.5% regular tax rate).

The 100% exemption also applies to income other than dividends, such as capital gains derived from qualifying participations.

#### Immovable property

The aforementioned clauses do not apply to dividends from a participation that (almost) exclusively (directly or indirectly) holds immovable property. The 100% participation exemption applies to these dividends.

#### Definition of dividend

A dividend is defined as a distribution of profits on shares or profit-sharing notes, paid from statutory profits or profit reserves. Dividends shall not be considered payments for the purchase of own shares or profit-sharing notes, distributions on shares upon liquidation, repayment of paid-up capital, or the distribution of bonus shares.

**Minimum cost-price threshold for participations**
The minimum cost-price threshold for shareholdings, profit-sharing notes, or voting rights of less than 5% is ANG 890,000.

### *Foreign income*
A Curaçao corporation is taxed on foreign interest and other income as earned, and on foreign dividends when received. Undistributed income of foreign subsidiaries is not taxable.

The profit of a PE is tax exempt, and foreign losses are not deductible.

## *Deductions*

### *Depreciation and amortisation*
Depreciation of tangible fixed assets, excluding land, is taken over the estimated useful life of the asset. The depreciable base includes purchase price, customs duties, shipping costs, and installation costs, less residual value, if any. The straight-line method is customary, but the declining-balance method is also acceptable. In addition, an accelerated deduction of one-third of the assets' depreciable basis may be taken. The assets' remaining cost basis (two-thirds) is depreciated using one of the acceptable methods.

The cost basis of certain intangible assets, such as patents, trademarks, and copyrights, can be amortised over their expected useful lives. Goodwill and other intangibles resulting from the excess of purchase price over the cost basis of assets purchased are amortised over three to five years.

### *Charitable contributions*
Charitable donations to qualifying entities within the Kingdom of the Netherlands may be deducted to the extent that they exceed 1% of net income and ANG 100 after utilisation of tax loss carryforwards. The maximum deduction is 3% of net income.

### *Taxes*
Taxes, other than the corporate profit tax itself, incurred in the course of doing business are deductible.

### *Fines and penalties*
Fines and penalties are not deductible in cases where they have been imposed by a criminal court in Curaçao, or have been paid to avoid prosecution, and in cases of administrative fines imposed by a Government agency in Curaçao.

### *Bribes, kickbacks, and illegal payments*
Expenses that are connected to a criminal offence for which a taxpayer has been convicted are not deductible. Bribes paid to public servants and politicians are not deductible.

### *Net operating losses*
Losses may be carried forward for a period of ten years. Start-up losses during the first four years for companies having tax holidays may be carried forward indefinitely. Carrybacks are not permitted.

### *Payments to foreign affiliates*
The Corporate Tax Act provides for specific limitations for deduction of interest in certain cases of restructuring and refinancing involving the creation of artificial flows of interest payments to persons who are tax exempt or subject to lower taxes in their jurisdiction.

## *Group taxation*

### *Fiscal unity*
The Corporate Tax Act provides for fiscal unity treatment for corporate profit tax purposes. Resident companies with wholly owned resident subsidiaries could qualify for this regime. The parent company is entitled to submit one consolidated income tax return on behalf of the entire fiscal unity group. As a result, only the parent company is assessed.

Within certain limitations, losses of one company can be offset against the profits made by another company in the fiscal unity group. No profits need to be recognised on inter-company transactions, as these are disregarded for tax purposes. The fiscal unity applies for profit tax purposes only; the participating entities remain separate and identifiable under civil law.

Fiscal unity relief is confined to companies organised under the laws of Curaçao, the Netherlands, Aruba, or St. Maarten. The companies which invoke this relief must have their place of management on Curaçao.

On the basis of the non-discrimination provision of a relevant tax treaty, entities established under the laws of a tax treaty party may also be admitted to the fiscal unity regime provided that they are resident on Curaçao.

### *Transfer pricing*
There are no specific regulations with regard to transfer pricing. However, based on case law, businesses can be required to show that in case of intra-company transactions, these transactions have been made at arm's length.

### *Thin capitalisation*
In cases where a company receives a loan from an associated exempt private limited liability company (Besloten Vennootschap or BV), and the amount of the loan is more than three times the net equity of the company, the interest on the loan is not deductible for the part that is more than three times the net equity.

## *Tax credits and incentives*

### *Foreign tax credit*
A tax credit applies to income from abroad that has been subject to tax at source or to another tax on income. The tax credit is allowed for the income tax levied abroad, but shall not exceed the Curaçao profit tax that is attributable to that foreign income.

### *Inward investment and capital investment*
There are tax incentives or holidays for the establishment of new economic enterprises and hotels with a predetermined minimum employment and capital investment. Special provisions relate to the taxation of shipping and insurance companies.

### *Investment allowance*
For a minimum investment of ANG 5,000, an 8% investment allowance on acquisitions and improvements (for new buildings, 12%) is permitted as a deduction from taxable profit in the year of investment and in the subsequent year, for businesses operating on Curaçao.

### *Accelerated depreciation and tax rollover reserve*
An accelerated deduction of one-third of the assets' depreciable basis may be taken. If a profit results at the time of sale of capital assets with the intention to replace that asset, the profit may be placed in a tax rollover account.

### *Tax exempt company*
It is possible to elect tax-exempt status for a private limited company (Besloten vennootschap or NABV). To qualify for the exemption, a number of conditions must be met, including (but not limited to) the disclosure of beneficiaries, management, financials, and the activities (only investment and financing activities) of the company. Recently, the licensing of intellectual and industrial property rights and other comparable property and usage rights have been added to the list of allowed activities.

Another condition has been added that requires that no more than 5% of the revenues of the exempt company consist of dividends from subsidiaries that are not subject to a tax regime comparable to that of Curaçao. A profit tax regime is comparable to that of Curaçao if the foreign tax regime provides for a profit tax rate of at least 15% (50% of the Curaçao tax rate, excluding island surcharges).

The subject-to-tax requirement is also met if the foreign tax regime appears on a list of comparable tax regimes. The list that has been issued includes all EU and OECD member states and all jurisdictions with which Curaçao has a tax treaty. According to the list, the subject-to-tax requirement is also met in the case of a jurisdiction that is included in the white list issued by the OECD, provided that no special tax regime is applicable.

#### Independent expert
Currently, an independent expert is required to certify that the exempt company meets the requirements for exempt status. If more than 5% of the revenues of the exempt company consist of dividends from subsidiaries that are not subject to a tax comparable to that of Curaçao, the independent expert must inform the Inspectorate of Taxes. The inspector notifies the company that it no longer meets the requirements for exempt status. The exempt status is then terminated starting the first day of the year following the year in which the notification becomes final.

### *Ocean shipping companies*
Ocean shipping companies are taxed on a fixed profit per net ton of ANG 0.60 up to ANG 2.00 (or per 10 net ton in case of management and control). International aviation companies may apply a reduced tax rate against 80% of their profit, as their profits are deemed to be gained outside of Curaçao. As a result, the overall effective tax rate is 9.66%.

### *E-zone companies*
An e-zone is an area designated for international trade and services. The activities of companies established in an e-zone must be focused on trading or providing services to companies located outside of Curaçao. There are two types of e-zones:

- Designated areas where, amongst others, goods can be stored, processed, machined, assembled, packaged, displayed, and released or handled in any other way. On Curaçao, there are two of this type of e-zone that are dedicated to goods, one located at the harbour, and the other at the airport.
- E-zones where international trade and trade supportive services may be performed, supported by electronic communcation and information equipment (e-commerce). There are several e-commerce zones on Curaçao.

E-zone companies are subject to a minimum 2% corporation tax until 1 January 2026. They will be granted special facilities regarding turnover tax.

### *New industries and hotels*
New industries and hotels are granted partial exemption from profit tax and a minimum 2% tax rate for a period of five to 11 years. A minimum investment is required. Losses incurred during the first four years of operations may be used to offset taxable income for an indefinite period of time.

### *Land development companies*
Land development companies are granted a tax holiday. They are exempt from tax on profits realised on the sale of the developed land. A minimum investment of ANG 1 million is required. Activities should be expected to enhance the economic development of Curaçao.

### *Private foundations*
Private foundations are exempt from Curaçao profit tax, and their distributions are exempt from Curaçao gift tax, as are contributions of assets to the foundation by a non-resident. Gift tax in the contributor's country may be applicable.

The 'private' foundation is a variant of the long-existing 'common' foundation. The most important difference is that the purposes of a common foundation may not include making distributions (other than distributions of an idealistic or social nature). This restriction does not apply to private foundations, whose purpose may include making distributions to the founders and others. A private foundation may not run a business or enterprise for profit. Acting as a holding company or investment company is not considered running a business. The private foundation is intended to be an alternative to the Anglo-Saxon trust, especially in civil law jurisdictions.

### *Mergers, split-ups, and re-incorporations*
In cases of a business merger, relief is granted under certain circumstances. Although there is no specific provision in the Corporate Tax Act with regard to legal mergers, legal split-ups, and re-incorporations, the Tax Inspectorate has announced that when certain conditions are met, a tax facility also applies in these cases.

## *Withholding taxes*

Although a dividend withholding tax (WHT) was approved in 1999, it has been decided that for the foreseeable future this tax will not enter into force. If it is decided that the tax will enter into force, there is a mandatory transitional period during which the tax will not be applicable to legal entities resident at that time on Curaçao.

### *Tax treaties*
Curaçao currently has tax treaties in effect with the Netherlands, Aruba, St. Maarten, and Norway. A double tax agreement (DTA) has been negotiated with Jamaica, but

this has not entered into force yet. Furthermore, TIEAs have been signed with several countries including Australia, Canada, Denmark, Mexico, Spain, Sweden, New Zealand, and the United States. As a result, Curaçao, as part of the former Netherlands Antilles, has been moved to the white list of the OECD Global Forum.

### *Tax arrangement for the Kingdom of the Netherlands (TAK)*

As part of the Kingdom of the Netherlands (TAK), Curaçao is party to a federal tax agreement with the Netherlands, Aruba, and St. Maarten. Subject to this treaty, dividends, interest, and royalties paid out to a Curaçao company may qualify for reduced rates of WHT in the subject countries.

Dutch dividend WHT is 15% if the Curaçao company owns less than 25% of the Dutch company. On Curaçao, only 5% of these dividends are taxed, at a rate of 34.5%, which results in an effective profit tax rate of 1.725%.

If the Curaçao company's interest is 25% or more, Dutch WHT can be reduced to 8.3%. This tax is then paid, under a special procedure, to the Curaçao tax authorities. These dividends are fully exempt from profit tax on Curaçao.

Capital gains derived from shareholdings in Netherlands' corporations are fully exempt from profit tax on Curaçao, provided that the shareholding amounts to at least 25% interest in the corporation. If the shareholding amounts to less than 25%, the capital gain is tax exempt for 95%.

The WHT regime in the TAK also applies to the old Curaçao offshore companies.

The TAK is to be revised.

## *Tax administration*

### *Returns*

Profit tax is levied by way of a self-assessment system. Returns are to be filed on a calendar-year basis. Non-resident corporations may file their returns based on a calendar-year basis or on a different book-year. On request, this may also apply, for example, when a resident company is the subsidiary of a foreign parent company (i.e. only a local company must request for a different tax year end).

A provisional return must be filed within three months after the end of the book-year. A final return must be filed within six months after the end of the book-year.

### *Payment of tax*

Payment is to be made at the time of filing and in a lump sum on the basis of the self-assessment.

In general, at the time of filing the provisional return, an amount equal to the profit tax of the previous year must be paid; the remaining balance due for the year for which the return is filed must be paid at the time of filing the final return.

For example, if the tax due for the year 2009 was 100, then at the time of filing the provisional return for 2010, that same amount must be declared and paid. If there is reason to believe that the amount for the year 2010 will be lower than for 2009, the estimated lower amount may be paid at the time of filing the provisional return, upon request.

At the time of filing the final return for the year 2010, the balance due must be paid; or if the total amount is less than the amount already paid up, a repayment will follow.

### *Statute of limitations*

A reassessment can be imposed until five years after the tax year. In cases where the tax payer is considered to be in bad faith, a reassessment can be imposed until ten years after the tax year.

## *Other issues*

### *Mergers*

The Corporate Tax Act provides for a tax facility for business mergers. In a business merger, a company acquires all or a substantial part of the trade or business of another company with a view towards combining the business operations of the two companies into a permanent financial and economic organisation. If the business is transferred as part of a business merger, the gains realised by the transferor are not subject to profit tax if certain conditions are met.

Although there is no specific provision in the Corporate Tax Act with regard to legal mergers, legal split-ups, and re-incorporations, the Tax Inspectorate has announced that when certain conditions are met, a tax facility also applies in these cases.

### *Exchange controls*

In general, exchange control regulations are very liberal for offshore companies. Offshore companies established on Curaçao can obtain non-resident status for exchange control purposes, which basically provides for total exemption from exchange controls. Onshore companies are subject to slightly stricter rules. These companies are subject to a licence fee of 1%.

# Cyprus



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## Significant developments

There have been no significant corporate tax developments in Cyprus during the past year.

## Taxes on corporate income

The corporate tax rate in Cyprus is 10% on taxable income.

### Life insurance companies

Profits of insurance companies are liable to corporation tax, similar to other companies, except in the case where the corporation tax payable on taxable profits of a life insurance business is less than 1.5% of the gross premiums. In this case, the difference is paid as additional corporation tax.

### International Collective Investment Schemes (ICIS)

The ICIS law, enacted in 1999, provides the required legal framework for the registration, regulation of operations, and supervision of ICIS. The sole objective of ICIS is the collective investment of funds of the unit-holders.

ICIS can take the following legal forms:

- International fixed capital company.
- International variable capital company.
- International unit trust scheme.
- International investment limited partnership.

ICIS are exempt from tax on profits arising on disposal of titles. Dividend income also is exempt (with minor limitations), whereas interest income is taxed at the rate of 10%.

ICIS set-up in Cyprus can utilise the double taxation treaty (DTT) network of Cyprus.

## Corporate residence

All companies that are tax residents of Cyprus are taxed on their income accrued or derived from all sources in Cyprus and abroad. A non-Cyprus tax resident company is taxed on income accrued or derived from business activity which is carried out through a permanent establishment (PE) in Cyprus and on certain other incomes arising from sources in Cyprus.

Only companies managed and controlled in Cyprus are treated as tax resident of Cyprus.

## Other taxes

### Value-added tax (VAT)

VAT is imposed on the provision of goods and services in Cyprus as well as on the acquisition of goods from the European Union and the importation of goods into Cyprus. Taxable persons charge VAT on their taxable supplies (output tax) and are charged with VAT on goods or services which they received (input tax).

The standard VAT rate in Cyprus is 15%. Two reduced VAT rates, an 8% rate and a 5% rate, apply in Cyprus:

- The reduced VAT rate of 8% applies on accommodation, restaurant and catering services, as well as on certain local passenger transport services. As of 10 January 2011, the term 'restaurant and catering services' includes the supplies of prepared and unprepared foodstuffs and beverages that are accompanied by sufficient support services that enable the immediate consumption of the foodstuffs and beverages supplied.
- The reduced rate of 5% applies on foodstuffs, pharmaceutical products, books and newspapers, as well as on a variety of other goods and services which are beyond the scope of this summary.

Exports from Cyprus are zero-rated (i.e. no VAT must be charged on the export, and the company is entitled to recover the relevant input VAT suffered). The services for the international transport of passengers as well as the transportation of goods either from or to countries outside the EU are also zero-rated.

Supplies of goods to businesses resident in other EU member states are outside the scope of Cypriot VAT. Certain education services as well as the majority of financial, insurance, and medical services are exempt from Cypriot VAT. Supplies of land and buildings also are exempt from VAT, unless the supply relates to new buildings before its first use.

#### VAT registration

VAT registration is compulsory for business with:

- turnover in excess of 15,600 euros (EUR) during the 12 preceding months or
- an expected turnover in excess of EUR 15,600 within the next 30 days.

Business with turnover of less than EUR 15,600, or with supplies that are outside the scope of VAT but for which the right to claim the amount of the related input VAT is granted, have the option to register on a voluntary basis.

An obligation for registration also arises for businesses which make acquisition of goods from other EU member states in excess of EUR 10,251.61 during any calendar year.

In addition, as of 1 January 2010, an obligation for VAT registration arises for businesses engaged in the supply of intra-Community services for which the recipient must account for VAT under the reverse charge provisions. Furthermore, an obligation for VAT registration arises for business carrying out economic activities from the receipt of services from abroad for which an obligation to account for Cyprus VAT under the reverse charge provision exists, subject to the registration threshold of EUR 15,600 per any consecutive 12 month period.

No registration threshold exists for the provision of intra-Community supplies of services.



Exempted products and services, and disposals of items of capital nature, are not taken into account for determining annual turnover for registration purposes.

Registration is effected by completing the appropriate application form.

### VAT declaration and payment/return of VAT

VAT returns must be submitted quarterly, and the payment of VAT must be made by the 10th day of the second month that follows the month in which the tax period ends.

VAT registered persons have the right to request for a different filing period. Approval of the VAT authorities is required. The VAT Commissioner also has the right to request for a taxable person to file one's VAT returns for a different period.

Where in a quarter input VAT is higher than output VAT, the difference is refunded or is transferred to the next VAT quarters.

## *Immovable property tax*

Immovable property is subject to property tax, which is levied on the market value of the property as of 1 January 1980, and is payable by the end of September each year.

The tax rates vary from 0 per thousand to 3.5 per thousand on values of up to EUR 854,300 and 4 per thousand on any excess.

Public property, buildings under preservation order and of charitable organizations, as well as agriculture, are generally exempt.

## *Capital duty*

### Upon incorporation of the company

Upon incorporation of the company, capital duty is due on the authorised share capital at EUR 102.52 plus 0.6% of the authorised share capital.

As for the issued share capital, there is no stamp duty payable if the shares are issued at their nominal value. There is a EUR 17.09 flat duty if the shares are issued at a premium.

### Upon subsequent increases

Upon subsequent increases, capital duty is due on the authorised share capital at 0.6% of the nominal value of the additional share capital.

As for the issued share capital, EUR 17.09 is due on every issue batch, whether the shares are issued at a premium or not and irrespective of the number of shares issued every time.

## *Stamp duty*

The general rule is that Cyprus stamp duty is imposed only on written contracts relating to assets located in Cyprus or to matters that will take place in Cyprus. The applicable rates are based on the value of each document and are 0.15% for the first EUR 170,860 and 0.20% thereafter, subject to an overall maximum of EUR 17,086 per contract.

### *Special contribution for defence*

Special contribution for defense is imposed on income earned by Cyprus tax residents. Non-tax residents of Cyprus are exempt from this special contribution for defence. Special contribution for the defence of the Republic is imposed on certain types of income.

Dividends generally are exempt from defence contribution, subject to certain rarely applicable limitations *(see Dividend income in the Income determination section)*.

Interest received by close-ended or open-ended collective investment schemes (CIS) is never subject to the special defence contributions but is only taxed under corporate income tax after deducting expenses at the standard corporate tax rate of 10%.

Interest received by other companies in the ordinary course of business, including interest closely connected to the ordinary course of business, is again only taxed under corporate income tax after deducting expenses at the standard corporate tax rate of 10%. When companies receive interest that does not satisfy the conditions prescribed immediately above, the interest is subject to special defence contribution without expense deduction at the rate of 10%, except interest received from government savings bonds and development bonds which are subject to special contribution for defence at the lower rate of 3%. Such 'passive' nature interest would, however, be exempt from corporate income tax.

Gross rental income reduced by 25% is subject to special contribution for defence at the rate of 3%.

### *Social security*

Employed persons are compulsorily insured under a state-administered social insurance fund. Contributions to the fund are borne by both employer and employee. The employer's contributions are made as a percentage of earnings to the following funds:

| Funds | Employer contribution (%) |
|---|---|
| Social insurance fund | 6.8 |
| Redundancy fund | 1.2 |
| Training development fund | 0.5 |
| Social cohesion fund | 2.0 |
| Holiday fund ( option for exception) | 8.0 |

With the exception of the social cohesion fund, the maximum amount of monthly earnings on which the contributions are made is EUR 4,342 as of 1 January 2011.

## *Branch income*

The rate of tax on branch profits is the same as on corporate profits. No further tax is withheld on transfers of profits to a foreign head office.

## Income determination

### Inventory valuation
Inventories generally are stated at the lower of cost and net realisable value. Last in first out (LIFO) is not permitted for taxation purposes. First in first out (FIFO) is permitted. Conformity between book and tax reporting is not required.



### Capital gains on immovable property
Capital gains tax is imposed at the rate of 20% on gains arising from the disposal of immovable property situated in Cyprus and of shares in companies (other than companies whose shares are listed in any recognised stock exchange) that own immovable property situated in Cyprus. Liability is confined to gains accruing since 1 January 1980. The costs deducted from gross proceeds on the disposal of immovable property are its market value at 1 January 1980, or the costs of acquisition and improvements of the property, if made after 1 January 1980, as adjusted for inflation up to the date of disposal on the basis of the consumer price index in Cyprus.

Other expenses which are related to the acquisition and disposal of immovable property also are deducted, subject to certain conditions (e.g. interest costs on related loans, transfer fees, legal expenses).

### Dividend income
All dividends received from other Cyprus companies are excluded from all taxes at all times.

Dividends earned from foreign investments are exempt from income tax in Cyprus. Such dividend income is also exempt from special contribution for defence unless:

- more than 50% of the foreign paying company's activities result directly or indirectly in investment income and
- the foreign tax is significantly lower than the tax burden in Cyprus (i.e. less than 5%).

Note that where the Cyprus participation exemption on foreign dividend incomes is not available, then any foreign withholding tax (WHT) imposition on dividends paid to the Cyprus company will be credited against the Cyprus flat tax rate of 15% tax on such dividends. Furthermore, in some cases, underlying tax credit will also be granted.

### Stock dividends
A Cyprus corporation can distribute tax-free dividends of common stock (bonus shares) proportionately to all common stock shareholders.

### Foreign income
Resident corporations are subject to tax on their worldwide income. However, foreign-branch income, as well as dividend income from abroad, is exempt from taxation in Cyprus *(see above)*.

Where foreign income is taxed in Cyprus, double taxation is avoided, either through unilateral relief by giving credit for foreign taxation or by treaty relief. This credit may not exceed the Cyprus taxes imposed on the same income.

Profits from a PE abroad are exempt from income tax. This exemption is always applicable unless:

- more than 50% of the foreign PE's activities result directly or indirectly in investment income and
- the foreign tax on the income of the foreign PE is significantly lower than the tax burden in Cyprus (i.e. less than 5%).

## Deductions

### Depreciation and depletion

Depreciation is computed on a straight-line basis at rates that vary, depending on the life and type of asset. Tax depreciation is not required to conform to book depreciation. Gains on the sale of depreciated property are taxable as ordinary income to the extent of depreciation allowed.

### Charitable contributions

Charitable donations or contributions made for educational, cultural, or other charitable purposes to the Republic, or to approved charitable institutions, are wholly deductible, provided that these expenses are supported with relevant vouchers.

### Taxes

Taxes that are deducted in computing profits for corporate tax purposes include VAT not recovered and the employer's share of contributions to the social insurance and other funds.

### Other significant items

Any expenditure on scientific research of a capital nature for which no capital allowance is granted is deductible from taxable income and spread equally over the year in which it has been incurred and the five subsequent years. Scientific expenditure of a revenue nature is deducted in the year incurred.

Any expenditure incurred on the acquisition of patents, patent rights, and intellectual property is deductible from taxable income, and spread equally over the life of the patents or patent rights.

### Net operating losses

Tax losses can be carried forward indefinitely and set-off against taxable profits of future years. Carrybacks are not permitted.

### Payments to foreign affiliates

A Cyprus corporation can claim a deduction for royalties and interest charges paid to foreign affiliates, and a reasonable amount of head office expenses of an overseas company, provided such expenditures can be justified as having been incurred in the production of the income.

In the case of insurance companies, the amount of head office expenses should not exceed 3% of the net premiums in Cyprus for the general insurance business and 2% for the life insurance business.

## Group taxation

Group relief provisions allow, subject to certain conditions, companies of the same group to transfer losses from the loss-making companies to profitable companies. A group includes only Cypriot resident companies with at least a 75% direct or indirect holding relationship.

### *Transfer pricing*

Cyprus tax law does not contain any transfer pricing provisions. However, transactions between related parties should be carried out at pure commercial terms (i.e. at arm's length).



## *Tax credits and incentives*

The following tax incentives exist:

- Profits from disposals of corporate titles are unconditionally exempt from income tax. 'Titles' is defined as shares, bonds, debentures, founders' shares, and other titles of companies or other legal persons incorporated in Cyprus or abroad and options thereon as well as futures/forwards on titles, short positions on titles, swaps on titles, depositary receipts, repos, units in open or close CIS, ICIS, undertakings for collective investments of transferable securities (UCITS), investment trusts and funds, mutual funds, real estate investment trusts (REITS), and units in stock exchange indices.
- For ship-owning companies, the profits derived by the owner or bare boat charterer of a ship registered in the European Union or European Economic Area (EEA) (as well as foreign subject to conditions) from its operation are fully exempt from all direct taxes. A similar exemption applies to charterers and ship managers. Instead of corporate tax, ship owners, charterers, and managers pay tonnage tax (TT) on the net tonnage of the ships they own, charter, or manage. In addition, there is no tax on dividends paid at all levels of distribution by the above persons out of profits subject to TT and related capital gains on the sale of the ship and no capital gains tax on the sale or transfer of a ship, share in a ship, or shares in a ship owning company. The same legislation also provides for income tax exemption of the salaries and benefits of the captain, the officers, and the crew aboard a Cyprus flag vessel. This treatment applies until 2020 and is compulsory for Cyprus flag ship owners, but optional for other ship owners, charterers, and ship managers.
- Transfers of assets and liabilities between companies can occur without tax consequences within the framework of a tax-exempt qualified reorganisation. Reorganisations include mergers, demergers, partial divisions, transfers of divisions of activities, and exchanges of shares.

## *Withholding taxes*

The following tables give a summary of the WHT provided under the double tax treaties entered into by Cyprus.

### *Paid from Cyprus*

| Recipient | Dividends (%) (1) | Interest (%) (1) | Royalties (%) (1) |
|---|---|---|---|
| Non-treaty countries | 0 | 0 | 0 (2) |
| Treaty countries: | | | |
| Armenia (20) | 0 | 0 | 0 |
| Austria | 10 | 0 | 0 |
| Belarus | 5 (18) | 5 | 5 |

| Recipient | Dividends (%) (1) | Interest (%) (1) | Royalties (%) (1) |
|---|---|---|---|
| Belgium | 10 (8) | 10 (6, 19) | 0 |
| Bulgaria | 5 (23) | 7 (6) | 10 |
| Canada | 15 | 15 (4) | 10 (5) |
| China, P.R. | 10 | 10 | 10 |
| Czech Republic | 0 (29) | 0 | 0 (30) |
| Denmark | 10 (8) | 10 (6) | 0 |
| Egypt | 15 | 15 | 10 |
| France | 10 (9) | 10 (10) | 0 (3) |
| Germany | 10 (8) | 10 (6) | 0 (3) |
| Greece | 25 | 10 | 0 (12) |
| Hungary | 0 | 10 (6) | 0 |
| India | 10 (9) | 10 (10) | 10 (16) |
| Ireland, Rep. of | 0 | 0 | 0 (12) |
| Italy | 0 | 10 | 0 |
| Kuwait | 10 | 10 (6) | 5 (7) |
| Kyrgyztan (20) | 0 | 0 | 0 |
| Lebanon | 5 | 5 | 0 |
| Malta | 15 | 10 | 10 |
| Mauritius | 0 | 0 | 0 |
| Moldova | 5 (27) | 5 | 5 |
| Montenegro (26) | 10 | 10 | 10 |
| Norway | 0 | 0 | 0 |
| Poland | 10 | 10 (6) | 5 |
| Qatar | 0 | 0 | 0 (28) |
| Romania | 10 | 10 (6) | 5 (7) |
| Russia | 5 (17) | 0 | 0 |
| San Marino | 0 | 0 | 0 |
| Serbia (26) | 10 | 10 | 10 |
| Singapore | 0 | 10 (6, 25) | 10 |
| Slovak Republic | 10 | 10 (6) | 5 (7) |
| Slovenia (26) | 10 | 10 | 10 |
| South Africa | 0 | 0 | 0 |
| Seychelles | 0 | 0 | 5 |
| Sweden | 5 (8) | 10 (6) | 0 |
| Syria | 0 (8) | 10 | 10 |
| Tadzhikistan (20) | 0 | 0 | 0 |
| Thailand | 10 | 15 (21) | 5 (22) |
| Ukraine (20) | 0 | 0 | 0 |
| United Kingdom | 0 | 10 | 0 (3) |
| United States | 0 | 10 (10) | 0 |

### *Received in Cyprus*

| Payer | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Treaty countries: | | | |
| Armenia (20) | 0 | 0 | 0 |

| Payer | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Austria | 10 | 0 | 0 |
| Belarus | 5 (18) | 5 | 5 |
| Belgium | 10 (8) | 10 (6, 19) | 0 |
| Bulgaria | 5 (23) | 7 (6, 24) | 10 (24) |
| Canada | 15 | 15 (4) | 10 (5) |
| China, P.R. | 10 | 10 | 10 |
| Czech Republic | 0 (29) | 0 | 0 (30) |
| Denmark | 10 (8) | 10 (6) | 0 |
| Egypt | 15 | 15 | 10 |
| France | 10 (9) | 10 (10) | 0 (3) |
| Germany | 10 (8) | 10 (6) | 0 (3) |
| Greece | 25 (11) | 10 | 0 (12) |
| Hungary | 5 (8) | 10 (6) | 0 |
| India | 10 (9) | 10 (10) | 15 (15) |
| Ireland, Rep. of | 0 | 0 | 0 (12) |
| Italy | 15 | 10 | 0 |
| Kuwait | 10 | 10 (6) | 5 (7) |
| Kyrgyzstan (20) | 0 | 0 | 0 |
| Lebanon | 5 | 5 | 0 |
| Malta | 0 | 10 | 10 |
| Mauritius | 0 | 0 | 0 |
| Moldova | 5 (27) | 5 | 5 |
| Montenegro (26) | 10 | 10 | 10 |
| Norway | 0 (13) | 0 | 0 |
| Poland | 10 | 10 (6) | 5 |
| Qatar | 0 | 0 | 0 (28) |
| Romania | 10 | 10 (6) | 5 (7) |
| Russia | 5 (17) | 0 | 0 |
| San Marino | 0 | 0 | 0 |
| Singapore | 0 | 10 (6, 25) | 10 |
| Slovak Republic | 10 | 10 (6) | 5 (7) |
| Slovenia (26) | 10 | 10 | 10 |
| South Africa | 0 | 0 | 0 |
| Serbia (26) | 10 | 10 | 10 |
| Seychelles | 0 | 0 | 5 |
| Sweden | 5 (8) | 10 (6) | 0 |
| Syria | 0 (8) | 10 (4) | 10 |
| Tadzhikistan (20) | 0 | 0 | 0 |
| Thailand | 10 | 15 (21) | 5 (22) |
| Ukraine (20) | 0 | 0 | 0 |
| United Kingdom | 15 (14) | 10 | 0 (3) |
| United States | 5 (9) | 10 (10) | 0 |

Notes

1. Under Cyprus legislation there is no WHT on dividends, interests, and royalties paid to non-residents of Cyprus.
2. Royalties earned on rights used within Cyprus are subject to WHT of 10%.

3. A rate of 5% on film and TV royalties.
4. 0% if paid to a government or for export guarantee.
5. 0% on literary, dramatic, musical, or artistic work.
6. 0% if paid to the government of the other state.
7. This rate applies for patents, trademarks, designs or models, plans, secret formulas, or processes, or any industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.
8. A rate of 15% if received by a company controlling less than 25% of the voting power.
9. A rate of 15% if received by a person controlling less than 10% of the voting power.
10. 0% if paid to a government, bank, or financial institution.
11. The treaty provides for WHT on dividends but Greece does not impose any withholding tax in accordance with its own legislation.
12. A rate of 5% on film royalties.
13. A rate of 5% if received by a person controlling less than 50% of the voting power.
14. This rate applies to individual shareholders regardless of their percentage of shareholding. Companies controlling less than 10% of the voting shares are also entitled to this rate.
15. A rate of 10% for payments of a technical, managerial, or consulting nature.
16. Treaty rate is 15%, therefore restricted to Cyprus legislation rate.
17. A rate of 10% if a dividend is paid by a company in which the beneficial owner has invested less than EUR 100,000.
18. If investment is less than EUR 200,000, dividends are subject to 15% WHT which is reduced to 10% if the recipient company controls 25% or more of the paying company.
19. No WHT for interest on deposits with banking institutions.
20. Armenia, Kyrgyzstan, Tajikistan, and Ukraine apply the USSR/Cyprus treaty.
21. A rate of 10% on interest received by a financial institution or when it relates to sale on credit of any industrial, commercial, or scientific equipment or of merchandise.
22. This rate applies for any copyright of literary, dramatic, musical, artistic, or scientific work. A 10% rate applies for industrial, commercial, or scientific equipment. A 15% rate applies for patents, trademarks, designs or models, plans, secret formulas, or processes.
23. This rate applies to companies holding directly at least 25% of the share capital of the company paying the dividend. In all other cases the WHT is 10%.
24. This rate does not apply if the payment is made to a Cyprus international business entity by a resident of Bulgaria owning directly or indirectly at least 25% of the share capital of the Cyprus entity.
25. A rate of 7% if paid to a bank or financial institution.
26. Slovenia, Serbia, and Montenegro apply the Yugoslavia/Cyprus treaty.
27. This rate applies if received by a company (excluding partnerships) that holds directly 25% of the shares. A rate of 10% applies in all other cases.
28. Applies to any consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films and films, tapes or discs for radio or television broadcasting), computer software, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial, or scientific experience.
29. This rate applies if received by a company (excluding partnership) which holds directly at least 10% of the shares for an uninterrupted period of no less than one year. 5% applies in all other cases.
30. 10% for patent, trademark, design or model, plan, secret formula or process, computer software or industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.

Tax treaties pending signature include Armenia, Bahrain, Georgia, Germany, Iran, Monaco, and United Arab Emirates.

## *Tax administration*

### *Returns*

Business organisations are required to prepare audited accounts based on International Financial Reporting Standards (IFRS). Tax returns are completed based on these accounts on a calendar-year basis. The tax return needs to be submitted to the tax authorities by 31 December of the year following the relevant tax year.

### *Payment of tax*

Corporate entities must pay provisional tax on the current year’s income in three equal instalments on 1 August, 30 September, and 31 December. A final payment must be made on or before 1 August of the following year on a self-assessment basis to bring the total payments of tax to the total actually due according to the tax return.

# Czech Republic

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## Significant developments

2010 was not a year rich in corporate income tax (CIT) developments, which may be perceived as a good signal of having relatively stable tax legislation. In 2010, for the first time, residents from other EU member states were expressly permitted to file a tax return for the tax liability on income sourced in the Czech Republic, which allows them to deduct related costs. In cases where their income was subject to withholding tax (WHT), they have a right to have the potential tax overpayment refunded.

2010 also brought certain crucial decisions made by the Supreme Administration Court. Once and for all, contrary to the past standpoint of tax authorities, the court concluded that the costs of financing of dividend payments should be treated as tax deductible.

As of 2011, tax exemptions for green energy sources (e.g. solar and wind energy plants) are no longer valid. A special regime for solar plants has been introduced, namely a special tax depreciation regime and a levy of 26% of the purchase price of electricity to be withheld by the energy distributor from the preferential price paid to the energy producer.

A new Code on Administration of Taxes has come into effect as of 1 January 2011.

The Value-added Tax (VAT) Act has been substantially amended as of 1 April 2011, and the changes are comprised of the following:

- The entitlement to claim input VAT is deferred to the moment when the taxpayer receives a tax document.
- Creditors whose receivable has not been paid are, under certain conditions, allowed to claim refund of VAT.
- VAT payers who purchase goods or services from other Czech VAT payers are exposed to potential liability to pay VAT if their supplier had not paid the output VAT and the purchaser knew, should have known, or might have known that this would be the case.
- The domestic reverse charge mechanism is extended also to the supplies of emission permits and scrap (further extended to the providers of construction works starting from 2012).
- VAT payers must issue a corrective tax document (credit note or debit note) in all situations when they allow an additional discount or goods are returned.

## Taxes on corporate income

CIT applies to the profits generated by all companies, including branches of foreign companies. Corporate partners in general partnerships (i.e. unlimited) and corporate general partners (i.e. unlimited) in a limited partnership are subject to CIT on their share of the profits in the partnership.

Czech resident companies are required to pay CIT on income derived from worldwide sources. Non-resident companies are required to pay CIT on income sourced in the Czech Republic.

The 19% CIT rate applies to all business profits, including capital gains from the sale of shares (if not exempt under the participation exemption regime).

There is a special tax rate of 15% levied on dividend income of Czech tax resident entities from non-resident entities (unless subject to participation exemption).

## *Corporate residence*

A company is resident in the Czech Republic for CIT purposes if it is registered in, or has a place of management located in, the Czech Republic. A Czech tax resident company is liable for CIT on its worldwide income.

## *Other taxes*

The taxes discussed below may apply in addition to CIT.

### *Value-added tax (VAT)*

VAT is charged at 20% on the supply of goods and services within the Czech Republic, but certain supplies (such as groceries) are taxed at a rate of 10%. It is planned that the lower rate will be increased to 14% in 2012. From 2013 onwards, only one unified VAT rate of 17.5% should apply.

Exports are generally exempt from VAT with a credit. Some supplies are exempt without a credit, including the lease of real estate (with certain exceptions), financial and insurance services, radio and TV broadcasting, education, health, and welfare.

#### VAT registration

A company must be registered for VAT if its taxable supplies exceed CZK 1 million for a period of 12 consecutive months or purchases of goods from other EU countries exceeds CZK 326,000 per calendar year. A company can register voluntarily even if its turnover fails to reach the threshold if it renders taxable supplies in the Czech Republic. These are general rules applicable to entities established in the Czech Republic. Different rules apply to non-Czech entities. It is planned that the registration threshold will be reduced to CZK 750,000 starting in 2012.

#### VAT returns and payments

The VAT return must be filed and tax paid within 25 days after the end of the taxable period. The taxable period is a calendar month or calendar quarter depending on taxpayer turnover. Tax overpayment should be returned to the taxpayer by the tax office within 30 days after the request for the tax overpayment refund.

### *Road tax*

Road tax is payable annually with respect to vehicles (including private vehicles) used for commercial purposes. Foreign vehicles are also liable to road tax while in the Czech Republic. Rates vary depending on engine capacity and vehicle size.

### Real estate tax
Real estate tax is payable annually by the owner of land or buildings. The amount of the tax is dependent on area, location, and usage of the land or buildings.

### Real estate transfer tax
Real estate transfer tax is levied on the transferor of real estate at a rate of 3% on the greater of the transaction price or the officially appraised value. The taxpayer is the transferor; transferee acts as tax guarantee.

### Excise taxes
Excise tax is charged on the production or import of tobacco products, wines, spirits, beer, fuel, and lubricants.

### Customs duties
The Czech Republic is an EU member state, and therefore EU customs code applies.

### Stamp duties
There are no stamp duties in the Czech Republic. Certain business operations in which a notary has to be involved by operation of law are subject to notarial fee.

### Environmental taxes
Environmental taxes are imposed on electricity and natural gas, and on certain solid fuels. The environmental taxes have a character similar to excise taxes.

### Social security and health insurance contributions
Employers contribute 34% of the employee’s gross salary to the state health and social security funds. A cap on the premium is available. Substantial changes are expected starting in 2012.

## Branch income

A foreign company can trade in the Czech Republic through a Czech branch. A branch usually creates a Czech permanent establishment (PE) of the foreign entity for CIT purposes (depending on the character of the activities carried out through the branch). The basis of taxation is the same as for corporations (i.e. tax base is calculated as taxable revenues less tax-deductible costs). In some cases, it may be possible for taxpayers to negotiate with the tax authorities regarding the basis on which profits are attributed to the branch.

A branch is liable for tax on its attributable profits at the standard CIT rate.

## Income determination

### Inventory valuation
Stock (i.e. inventory) is valued at cost. Czech legislation specifically provides for the use of the arithmetical average cost and first in first out (FIFO) methods to value stock. Last in first out (LIFO) and the replacement-cost methods (except for livestock) may not be used.

### Capital gains
No separate capital gains tax is levied in the Czech Republic. Capital gains are included in the CIT base and taxed as ordinary income in the year in which they arise.

Capital gains from the sale of shares may be exempt from Czech taxation if all of the following conditions are met:

- The Czech or EU parent holds at least 10% of the shares of the subsidiary for at least 12 months.
- The subsidiary is a tax resident of the Czech Republic or another EU member state.
- Both the parent and the subsidiary have one of the legal forms listed in the Annex to the EU P/S directive.

If the subsidiary is not a tax resident of the Czech Republic or another EU member state, the exemption may be applied, provided that the subsidiary is a tax resident of a country where there is a double-tax treaty (DTT) in place with the Czech Republic, it has a legal form similar to a limited liability company or a joint stock company, it is subject to CIT at the nominal rate of at least 12% in a year when dividends are paid, and the time test of 10% for at least 12 calendar months is met. The time test may be met both prospectively and retrospectively.

### *Dividend income*

Dividends received by Czech tax resident corporations from non-resident entities are subject to a special tax rate of 15%, unless exempt under the participation exemption regime described below.

Dividends paid by Czech tax resident corporations to Czech resident entities are subject to 15% final withholding tax (WHT), unless exempt under the participation exemption regime.

Dividends paid by Czech tax resident corporations to Czech non-resident entities are subject to 15% final WHT, unless exempt under the participation exemption regime or decreased under the relevant DTT.

### *Participation exemption regime*

Dividend income may be exempt from Czech taxation (i.e. WHT, when a Czech company is paying dividends and CIT, when a Czech company is receiving dividends) if all of the following conditions are met:

- The Czech or EU parent holds at least 10% of the shares of the subsidiary for at least 12 months.
- The subsidiary is a tax resident of the Czech Republic or another EU member state.
- Both the parent and the subsidiary have one of the legal forms listed in the Annex to the EU P/S directive.

Regarding dividends paid, provided that conditions above are met, the exemption also applies when dividends are paid by a Czech subsidiary to Switzerland, Norway, or Iceland.

Regarding dividends received, if the subsidiary is not a tax resident of the Czech Republic or another EU member state, exemption on dividends received by a Czech resident may be applied, provided that the subsidiary is a tax resident of a country where a DTT with the Czech Republic is in place, it has a legal form similar to a limited liability company or a joint stock company, it is subject to CIT at the nominal rate of at least 12% in a year when dividends are paid, and the time test of at least 10% for at least 12 consecutive calendar months is met.

### *Foreign income*

Companies resident in the Czech Republic are taxed on their worldwide income. A Czech corporation is taxed on its foreign branch income when earned (accrual basis) and on foreign dividends when approved by general meeting.

The participation exemption regime described above may be applicable.

There is no controlled foreign companies (CFC) legislation in the Czech Republic.

### *Exchange gains and losses*

Realised as well as unrealised foreign exchange gains and losses are accounted for in profit and loss accounts and represent taxable revenues or tax-deductible costs, respectively.

The default functional currency is the Czech koruna (CZK). A Czech company cannot opt for any foreign currency to be the functional currency for tax purposes.

## *Deductions*

### *Depreciation and amortisation*

Methods of tax depreciation are prescribed by tax legislation and are independent from depreciation methods for accounting purposes. Tax depreciation is calculated on an asset-by-asset basis, applying the straight-line or accelerated basis methods of depreciation at statutory rates. Under both methods, depreciation expense in the first year is lower than for subsequent years. The company may choose which method to apply to a new asset, but once the choice is made, it cannot be altered. All assets are classified into six groups, which determine the number of years over which the asset will be written off, as follows:

| Assets | Depreciation group | Minimum depreciation period (years) |
|---|---|---|
| Office machines and computers, tools | 1 | 3 |
| Engines, motor vehicles, machines, audio-visual equipment | 2 | 5 |
| Elevators, escalators, turbines, air conditioning equipment, electric motors, and generators | 3 | 10 |
| Buildings made of wood and plastic, long-distance lines, and pipes | 4 | 20 |
| Buildings (except for those listed in groups 4 and 6), roads, bridges, tunnels | 5 | 30 |
| Administrative buildings, department stores, historical buildings, and hotels | 6 | 50 |

'Tangible assets' (i.e. assets which are subject to tax depreciation) are defined by tax legislation generally as assets with economic useful lives of greater than one year and acquisition prices higher than CZK 40,000. Certain assets, such as buildings, are always considered tangible assets.

Taxpayers are generally not obliged to depreciate a tangible asset for tax purposes every year. Depreciation may be interrupted in any year and continued in a later year without a loss of depreciation potential.

Tangible assets are generally depreciated by the taxpayer with ownership title. Certain exceptions apply, for instance, technical appreciation of a rented asset carried out by a tenant may be depreciated by that tenant, subject to certain conditions.

Depreciation can start only once the assets are put into use and comply with the requirements of specific laws.

Certain assets have special depreciation methods (e.g. moulds are depreciated based on expected life or number of products).

The value to be used as the basis for tax depreciation depends on how the asset is acquired, for example:

- Acquisition cost (construction and equipment costs, architect fees, legal fees, notary's fees, etc.), if the asset is acquired for consideration.
- Internal costs incurred, if the asset is acquired or produced internally.

'Intangible assets' are defined by tax legislation as software, valuable rights, intangible results of research and development (R&D), and other assets regarded as assets for accounting purposes, provided that they:

- were acquired from a third party or developed internally for the purpose of trading with them
- have an acquisition price of more than CZK 60,000, and
- have a useful life of greater than one year.

Intangible assets are amortised for tax purposes based on the number of years that the taxpayer has a license for the assets, if the license is for a limited number of years. Otherwise, amortisation for tax purposes will vary depending on the asset (e.g. software is amortised over 18 months, results of R&D is amortised over 36 months).

### *Travel expenses and meal allowances*
Payments for travel expenses and meal allowances that are made to employees are tax-deductible, but only within the statutory limits.

### *Charitable contributions*
Certain charitable donations are deductible. The minimum deductible donation is CZK 2,000 and the maximum deductible donation is 5% of the tax base (a maximum of up to 10% of the tax base is possible if gifts are granted to universities or R&D centres).

### *Taxes*
Road tax, real estate tax, and most other taxes, with the exception of income taxes, are deductible, as are social security contributions paid by an employer with respect to employees.

### *Other deductions*
Fees paid to members of other statutory bodies of companies for their services are not deductible for tax purposes.

### *Net operating losses*
Losses incurred in a tax year may be carried forward to offset taxable profits generated in the following five tax years. Losses may not be carried back.

### Payments to foreign affiliates

Generally, deductions may be claimed for royalties, management service fees, and interest charges paid to foreign affiliates, provided such amounts are at arm's length.



## Group taxation

Currently, the Czech Republic does not permit group taxation. Each company in a group is taxed individually. Consolidated tax base applies only for the general partners and their shares in profit of their general partnership.

### Transfer pricing

For tax purposes, prices agreed between related parties have to meet the definition of the arm's-length principle, and these prices are often subject to tax audits by tax authorities. The consequences of incorrect transfer pricing adjustments are tax exposure and penalties. In the case of companies receiving investment incentives, incorrect transfer pricing can cause a loss of the investment incentives. Generally, pricing methods as described in Organisation for Economic Co-operation and Development (OECD) guidelines should be followed.

Although there is no legal requirement to keep transfer pricing documentation, in practice it is strongly recommended to keep it as the taxpayer bears the burden of proof upon challenge of prices by tax authorities.

Taxpayers may request the tax administrators to issue an advance pricing agreement (APA) regarding progressing or future transactions between related parties.

### Thin capitalisation

Thin capitalisation rules apply in the Czech Republic and may limit the tax deductibility of interest payments on debt financing from related parties as well as from third parties.

Below is a brief summary of the thin capitalisation rules:

- The tax-deductibility test applies not only to interest but also to all so-called 'financial costs' on loans (e.g., interest plus other related costs, such as bank fees).
- Thin capitalisation applies only to related-party loans.
- The debt-to-equity ratio for related-party loans is 4:1.
- Unrelated-party loans (e.g. bank loans) guaranteed by a related party are not considered related-party loans for thin capitalisation purposes. If, however, a bank provides a back-to-back loan to a Czech entity where the loan is provided to the bank by a related party, such a bank loan to the Czech entity is considered a related party loan.
- Interest on profit-participating loans is not deductible for tax purposes.

### Controlled foreign company regime

There is no controlled foreign companies (CFC) legislation in the Czech Republic.

## Tax credits and incentives

### Foreign tax credit

Foreign tax credits are available only under tax treaties. If credit is not available under a treaty, CIT paid abroad may be deducted as an expense in the following year provided it is imposed on the income included in Czech taxable income.

### Investment incentives

Investment incentives are available only to Czech entities (including Czech subsidiaries of foreign companies) engaged in the manufacturing industry. Incentives include income tax relief, financial support for the creation of new jobs, financial support for training or retraining of employees, and a transfer of land at a specially reduced price.

The former programmes for the support of business support service centres and for the development of technology centres, which were focused primarily on investments in human capital as well as the training or retraining of skilled staff, were abolished based on the decision of the Ministry of Industry and Trade in July 2008. However, these activities currently are supported by the EU structural funds, especially under the operational programmes Enterprise and Innovation.

### R&D allowance

Up to 100% of specific R&D expenses (or costs) incurred in a given tax year may be deducted from the tax base as a special tax allowance. These costs are deducted twice for tax purposes: once as a normal tax-deductible cost and then again as a special tax allowance.

The following costs can be included in the R&D tax allowance:

- Direct costs (e.g. personnel costs of R&D engineers, consumed materials).
- Tax depreciation of fixed assets used for R&D activities.
- Other operational expenses directly related to the realisation of R&D activities (e.g. telecommunications fees, electricity, water, gas).

Only qualifying expenses are deductible for tax purposes and must be separately identified from other expenses (or costs). This allowance does not apply to costs of purchased services or intangible results of R&D acquired from other entities, except for expenses (or costs) incurred in connection with the certification of the results of R&D projects. In addition, expenses that were supported from public sources are also excluded.

Any non-utilised R&D allowance may be carried forward for three subsequent years.

A taxpayer may request a binding ruling with respect to R&D costs from the respective Tax Office in the event that the taxpayer is unsure of whether certain R&D costs are eligible for the allowance.

## Withholding taxes

Czech corporations are required to withhold tax on payments of dividends, interest, and royalties as follows:

| Recipient | Dividend (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Resident corporations | 15 | 0 | 0 |
| Resident individuals | 15 | 0 | 0 |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 15 | 15 | 15 |
| Treaty: | | | |
| Albania | 5/15 | 0/5 | 10 |

| Recipient | Dividend (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Armenia | 10 | 5/10 | 5/10 |
| Australia | 5/15 | 10 | 10 |
| Azerbaijan | 8 | 5/10 | 10 |
| Austria | 0/10 | 0 | 0/5 |
| Belarus | 10 | 0/5 | 10 |
| Belgium | 5/15 | 10 | 0/10 |
| Bosnia | 5 | 0 | 0/10 |
| Brazil | 15 | 10/15 | 15/25 |
| Bulgaria | 10 | 0/10 | 10 |
| Canada | 5/15 | 0/10 | 0/10 |
| China, P.R. | 10 | 0/10 | 10 |
| Croatia | 5 | 0 | 10 |
| Cyprus | 0/5 | 0 | 0/10 |
| Denmark | 15 | 0 | 0/5 |
| Egypt | 5/15 | 0/15 | 15 |
| Estonia | 5/15 | 0/10 | 10 |
| Ethiopia | 10 | 0/10 | 10 |
| Finland | 5/15 | 0 | 0/1/5/10 |
| France | 10 | 0 | 0/5 |
| Georgia | 5/10 | 0/8 | 5/10 |
| Germany | 5/15 | 0 | 5 |
| Greece | Local rates | 0/10 | 0/10 |
| Hungary | 5/15 | 0 | 10 |
| Iceland | 5/15 | 0 | 10 |
| India | 10 | 0/10 | 10 |
| Indonesia | 10/15 | 0/12.5 | 12.5 |
| Ireland, Rep. Of | 5/15 | 0 | 10 |
| Israel | 5/15 | 0/10 | 5 |
| Italy | 15 | 0 | 0/5 |
| Japan | 10/15 | 0/10 | 0/10 |
| Jordan | 10 | 0/10 | 10 |
| Kazakhstan | 10 | 0/10 | 10 |
| Korea, Rep. Of | 5/10 | 0/10 | 0/10 |
| Latvia | 5/15 | 0/10 | 10 |
| Lebanon | 5 | 0 | 5/10 |
| Lithuania | 5/15 | 0/10 | 10 |
| Luxembourg | 5/15 | 0 | 0/10 |
| Malaysia | 0/10 | 0/12 | 12 |
| Malta | 5 | 0 | 5 |
| Mexico | 10 | 0/10 | 10 |
| Moldova | 5/15 | 5 | 10 |
| Mongolia | 10 | 0/10 | 10 |
| Netherlands | 0/10 | 0 | 5 |
| New Zealand | 15 | 0/10 | 10 |
| Nigeria | 12.5/15 | 0/15 | 15 |
| Norway | 5/15 | 0 | 0/5 |

| Recipient | Dividend (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Philippines | 10/15 | 0/10 | 10/15 |
| Poland | 5/10 | 0/10 | 5 |
| Portugal | 10/15 | 0/10 | 10 |
| Romania | 10 | 0/7 | 10 |
| Russia | 10 | 0 | 10 |
| Singapore | 5 | 0 | 10 |
| Slovak Republic | 5/15 | 0 | 0/10 |
| Slovenia | 5/15 | 0/5 | 10 |
| South Africa | 5/15 | 0 | 10 |
| Spain | 5/15 | 0 | 0/5 |
| Sri Lanka | 15 | 0/10 | 0/10 |
| Sweden | 0/10 | 0 | 0/5 |
| Switzerland | 5/15 | 0 | 10/5 |
| Syria | 10 | 10 | 12 |
| Tajikistan | 5 | 0/7 | 10 |
| Thailand | 10 | 0/10 | 5/10/15 |
| Tunisia | 10/15 | 0/12 | 5/15 |
| Ukraine | 5/15 | 5 | 10 |
| United Arab Emirates | 0/5 | 0 | 10 |
| United Kingdom | 5/15 | 0 | 0/10 |
| United States | 5/15 | 0 | 0/10 |
| Uzbekistan | 10 | 0/5 | 10 |
| Venezuela | 5/10 | 0/10 | 12 |
| Vietnam | 10 | 0/10 | 10 |
| Yugoslavia (former) | 5/15 | 0 | 10 |

Notes

1. The lower rate applies if the recipient is a company that owns at least a certain amount of the capital or a certain amount of the voting shares of the company paying the dividend directly.
2. The lower rate applies mostly in situations when the interest is received by the government or a state-owned institution or is paid by the government.
3. The lower rate applies mostly to cultural royalties.

## *Tax administration*

### *Returns*

A corporation may choose between the calendar year or an accounting year as its tax year.

Returns must be filed within three months of the end of the tax period.

A three-month extension of the filing deadline is available if a taxpayer is represented by a registered tax advisor or if the taxpayer is subject to a statutory accounting audit.

In some special cases, a filing deadline of less than three months may apply (e.g. upon merger or liquidation). This shorter deadline may, however, be extended if approved by the tax office.

### *Payment of tax*

Tax payments are due on the same day as the filing deadline.

A company is obliged to make CIT advances based on its last known tax liability. The tax advances are paid semi-annually or quarterly, depending on the amount of the last known tax liability.

Upon filing a tax return, tax advances paid during the year for which the tax return is filed will offset the tax liability declared in the tax return. Any outstanding amount must be paid on the date the tax return is due. Any overpayment will be refunded upon request or may be credited against future tax liabilities.

# Denmark

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## Significant developments

Taxation of dividends and interest paid by Danish entities to foreign group companies has been a hot topic in Danish taxation in the last year or two. One of the main issues seems to be whether holding companies incorporated in the European Union (EU) can qualify as the beneficial owner of dividends and interest payments received from Danish group entities and, consequently, whether these payments can be remitted from Denmark without source taxation (withholding taxes).

One of the most recent developments within this area was a ruling from the Danish tax tribunal (the highest Danish administrative tax authority) in late December 2010 in which the Danish tax authorities prevailed. Two previous cases from 2010 had been decided in favor of the taxpayer.

The Danish tax authorities brought up these issues when they started to enquire into the tax implications related to inter-company payments and, more specifically, whether Danish entities have complied with the withholding tax (WHT) requirements regarding dividends and interest. After these enquiries, numerous Danish entities belonging to international groups have been asked to pay substantial amounts of non-withheld taxes to the Danish tax authorities. Many of the Danish companies involved in these cases have disputed the claims.

The main focus of the Danish tax authorities seems to be private-equity-owned Danish groups, a number of which have been subject to the enquiries by the Danish tax authorities. However, industrial groups have also been subject to enquiries from the Danish tax authorities.

The increased focus on beneficial ownership has had some related effect on Danish tax legislation enacted in March 2011. Despite Danish tax law not defining the term ‘beneficial ownership’, rules on cross-border mergers and rules on transparent entities (rules targeting adverse consequences of the US ‘check-the-box’ rules) have been amended so as to affect the possibilities for tax exemption and deductibility of interests/royalty payments respectively.

## Taxes on corporate income

According to Danish tax law a territoriality principle prevails. Hence, a Danish company is not taxed on its worldwide income. Instead, income from a permanent establishment (PE) outside Denmark or from real estate located abroad is excluded from taxable income. Non-resident companies are taxed only on profits distributed from income sourced in Denmark.

The corporate income tax (CIT) rate is 25%. There is no local corporate income tax or similar surcharge.

### *Hydrocarbon income tax*
A special CIT is levied on profits from the exploration and extraction of oil and gas on the Danish continental shelf at a rate of 52% under the new system applicable for licenses granted after 1 January 2004 (70% in the old system). CIT (25%) is deductible in computing the hydrocarbon tax.



### *Tonnage Tax Scheme*
Danish tax law provides for a special tax scheme for shipping entities.

The main principle of the Tonnage Tax Scheme is that qualifying shipping entities are not taxed on the basis of their actual income derived from their business but on a fictitious income based on the net tons carrying capability of their fleet used for purposes covered by the Tonnage Tax Act.

The Tonnage Tax Scheme is available to Danish shipping entities organised as limited liability companies (Aktieselskab (A/S) or Anpartsselskab (ApS)), foreign shipping companies with the place of management and control in Denmark, and European Union (EU) shipping companies with a PE in Denmark.

The scheme is available upon application to the Danish tax authorities. A decision to enter into the scheme is binding for a period of ten years.

As a general rule, group related shipping companies based in Denmark must make the same choice regarding the Tonnage Tax Scheme. However, shipping companies that do not have the same management or operating organisation and do not conduct business in related fields may be exempt from the joint decision provision.

The Tonnage Tax Scheme is restricted to certain types of business activities. The entity must carry out commercial transportation of passengers or cargo between different destinations. The ships must be owned or chartered on a 'bareboat' or time-charter with a call/buy option by the company' basis and have a minimum gross tonnage of 20 tons. Certain restrictions apply for ships chartered on a time-charter basis without a call/buy option. The ships must be strategically and commercially run from Denmark.

Income from activities that are carried out in close connection with this business, such as the usage of containers and loading facilities, etc. may also be included in the Tonnage Tax Scheme. Ships used for exploration, diving, fishing, towing, sand dredging, etc. are specifically exempt from the scheme. The same applies for certain types of ships, such as barges, floating docks, etc. However, EU or European Economic Community (EEC) registered ships used for towage activities at sea (i.e. not in and around ports) during at least 50% of its operating time during the income year may be included in the tonnage tax system.

Ship operating companies may also use the Danish Tonnage Tax Scheme. A ship operator is defined as a company doing business with crew management and technical management of ships qualified for use in the tonnage tax system. It is a requirement that the ship operator has taken over the full operating responsibility and all obligations and responsibilities according to the International Safety Management codex.

### Taxable income
The taxable income for the part of the business that qualifies for the Tonnage Tax Scheme is determined for each ship as a fixed amount of Danish kroner (DKK) per 100 net tons (NT) per day according to the following:

| Ship net ton | Fixed amount per day |
|---|---|
| 0 to 1,000 NT | DKK 7.8 per day per 100 NT |
| 1,001 to 10,000 NT | DKK 5.6 per day per 100 NT |
| 10,001 to 25,000 NT | DKK 3.35 per day per 100 NT |
| Over 25,000 NT | DKK 2.2 per day per 100 NT |

The income is taxed at the ordinary corporate tax rate (25%). No deductions relating to shipping income will be allowed. Special rules apply for financial income and financial expenses, and in relation to so called ‘thin capitalisation’. Income that does not qualify for the tonnage tax scheme is taxed according to the general tax provisions in Denmark.

### Depreciation
Shipping entities that apply the Tonnage Tax Scheme from the time of their establishment may not deduct depreciation for tax purposes. Special rules apply for shipping entities that were already in existence when they elected to become subject to the scheme and for entities that elect to include certain other assets at a later point in time that were not previously subject to the scheme.

### Gains on the sale of ships
Gains on the sale of ships that have not been used in the scheme prior to 1 January 2007 are tax exempt. The same applies to gains on the sale of contracts on the delivery of ships, provided that the ship was destined to be delivered after 1 January 2007. Gains on the sale of ships used in the scheme in prior years are taxable. The taxable gain is calculated as the sale price minus the purchase price plus improvements. Any losses on ships acquired and sold within the same income year as the income year in which a gain is realised may be offset against the gain.

## *Corporate residence*

A corporation is resident in Denmark for tax purposes if it is incorporated in Denmark and registered in the Companies Register as having a Danish place of business. Further, foreign companies having their actual place of management in Denmark are also tax resident in Denmark. The actual place of management is typically the place where the management decisions concerning the company’s day-to-day operations are made.

### *Permanent establishment (PE)*
Non-resident companies are only liable to tax in Denmark on business profit if derived trough a PE in Denmark. Domestic law does not provide autonomous rules for determining the existence of a PE. Instead, the existence of a PE is determined according to the guidelines provided in the Organisation for Economic Co-operation and Development (OECD) Model Convention (article 5).

## Other taxes

### Value-added tax (VAT)

The general VAT rate is 25% of the price charged (exclusive of VAT).

Exemption or a special reduced rate of 0% applies to a limited range of supplies (e.g. newspapers; hospital treatment; insurance and reinsurance services; most financial activities, including deposits of money, loans, and provision of loans).



Denmark was one of the first countries to introduce a VAT system. Since the first VAT Act came into force on 3 July 1967, the VAT legislation in Denmark has undergone several changes. The most important changes have been modifications to bring the legislation in line with the Sixth EC VAT Directive (which from 1 January 2007 is officially named the Council Directive 2006/112/EC on the common system of Value Added Tax) and the so-called EU VAT Package1 that entered into force on 1 January 2010.

Compared to the Directive, the Danish VAT legislation includes minor deviations and the use of various discretionary provisions.

All supplies of goods and services by so-called 'taxable persons' (entrepreneurs who independently carry out economic activity) are subject to VAT, unless specifically exempted. The VAT exemptions are restricted to a limited range of services and goods but are nonetheless subject to discussions and complications in the Danish VAT jurisprudence. Transactions are subject to Danish VAT only when they are deemed to take place in Denmark. For the sake of tax neutrality, VAT is also levied on (i) imports (i.e. receipt of goods from non-EU territories), (ii) intra-Community acquisitions (i.e. receipt of goods from EU member states), and (iii) purchase of most types of services from abroad.

In order to avoid VAT being borne by any other than the final consumer, those who qualify as taxable persons can, with some exceptions, recover VAT charged by their suppliers according to the invoice/credit method, provided that the purchases relate to VAT taxable transactions. VAT is recovered either via the periodical VAT return (as a deduction in VAT payable) or by filing a special application.

In general, it is the supplier's responsibility to collect and report VAT on supply of goods or services.

### Customs duties

Denmark is a member state of the European Union, and, according to EU's Common Customs Tariff, many goods imported into Denmark from outside the European Union are subject to customs duties. The rates of duty vary widely between goods.

### Excise duties

According to Danish tax law, several excise duties are levied. Some of the excise duties are enacted based on EU regulations while others are enacted according to domestic law only.

Excise duties are chargeable on a long list of goods, including hydrocarbon oil products, packaging, alcoholic drinks and tobacco, chocolate and products containing sucker, coffee/tea, etc.

The excise duty rates depend on the type of goods (e.g. chocolate, packaging) as well as, in some cases, the category of the goods (e.g. plastic bags, paper bags).

Only goods sold in Denmark (or taken into Denmark) are liable to the Danish excise duties. Companies importing goods into Denmark or companies producing goods in Denmark must be registered with the Danish tax authorities to settle the excise duties. This also applies even though the goods are taken out of Denmark again. If goods are taken from Denmark to another country, difficulties may appear regarding the reimbursement of excise duties paid.

### *Property Tax*
Owners of non-residential property must pay land tax. The land tax rate is set by the municipalities and must be between 1.6% and 3.4% of the value of the land. Municipalities may, furthermore, levy a special coverage charge on certain properties of maximum 1% of the value minus the value of the land. Land tax and coverage charge are deductible.

### *Stamp tax*
Stamp tax is payable on a few documents, such as a deed of transfer of real estate (0.6% of the transfer sum). There is no stamp duty on transfer of shares.

### *Employer's tax (social security charges)*
The employer's contribution to Arbejdsmarkedets Tillægspension (ATP) (i.e. old-age pension) charges is DKK 2,160 per annum for a full-time employee.

Companies that provide VAT-exempt services are liable to pay the employer's tax, which is calculated on the total annual salary cost. The rate can be as high as 9.13%, which is the rate for banks and other financial institutions, the most significant sector paying the employer's tax. This tax is deductible for income tax purposes.

Other than these taxes, an employer's obligation for social security taxes is minimal. The main social security charge is an additional income tax of 8% on salaries and wages, which is borne by employees.

### *Environmental taxes*
Danish companies must pay environmental taxes, which were introduced to reduce companies' energy consumption, discharges of fluids with an environmental impact, and emission. The tax is paid to the company that provides the energy, who pays the tax to the Danish tax authorities.

In general, almost all VAT registered companies in Denmark can receive a reimbursement of some of the environmental taxes. From 2010, the environmental taxes have increased, the possibilities to get a reimbursement have decreased, and the majority of companies will likely suffer a significant increase in tax costs.

## *Branch income*

Danish branches and PEs of foreign companies are taxed under the same rules and rates as Danish resident companies. There is no branch remittance tax or other similar tax on branch profits.

## Income determination

Taxable income generally is calculated as income determined for accounting purposes that is adjusted and modified for several items, as prescribed by the tax laws. Typical timing differences include reserves, work in progress, and depreciation.



### Inventory valuation

Inventory is valuated at either acquisition costs, current market value, or manufacturing costs (if manufactured by the company itself) according to a first in first out (FIFO) principle. The company may opt for different principles for each category of goods and may furthermore change principle from income year to income year, provided certain conditions are met.

### Capital gains

Gains and losses realised on the sale of tangible and intangible assets, including goodwill, are generally included in taxable income. However, gains realised on the sale of shares are tax-exempt if the shares qualify as either ‘subsidiary shares’ or ‘group shares’.

‘Subsidiary shares’ are shares held by a corporate shareholder that holds a minimum of 10% of the share capital in a subsidiary that is located in the European Union, European Economic Area (EEA), or a country with which Denmark has a double taxation treaty (DTT). A special anti-avoidance rule applies, which is targeted at Danish shareholders joining their shareholdings in order to reach the 10% threshold.

‘Group shares’ are defined as shares in companies with which the shareholder is jointly taxed or might be jointly taxed. The definition of a group is therefore the same as in the joint taxation rules and generally corresponds to the definition of a group for accounting purposes. The location where the companies are registered is irrelevant, as long as the companies are affiliated.

If the shares do not constitute group shares, subsidiary shares, or treasury shares, they constitute portfolio shares. Gains on portfolio shares are fully taxable regardless of holding period. Losses on the sale of portfolio shares generally are tax-deductible. However, special rules may apply for losses on unlisted shares.

Gains realised on the sale of real estate property are taxable whereas losses are not tax-deductible unless the property is a building qualifying for tax depreciation. A loss realised on the sale of land and other buildings may be utilised only against taxable profits on the sale of real estate properties in the same year or may be carried forward infinitely.

A capital gain may, under certain conditions, be deferred if the capital gain is reinvested in properties. Reinvestment must be made no later than the income years following the income year of disposal.

Gains and losses on financial instruments generally are included in taxable income, according to the mark-to-market principal, which is required. There are special rules for losses on certain share-based contracts.

### Dividend income

Dividends received on ‘subsidiary shares’ or ‘group shares’ are tax exempt regardless of the length of the ownership period, whereas dividends received on portfolio shares are fully included in taxable income.

Regardless of whether the shares qualify as 'subsidiary shares' or 'group shares', dividends are fully taxable if received from a foreign company that can deduct the dividends paid, unless a tax exemption is provided for in the EU parent/subsidiary directive.

### *Stock dividends*
Stock dividends may be distributed to shareholders free of tax, provided that the dividends are in proportion to the existing shareholdings (i.e. bonus shares).

### *Foreign income*
As a general rule, foreign source income, such as interest, is included in taxable income. However, income from a PE or real estate outside Denmark is excluded from taxable income.

The income of a foreign subsidiary may be taxed in the hands of its Danish parent company if the subsidiary constitutes a controlled foreign company (CFC). *See the Group taxation section for more information.*

## *Deductions*

### *Depreciation, amortisation, and depletion*
Tax depreciation need not be in conformity with book depreciation.

Annual depreciation allowances on machinery and equipment may be claimed under the diminishing-balance method at up to 25%. The depreciation base is the cost of fixed assets less sales proceeds from disposals and depreciation allowances previously claimed.

For ships, the depreciation rate is 20% in the year of construction and a 12% declining-balance basis in subsequent years.

Depreciation allowances on buildings (other than residential buildings and office buildings not adjoining an industrial building) may be claimed at up to 4% on the straight-line basis.

Airplanes, trains, and utility plants can be depreciated only at a 15% declining balance (presently subject to phasing-in rates).

Rails, telecommunications facilities, and certain other long-life plant and equipment can be depreciated only at a 7% declining balance.

Depreciation allowances that are recaptured as part of a capital gain on the sale of an asset generally are fully taxable.

Acquired goodwill and other intangible property rights can be amortised at up to one-seventh per year on a straight-line basis. Costs related to the purchase of patents or know-how (including rights/licenses to utilise patents or know-how) can either be fully expensed in the year of acquisition or amortised over a seven-year period on a straight-line basis.

Certain restrictions regarding the depreciable value of goodwill apply in the case of group transactions. Goodwill on the purchase of shares cannot be amortised for tax purposes.

Depletion of the cost of acquisition or exploitation of natural resources is subject to special rules.

### *Interest expense*

*See Thin capitalisation and interest relief limitations in the Group taxation section.*

### *Taxes*

Taxes are non-deductible for income tax purposes, except for employer's tax and non-recoverable VAT.



### *Net operating losses*

Tax losses may be carried forward indefinitely.

Certain restrictions on the right to carry tax losses forward apply when more than 50% of the share capital or 50% of the voting rights at the end of the financial year are owned by shareholders different from those that held control at the beginning of the income year in which the tax loss was incurred.

Similarly, under certain circumstances, tax losses are cancelled if a Danish company receives a debt forgiveness or comparable transaction. However, there are numerous exceptions (e.g. inter-company transactions).

Tax losses may not be carried back and utilised in previous income years.

### *Payments to foreign affiliates*

A Danish corporation can claim a deduction for royalties, management fees, and similar payments made to foreign affiliates, provided that such amounts are made on an arm's-length basis and reflect services received. Interest at normal commercial rates paid to foreign affiliates generally will be allowed as a deduction but is subject to very complex thin capitalisation and interest relief limitation rules.

## *Group taxation*

### *Mandatory Danish tax consolidation*

A mandatory tax consolidation regime obliges all Danish resident companies and Danish branches that are members of the same domestic or international group to file a joint group tax return. The definition of a group generally corresponds with the definition of a group for accounting purposes. The tax consolidated income is equal to the sum of the taxable income of each individual Danish company and branch that are a member of the consolidated group.

The top parent company participating in the Danish tax consolidation group will be appointed the role of a so-called management company; this company is responsible for settling advance and final corporate tax payments of all group members.

### *Elective cross border tax consolidation*

A non-Danish subsidiary may be included as a member to a Danish tax grouping provided that the group includes all of its foreign companies and branches in the Danish tax grouping. In effect, this all-or-nothing provision rules out the possibility for major international groups to have their Danish subgroup file a Danish group tax return that includes only certain hand-picked (typically loss-making) foreign group members.

If a general cross-border tax consolidation is established, it will be binding for ten years; however, there are certain possibilities of 'breaking' the ten-year period (e.g. in connection with takeovers).

The comments under Mandatory Danish tax consolidation with respect to the calculation of the tax consolidation income, 'management' company, etc. generally also apply to international tax consolidation.

### *Transfer pricing*
Danish transfer pricing rules apply to transactions between related parties (e.g. inter-group transactions), whether the transactions are made between residents or non-residents. The rules apply when a company or person directly or indirectly owns at least 50% of the share capital or 50% of the voting rights in another company.

Companies are obliged to disclose in the annual tax return certain information regarding type and volume of intra-group transactions. Companies also are obliged to maintain detailed and extensive transfer pricing documentation to substantiate that intra-group transactions are conducted in accordance with arm's-length principles. A company is subject to fines for failure to comply with the documentation rules.

### *Thin capitalisation and interest relief limitations*
Danish resident companies and Danish branches of foreign companies are subject to three sets of restrictions, each of which may seriously limit or disallow Danish tax relief for financing costs. There is no recharacterisation of interest as dividends.

Firstly, there is the thin capitalisation rule. This rule works to disallow gross interest costs and capital losses on related party debt to the extent the overall debt to equity ratio exceeds 4 to 1. Related party debt is defined so as to include external bank debt if group member companies or shareholders have provided guarantees to the bank. This rule does not apply if the controlled debt is less than DKK 10 million. When calculating the 4 to 1 ratio, a special consolidation rules applies if two or more companies are considered affiliated (note that the definition of affiliated companies differs from the definition under the Danish rules on joint taxation).

Secondly, there is an asset-based rule. To the extent a Danish company on a stand-alone basis or, if part of a joint tax group, together with group companies has net financing costs in excess of DKK 21.3 million (full-year amount for 2010 and 2011), tax relief may be obtained only within an amount equal to 5% (rate applicable for 2010) of the tax basis of certain assets of the group (rate applicable for 2011 is 4.5%). Net financing costs consist of, among other things, interest income/expenses, taxable gains/losses on debt, receivables and financial contracts, taxable gains/losses on shares, and taxable dividend.

Thirdly, there is an earnings before interest and tax (EBIT) based rule that works to limit interest relief to an amount equal to 80% of the Danish company's/tax group's taxable EBIT income. This rule applies the same definition of net financing costs as the asset-based rule, and it also allows for a minimum deduction of DKK 21.3 million in cases where EBIT is too low or negative.

### *Controlled foreign company (CFC) rules*
According to the Danish CFC rules, a Danish company has to include in its taxable income the total income of a subsidiary, foreign or Danish, if such subsidiary qualifies as a CFC. A subsidiary qualifies as a CFC if all of the following criteria are met:

- The Danish company, together with other group member companies, directly or indirectly owns more than 50% of the capital or controls more than 50% of the voting rights in the subsidiary.
- More than half of the subsidiary's taxable profits, as hypothetically assessed under Danish tax laws, are predefined CFC income types (mainly interest, royalty, capital gains, etc.).
- During the income year, the subsidiary's CFC assets (assets, where the return is characterised as a CFC income type) make up more than 10% of the subsidiary's total assets.



There is no black or white list that exempts subsidiaries resident in certain countries.

## *Tax credits and incentives*

### *Capital expenditure incentives*

A small variety of tax incentives are available in the form of deductions for capital expenditures.

Danish tax law allows for an immediate write-off of capital expenditures for research and development (R&D). Alternatively, the taxpayer may choose to take tax depreciation in the same year and the following four years on a straight-line basis. Costs incurred in connection with the exploration for raw materials may also be fully deducted in the same year.

Costs related to purchase of patents, know-how (including rights/licenses to utilise patents or know-how) may either be fully expensed in the year of acquisition or amortised over a seven-year period on a straight-line basis.

### *Foreign tax credit*

According to Danish tax law, relief is generally available to credit foreign tax paid on non-Danish source profits against the Danish tax on the same profits. As Danish companies are not taxed on income from foreign PEs or properties, the rules have limited application.

For share holdings of 10% or more of the share capital in foreign companies, Denmark has further rules allowing 'underlying' tax relief in respect of foreign dividends, so that tax suffered at lower levels can be relieved where dividends flow to Denmark via a chain of companies. As Danish tax law, as a main rule, exempts dividends from companies resident in countries with which Denmark has a tax treaty in which the Danish recipient company holds 10% or more, this rule, as well, has a limited application.

## *Withholding taxes*

### *On payments to foreign corporations and non-resident aliens*

**Dividends**

Dividends paid to a parent company in another EU member state or a state with which Denmark has a DTT are exempt from WHT provided that the shares qualify as subsidiary shares. The same applies for dividends paid on group shares (that are not also subsidiary shares, i.e. holdings below 10%), provided that the recipient company is resident within the EU/EEA.

Dividends paid on portfolio shares to a foreign shareholder are levied WHT of 28%. A change in law has reduced the rate to 27% with effect from 2012. If the portfolio shareholder is situated in a country with which Denmark has a Tax Information Exchange Agreement (TIEA), the tax rate on the dividend is reduced to 15% and the difference between the higher WHT rate and the lower WHT rate may be reclaimed. However, the reduced rate does not apply if the shareholder is resident outside the European Union and together with related entities owns more than 10% of the capital in the Danish distributing company.

### Interest

Interest generally is not subject to WHT unless paid to a foreign group member company that is tax resident outside the European Union and outside any of the states with which Denmark has concluded a tax treaty. In this situation, interest WHT is levied at 25%. Certain other exemptions apply, mainly relating to CFC taxation.

### Royalties

Royalties are subject to a 25% WHT. In most cases, the payer may reduce its withholding in accordance with the tax treaty applicable to the payee. Also, the EU Interest/Royalty Directive may provide an exemption from WHT if the payee is an immediate parent, sister, or subsidiary company resident in the European Union.

| | Dividend (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Qualifying companies (1a+b)** | **Others** | **Interest (%) (2)** | **Royalty (%)** |
| Resident corporations | 0 | 28 | 0 | 25 (5) |
| Resident individuals | | 28 | 0 | 25 |
| Non-treaty (4): | | | | |
| Non-resident corporations | 28 | 28 | 25 (3, 5) | 25 (5) |
| Non-resident individuals | | 28 | 0 | 25 |
| Treaty: | | | | |
| Argentina | 0 (1a) | 15 | 0 | 3/5/10/15 (7) |
| Australia | 0 (1a) | 15 | 0 | 10 |
| Austria | 0 (1a+b) | 15 | 0 | 0 |
| Bangladesh | 0 (1a) | 15 | 0 | 10 |
| Belgium | 0 (1a+b) | 15 | 0 | 0 |
| Brazil | 0 (1a) | 25 | 0 | 15/25 (7) |
| Bulgaria | 0 (1a+b) | 15 | 0 | 0 |
| Canada | 0 (1a) | 15 | 0 | 0/10 (7) |
| Chile | 0 (1a) | 15 | 0 | 5/15 (7) |
| China, P.R. | 0 (1a) | 10 | 0 | 10 |
| Cyprus | 0 (1a+b) | 15 | 0 | 0 |
| Czech Republic | 0 (1a+b) | 15 | 0 | 5 |
| Egypt | 0 (1a) | 20 | 0 | 20 |
| Estonia | 0 (1a+b) | 15 | 0 | 5/10 (7) |
| Faroe Islands | 0 (1a) | 15 | 0 | 0 |
| Finland | 0 (1a+b) | 15 | 0 | 0 |
| Georgia | 0 (1a) | 10 | 0 | 0 |
| Germany | 0 (1a+b) | 15 | 0 | 0 |
| Greece | 0 (1a+b) | 18 | 0 | 5 |

| Recipient | Dividend (%) Qualifying companies (1a+b) | Others | Interest (%) (2) | Royalty (%) |
|---|---|---|---|---|
| Greenland | 0 (1a) | 15 | 0 | 10 |
| Hungary | 0 (1a+b) | 15 | 0 | 0 |
| Iceland | 0 (1a+b) | 15 | 0 | 0 |
| India | 0 (1a) | 25 | 0 | 20 |
| Indonesia | 0 (1a) | 25 | 0 | 15 |
| Ireland, Rep. of | 0 (1a+b) | 15 | 0 | 0 |
| Israel | 0 (1a) | 15 | 0 | 10 |
| Italy | 0 (1a+b) | 15 | 0 | 5 |
| Jamaica | 0 (1a) | 15 | 0 | 10 |
| Japan | 0 (1a) | 15 | 0 | 10 |
| Kenya | 0 | 28 | 0 | 20 |
| Korea, Rep. of | 0 (1a) | 15 | 0 | 10/15 (7) |
| Croatia | 0 (1a) | 10 | 0 | 10 |
| Latvia | 0 (1a+b) | 15 | 0 | 5/10 (7) |
| Lithuania | 0 (1a+b) | 15 | 0 | 5/10 (7) |
| Luxembourg | 0 (1a+b) | 15 | 0 | 0 |
| Macedonia | 0 (1a) | 15 | 0 | 10 |
| Malaysia | 0 (1a) | 0 | 0 | 0 |
| Malta | 0 (1a+b) | 15 | 0 | 0 |
| Mexico | 0 (1a) | 15 | 0 | 10 |
| Morocco | 0 (1a) | 25 | 0 | 10 |
| Netherlands | 0 (1a+b) | 15 | 0 | 0 |
| New Zealand | 0 (1a) | 15 | 0 | 10 |
| Norway | 0 (1a+b) | 15 | 0 | 0 |
| Pakistan | 0 (1a) | 15 | 0 | 12 |
| Philippines | 0 (1a) | 15 | 0 | 15 |
| Poland | 0 (1a+b) | 15 | 0 | 5 |
| Portugal | 0 (1a+b) | 10 | 0 | 10 |
| Romania | 0 (1a+b) | 15 | 0 | 4 |
| Russia | 0 (1a) | 10 | 0 | 0 |
| Serbia (6) | 0 (1a) | 15 | 0 | 10 |
| Singapore | 0 (1a) | 10 | 0 | 10 |
| Slovak Republic | 0 (1a+b) | 15 | 0 | 5 |
| Slovenia | 0 (1a+b) | 15 | 0 | 5 |
| South Africa | 0 (1a) | 15 | 0 | 0 |
| Sri Lanka | 0 (1a) | 15 | 0 | 10 |
| Sweden | 0 (1a+b) | 15 | 0 | 0 |
| Switzerland | 0 (1+a) | 15 | 0 | 0 |
| Taiwan | 0 (1a) | 10 | 0 | 10 |
| Tanzania | 0 (1a) | 15 | 0 | 20 |
| Thailand | 0 (1a) | 10 | 0 | 5/15 (7) |
| Trinidad and Tobago | 0 (1a) | 20 | 0 | 15 |
| Tunisia | 0 (1a) | 15 | 0 | 15 |
| Turkey | 0 (1a) | 20 | 0 | 10 |

| Recipient | Dividend (%) Qualifying companies (1a+b) | Others | Interest (%) (2) | Royalty (%) |
|---|---|---|---|---|
| Uganda | 0 (1a) | 15 | 0 | 10 |
| Ukraine | 0 (1a) | 15 | 0 | 10 |
| United Kingdom | 0 (1a+b) | 25 | 0 | 0 |
| United States | 0 (1a) | 15 | 0 | 0 |
| Venezuela | 0 (1a) | 15 | 0 | 5/10 (8) |
| Vietnam | 0 (1a) | 15 | 0 | 15 |
| Zambia | 0 (1a) | 15 | 0 | 15 |

Notes

1. Denmark does not operate a system of WHT on dividends when the parent company holds:
   a. at least 10% of the share capital of the distributing Danish company, provided the receiving company is resident in a EU/EEA member state or a state with which Denmark has entered a double tax treaty (subsidiary shares) or
   b. less than 10% of the share capital in the distributing company, provided that the receiving company is an EU/EEA-resident and the distributing and the receiving company are affiliated companies (group shares).
2. Interest generally is not subject to WHT unless paid to a foreign group member company that is tax resident outside of the European Union and outside of any of the states with which Denmark has concluded a tax treaty. In this situation, interest WHT is levied at 25%.
3. Exemptions apply if the receiving company is directly or indirectly controlled by a Danish parent company or if the receiving company is controlled by a company resident in a state with which Denmark has a double tax convention and that company may be subject to CFC taxation. Finally, an exemption applies if the receiving company establishes that the foreign taxation of interest is not less than three-quarters of the Danish corporate taxation and that the interest is not paid to another foreign company subject to taxation less than three-quarters of the Danish corporate taxation.
4. Denmark has terminated its treaty with Spain and France with effect from 1 January 2009. The termination means that each country will tax the relevant income according to its domestic tax rules. New treaties are not expected to be agreed in the near future. Companies in Spain and France receiving dividends from a Danish company may, however, qualify for tax exempt dividends since they are EU member states.
5. The EU Interest/Royalty Directive may provide an exemption from WHT if the payee is an immediate parent, sister, or subsidiary company resident in the European Union.
6. Serbia has succeeded in the treaty between Denmark and Yugoslavia.
7. Different rates apply depending on the characteristics of the assets on which royalty is paid.
8. The 10% rate is applicable for royalties, whereas the 5% rate is applicable to fees for technical support.

## *Tax administration*

### *Returns*

Tax returns are completed on the basis of audited financial accounts with adjustments for tax. Tax returns should be filed no later than six months following the end of the accounting year. Corporations with an accounting year-end that falls in the period from January 1 to March 31 must file a tax return no later than 1 August in the same calendar year.

The tax system, in practice, is based on self-assessment. Tax assessments are made automatically by the tax authorities on the basis of the tax return. However, the tax authorities may subsequently audit the tax return.

### *Payment of tax*
Corporate income tax must be paid on a current year basis in two equal instalments due on 20 March and 20 November. The authorities request payments of 50% of the average of the last three years' final income tax. In addition, voluntary additional payments may be made at the same dates; such voluntary payments are adjusted by 0.7% when set against the final tax bill.

The final tax bill is settled by 20 November in the following year. Underpaid tax is then payable by 20 November with a surtax of 5.1% of the tax amount (for the 2010 tax year). Overpaid tax is refunded by November of the following year with interest of 1.6% (for the 2010 tax year).



### *Statute of limitations*
The general statute of limitations is 1 May in the fourth calendar year after that of the end of the relevant accounting period. This limitation is extended for another two years with respect to inter-company (transfer pricing) issues.

## *Other issues*

### *Tax-free restructuring*
Restructuring, such as mergers, demergers, share exchanges, drop-down of assets, etc., can, in many cases, be carried out tax-free under the provisions of the EU Mergers Directive as implemented into Danish law. These types of restructuring can be carried out in a tax-exempt manner without prior approval from the tax authorities. However, several objective conditions must be fulfilled. Formation, merger, reorganisation, and liquidation expenses are mostly non-deductible.

# Dominican Republic

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## Significant developments

### General Norm 01-11 of 4 March 2o11

Legal entities that purchase advertising services, or other services subject to value-added tax (VAT) from a non-for-profit entity, shall serve as VAT withholding agents. All expenses incurred from receiving such services will be deductible against income tax returns provided (i) withholding tax (WHT) is made and (ii) such expenses have a fiscal supporting document number (NCF).

Non-profit entities are not bound to file monthly Tax on the Transfer of Industrialized Goods and Services (ITBIS) tax returns unless the totality of such tax was not withheld.

### General Norm 02-11 of 10 March 2011

A new corporate vehicle 'Simplified Stock Company' is added to the definition of legal entities, which shall have the same tax treatment as stock companies regarding Capitalization Tax (1%) for its incorporation or capital increase. Furthermore, Tax Authorities may inactivate Tax Identification Numbers (RNC) in the following cases: (i) the fiscal domicile registered by taxpayers does not correspond to the social domicile or to the company's main establishment and (ii) non-compliance to the dispositions of the Dominican Tax Code.

### Decree 162-11 of 15 March 2011 (modified by Decree No. 294-11 of 12 May 2011)

All requests for tax exemptions granted by any law, concession, or contracts duly ratified by the National Congress shall be submitted before the Ministry of Finance for its analysis and process. Furthermore, Tax and Custom Authorities will only admit tax exemptions approved by the Ministry of Finance. These dispositions do not apply to exemptions that benefit diplomatic and consular missions, duly credited, nor religious entities signatory to the Catholic, Apostolic, and Roman Church.

Prior to this Decree, the tax exemption requests were channelled through Tax Authorities.

### Ruling No. 293-11 of 12 May 2011

This Decree modifies Ruling No. 140-98 for the Application of Title III of the Dominican Tax Code. The main modifications include the following:

- The concept of the persons subject to this new legislation is broadened, adding those that lack civil personality and capacity but are considered an economic unit.

- Transfer of industrialised goods, even when discount applies, and services, whether there is a counterpart or not, are VAT generating activity, as well as the transfer of industrialised goods for promotion (samples), exchange for other goods/services subject to VAT, and goods for waste.
- Services rendered are subject to VAT, even if it isn't expressly stated in the contract.
- VAT payment obligation to:
  - debtor when a debt is liquidated through a 'giving in payment'
  - creditor when the event that generates the debt occurs, and
  - those that exchange industrialized goods for the good received.
- Lease of ships and airplanes are subject to VAT.
- Airfares bought abroad are subject to VAT, provided the departure is Dominican Republic (DR).
- Charge on excess luggage weight, made by airlines or ships, are subject to VAT. Foods and beverages offered in said transportation are not.
- Non-VAT taxpayers shall file a VAT return if these have acted as withholding agent for this tax.
- Services benefited by entity's owners, partners, managers, shareholders, legal representatives, and similar, are subject to tax.
- VAT obligation of goods missing on inventory is generated from the moment the good is missing.
- VAT for the return of goods after 30 days of the generation of the taxable event should be assumed by the entity that makes the return.
- Excise Tax will be part of VAT's taxable base, except for telecommunication services.
- Introduces transfer pricing concept for determining VAT's taxable base on the transfer of goods/services between related parties.
- Air or maritime cargo is not part of VAT taxable base when the service is rendered from abroad into the Dominican Republic or vice-versa.
- VAT compensation or refund request may be made when filing VAT return (Form IT-1) in which it shall reflect the fiscal credit.

### *Pending legislation*

Please note this information is current as of 1 June 2011. Typically, pending legislation is announced in June or July. Please visit the Worldwide Tax Summaries website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

## *Taxes on corporate income*

The Dominican Republic follows a territorial concept, ergo the tax treatment for corporations, partnerships, and limited liability companies is similar in most aspects.

The current corporate income tax rate is a flat rate of 25%. Please note that the asset tax is an alternative minimum tax that is payable when it is higher than a company's corporate income tax liability *(see Asset tax in the Other taxes section)*.

Dividends remitted abroad or paid locally by Dominican entities (not applicable to branches or permanent establishments) are subject to a WHT of 25%. This WHT may be used as a credit against the company's corporate income tax of the same tax year as long as the dividends were paid out of profits which had already been subject to the corporate income tax.

# Dominican Republic

## *Corporate residence*

A company is resident when it is registered or incorporated under the laws of the Dominican Republic. Foreign entities are considered as residents when they are registered in the Dominican Republic as a branch or permanent establishment (PE), and they are subject to local tax in the same manner.

## *Other taxes*

### *Value-added tax (VAT)*

In the Dominican Republic, VAT is known as Tax on the Transfer of Industrialized Goods and Services (ITBIS). The ITBIS is a VAT applied to industrialised goods (movable) and services, with exemptions established by law to certain goods and services. The rate is 16%. 0% rates apply to exports, including sales to Free Trade Zones.

### *Internal and consumption taxes collected at customs upon import*

These taxes are assessed at various rates depending on the nature of the goods and their country of origin since free trade agreements exist (e.g. the United States-DR-Central American Free Trade Agreement (CAFTA)) which decrease the custom duty rates for goods imported from the member countries.

#### Selective Consumption Taxes (ISC)

The ISC is applied to the acquisition or import of certain goods and services.

There is an ISC for alcoholic goods and cigarettes, adjusted by inflation annually:

- Alcohol: ranges from 356.84 Dominican Republic pesos (DOP) to DOP 437.56 for every litre of pure alcohol.
- Cigarettes: DOP 33.24 for a 20 pack and DOP 16.62 for a 10 pack.

There are ISC that vary based on the product, which range from:

- 7.5% on the transfer of alcoholic beverages, applied on the retail price. Imports and transfers made by local manufacturers are accountable for this tax.
- 20% on the transfer of tobacco products, applied on the retail price. Imports and transfers by local manufacturers are accountable for this tax.
- 19.50% to 130% on the consumption of certain imported goods (listed in the law) that are considered to be non-essential.
- 10% on telecommunications services.
- 16% on insurance services.
- 0.0015% on the value of cheques or wire transfers made through financial entities (this tax does not apply to cash withdrawals or credit card use).

### *Real Property Transfer Tax*

The Real Property Transfer Tax is assessed at a basic rate of 3% on any transfer of ownership of real estate.

### *Stamp taxes*

Stamp taxes have been abolished.

### *Asset tax*

Asset tax/Law No. 557-05 imposes a 1% tax on total assets, net of depreciation, amortization, and bad debt reserves. Share investments in other companies, land in rural areas, immovable property pertaining to livestock and agriculture, asset revaluations, and tax advance payments are excluded from this tax base.

The asset tax is a minimum tax filed and liquidated through the Annual Corporate Income Tax Return (Form IR-2) and paid, applying the following rules:

- The income tax is allowed as a credit against the asset tax.
- If the income tax is greater than the asset tax, the obligation to pay the asset tax is cancelled and the income tax is paid instead.
- If the income tax is less than the asset tax, the difference (in order to complete the asset tax value) shall be paid in two equal instalments as follows:
  - First instalment: shall be paid during 120 days subsequent to closing date.
  - Second instalment: shall be paid within six months after first quote's due date.



Entities may request a temporary exemption from the asset tax. Entities that require large capital (among other requirements established by General Ruling 3-06) may make such a request, which should be submitted at least 90 days before the filing due date. The local internal revenue service shall evaluate the merits of the request and approve or deny, as appropriate.

If the entity has an income tax credit arising from excess advance payments, it may request the refund of such balance be applied against the asset tax.

In the case of financial institutions, power generation and distribution companies, pension fund entities, and stock brokerage companies, the tax is calculated based on the fixed assets book value.

According to Rule 07-2007, construction companies may seek exemption from the asset tax, provided that such entities meet the requirements established in this rule.

## *Branch income*

Branch profits are taxed at the same rate as corporate profits (25%). There is no WHT on branch profit remittances to the company's headquarters, provided that the corresponding annual corporate tax has been paid.

## *Income determination*

### *Inventory valuation*

The last in first out (LIFO) method of inventory valuation is accepted for tax purposes. Other methods may be authorised upon request.

Conformity between book and tax reporting is not required.

### *Capital gains*

Capital gains are added to the ordinary taxable income and subject to the same tax rate of 25%. Capital gains are defined as the difference between the sale price of an asset and the acquisition or production price adjusted for inflation.

### Dividend income
Dividend distributions are subject to a 25% WHT, which should constitute a tax credit against the annual corporate income tax corresponding to the same taxable year in which the distribution was made.

### Stock dividends
Stock dividends are not subject to taxation.

### Foreign income
Dominican-resident companies, branches, and PEs are subject to taxation on income from Dominican sources and on income from foreign sources arising from investments and financial gains. Tax determined on income from foreign source is subject to a credit mechanism. Taxes paid in the country where the income is originated can be credited up to the amount of the tax payable in the Dominican Republic on the same income.

## Deductions

### Depreciation and depletion
Depreciation allowances on fixed assets are determined by the declining balance method at the following rates:

| Assets | Rate (%) |
|---|---|
| Buildings | 5 |
| Office furniture, fixtures, computers, light vehicles, etc. | 25 |
| Other assets not specified | 15 |

The fiscal book value is adjusted by the annual inflation rate.

### Taxes
In principle, income taxes, as well as taxes related to inheritances, donations, and fringe benefits, are not deductible. Interest and surcharges imposed on taxes are not deductible in general.

### Other significant items
For tax purposes, the following significant items should be considered:

- Bad debts are deductible only in the year the loss is suffered. Authorisation may be obtained to use an alternative method, which consists of creating a provision allowing the deduction only in the year the bad debts qualify as doubtful, up to 4% of the balance of the accounts receivable at year-end.
- Amortisation of intangible assets (e.g. patents, author's rights, drawings, franchises, and contracts without set expiration date) is not deductible.
- Changes in methods are not allowed without prior approval.
- Bonuses paid to employees within 120 days after the end of the taxable year are deductible for the year just ended.

### Net operating losses
The carryforward of losses of legal entities can be used to offset profits up to the fifth period following the period in which the losses were generated, with a maximum amortisation of 20% in each period. For the fourth period, the deduction allowed

should not exceed 80% of the net taxable income. In the fifth period, the percentage is 70%.

### *Payments to foreign affiliates*
Payments to foreign affiliates for royalties, interest, or service fees are deductible, provided that the 25% WHT was paid.



Payments of interest on loans abroad to foreign financial institutions are subject to a WHT of 10%.

## *Group taxation*

Group taxation is not permitted in the Dominican Republic.

## *Tax credits and incentives*

In the Dominican Republic, tax incentive laws exist for the following:

- Tourism.
- Alternative energy.
- Industrial renovation and modernisation.
- Industrial Free Trade Zone operations.
- Border development.

## *Withholding taxes*

Dividends in cash to resident and non-resident individuals and corporations are subject to a WHT of 25%.

The WHT on payments to foreign corporations, which are not permanently established in the Dominican Republic, are as follows:

| Recipient | Interest/dividends (%) | Royalties (%) | Technical assistance (%) | Other services (%) |
|---|---|---|---|---|
| Non-treaty, basic | 25* | 25 | 25 | 25 |
| Treaty (Canada) | 18 | 18 | 25 | 25 |

* Payments on interest (loans) to foreign financial institutions are subject to a WHT of 10%.

## *Tax administration*

### *Returns*
The Corporate Annual Tax Return (Form IR-2) must be filed and taxes paid within 120 days after year-end. Tax authorities may allow extensions of up to 60 days, upon request.

Tax returns are based on self-assessment and must be filed on electronic forms supplied by the internal tax department.

### *Payment of tax*

The balance of any tax due must be paid no later than the due date for filing the return. Corporations domiciled in the country and PEs of foreign enterprises shall be obliged to make monthly advance payments of tax related to the period in progress.

### *Year-end dates established by the DR tax code*

Corporate bylaws should establish as year-end, one of the following: 31 December, 31 March, 30 June, or 30 September. Once the year-end is selected, any change should be authorised by the tax authorities.

### *Example of income tax calculation for the year ending 31 December 2010*

| **Pre-tax income** | **DOP 1,000,000** |
|---|---|
| Add: | |
| Non-deductible expenses: | |
| Charitable contribution in excess of limitation | 25,000 |
| Tax on compensation-in-kind (120,000 at 25%) | 30,000 |
| Total of non-deductible expenses | 55,000 |
| | |
| Deduct: | |
| Dividends from domestic operation | 50,000 |
| Carryover loss | 100,000 |
| Total deductions | 150,000 |
| | |
| Taxable income | 905,000 |
| | |
| Tax at 25% | 226,250 |

# Ecuador



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## Significant developments

As in previous years, a new tax reform was introduced at the end of 2010, with the publication of the Production Code. The reform intends to promote new investments within the country by granting tax holidays for up to five years *(see the Tax credits and incentives section for more information)*.

The International Financial Reporting Standards' (IFRS) implementation deadline for companies (except for financial institutions) was suspended until 2012 (for entities with assets lower than 4 million US dollars (USD)). As to date, the local Internal Revenue Service has not established the tax treatment for the accounting records that were or may be booked as a consequence of the implementation of the IFRS.

## Taxes on corporate income

Taxes on corporate income are levied at the following rates for fiscal year 2011:

| Income | Rate (%) |
|---|---|
| Distributed or undistributed profits of local corporations and branches | 24 |
| Reinvested profits of local corporations and branches | 14 |

Note that these rates are reduced annually by 1% until they reach 22% and 12%, respectively, in 2013.

Resident entities are taxed on their worldwide income. Non-resident entities are subject to tax on Ecuadorian-source income only.

## Corporate residence

Corporate residence is determined by the place of incorporation. For foreign branches, it is the place stated in the domiciliary deed.

### Permanent establishment (PE)

According to the tax legislation in force, a company can be deemed to have a PE in Ecuador if it maintains any place or fixed center within the country, in which a foreign company develops all or part of its activities.

In that sense, the corresponding regulations point out that a PE also exists when a foreign company maintains within the country a person or an entity that acts on its behalf and habitually exercises an economic activity. Said regulations contemplate several instances where this is applicable, among them:

- A person with legal representation, which is normally granted through a power of attorney or through a legalized decision by the company and includes the capacity to legally act on behalf of the company.
- A person working under a contractual relationship for a foreign company to carry out economic activities on behalf of that company.
- A centre for the direction of the activities of the foreign company.
- A branch, agency, or office that acts on behalf of the foreign company.
- An office for the provision of technical consultancy services related to contracts that are executed in the country.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is levied at the rates of either 12% or 0% on the ownership transfer of goods, import of goods and services, as well as services rendered within the country or imported. Royalties and intangible property imported or locally paid are also levied with a 12% VAT.

The following are transactions exempt from VAT:

- In-kind contributions to capital of companies.
- Inheritance and assets obtained from liquidation of companies.
- Transfer of business as a whole, amalgamations, mergers, takeovers, and spin-offs.
- Donations to public entities and non-profit organisations.
- Transfers of shares and securities.

Goods and services which are subject to 0% rate are explicitly listed in the law.

Among others, the following goods are taxed at a 0% rate upon either importation or local transfer of ownership:

- Most agricultural goods and foodstuff, when these remain in their natural state; this includes refrigerated or packaged goods that have not undergone further processing. Also included in this category are milk, meats, sugar, salt, bread, butter and margarine, flour, and cooking oil.
- Drugs, medicines, and other pharmaceutical products, including raw materials for their production.
- Fertilisers, insecticides, animal foods, and similar products, including the raw materials required for processing such goods.
- Agricultural machinery and equipment.
- Goods that are exported.
- Paper, books, magazines, and newspapers.

Among others, the following services are taxed at a 0% rate:

- Transportation of persons and cargo, except air transportation of persons and local air transportation of cargo.
- Book printing services.
- Housing rental.

- Water, electric, sewage, and other public services, including garbage collection.
- Financial services.
- Exported services.

12% VAT paid on imports and local purchases can be deducted from 12% VAT charged on sales or services rendered. The VAT paid on raw materials, fixed assets, or components required for the production of goods or rendering of services is also creditable when the final product is considered taxable at 12%. Similarly, VAT paid on raw materials, services, components, or fixed assets necessary for production of export goods is also recoverable.



VAT may not be recovered (by either tax credit or other means) on the local acquisition or import of goods and services that are used for the production of goods or services taxed at a rate of 0%. In these cases, non-recoverable VAT is part of the cost of the purchased goods and services or an expense, both deductible for income tax computation purposes.

Companies designated as 'special taxpayers' (qualified as such by the tax authorities, which, in recognition of its economic importance defined in special parameters, contributes to the effective collection of taxes, subject to special regulations regarding the compliance of their formal duties and payment of taxes) are required to withhold 30% of VAT applicable on their purchases of goods taxed at 12% and 70% of VAT applicable on their purchase of services taxed at 12%, except with respect to services rendered by professionals, in which case 100% of VAT charged must be withheld.

### *Customs duties*

Since Ecuador is a member of the Andean Community, goods to be imported are classified under the Common Nomenclature of the Andean Countries participating in the Categena's Agreement (NANDINA) Pact, which is based on the Customs Cooperation Council Nomenclature (also known as the Brussels tariff nomenclature). Most consumer good imports pay 20%, while intermediate goods are usually imported at a 10% or 15% rate. Raw materials and capital goods generally pay 0% to 5%. Ecuador has negotiated exceptions under the Andean common tariff that allow lower duties on certain capital goods and industrial inputs. There is duty-free import of agricultural goods and equipment.

The price listed on the commercial bill or invoice is the basis for the assessment of duties, except when the Central Bank of Ecuador (CBE) considers the listed price unreasonable, in which case market prices in arm's-length transactions will be used. The burden of proof lies with the importer.

In addition to import duties, all imports are subject to 12% VAT, 0.25% for CORPEI (Exports and Investment Promotion Corporation), and an additional 0.5% tax for the Children's Development Fund.

Except for the 0.25% for CORPEI, which is based on the free on board (FOB) value, all other charges are based on the cost, insurance and freight (CIF) value of the merchandise.

All Ecuadorian imports and exports are subject to inspection by authorized international verification companies operating in the country (there are some imports exempt from verification). Goods are appraised for value, quantity, quality, and weight at the port of origin.

### *Municipal asset tax*
The municipal asset tax is levied on all individuals and companies required to keep accounting records in accordance with Ecuadorian tax legislation. This tax is levied annually at a rate of 1.5 per thousand (or 0.15%) of total assets less current and contingent liabilities, as shown on the balance sheet.

### *Municipal real estate tax*
The city governments assess an annual municipal property tax, which ranges between 0.25 per thousand and 5 per thousand (0.025% to 0.5%) of the commercial value of the property, as determined by valuation carried out every five years by the city government, for both urban and rural properties (rural property is taxed at a maximum of 3 per thousand or 0.3%).

### *Municipal tax on capital gain in the transfer of real estate (Plusvalía)*
The real estate transfer tax applies to the transfer of real estate. It is taxed at 10% of profits.

### *Special consumption tax (Impuesto a los Consumos Especiales, ICE)*
ICE is imposed on domestic and imported goods which are explicitly listed in the law. This tax is levied at a progressive rate from 5% to 35% on certain automobiles and 15% on airplanes, helicopters, and boats. The tax on cigarettes, alcoholic beverages, and soft drinks ranges from 10% to 150%. It must be paid monthly and is collected upon sales. The ICE tax base for imported goods is the *ad valorem* value.

### *Foreign assets tax (Impuesto a los Activos en el Exterior)*
The tax base for the foreign assets tax is the average monthly balance of cash deposits held in foreign entities by private entities registered in the stock market and regulated by the Superintendent of Banks and Companies. The monthly tax rate is 0.084%.

### *Remittance tax (Impuesto a la Salida de Divisas)*
Remittance tax is imposed on the transfer of money abroad in cash or through cheques, transfers, or courier of any nature carried out with or without the mediation of the Ecuadorian financial system. As of January 2010, the applicable rate is 2%.

## *Branch income*

Distributed or retained branch profits are taxed at a 24% rate. No further taxes are payable when profits are remitted to headquarters, except if located in a tax haven country. Re-invested profits are levied at a 14% income tax rate. Companies must increase their share capital within the following fiscal year to be beneficiaries of the income tax rate reduction. There is not a branch remittance tax in Ecuador, except for payments to tax haven countries, which are subject to withholding tax (WHT) at 10%.

### *Countries and territories considered as tax havens by tax authorities*

| | | | |
|---|---|---|---|
| Albania | Cook Island | Maldivas | Saint Elena |
| Andorra | Djibouti | Malta | Saint Kitts and Nevis Islands |
| Angola | Emirates of Saudi Arabia | Man Islands | Saint Lucia |
| Anguila | French Polinesia | Marshall Islands | Saint Marino |
| Antigua and Barbuda | Gibraltar | Mauricio | Saint Peter Islands and Miguelon |

| | | | |
|---|---|---|---|
| Aruba | Granada | Mónaco | Saint Vincent and the Grenadines |
| Ascension Island | Groenlandia | Montserrat (UK) | Salomon Islands |
| Azores Islands | Guam | Myamar | Samoa |
| Bahamas | Guernesey, Jersey, Alderney, Great Stark Islands, Herm, Little Sark, Brechou, Jethou Lihou | Nauru | Seychelles |
| Bahrein | Guyana | Netherlands Antilles | Sri Lanka |
| Barbados | Hong Kong | Nigeria | Svalbard Islands |
| Belice | Kingdom of Jordania | Niue | Tokelau |
| Bermudas | Kingdom of Swaziland | Norfolk Islands | Triesta (Italy) |
| Brunei Darussalam | Kingdom of Tonga | Oman | Trinidad and Tobago |
| Cabo Verde | Kiribati | Ostrava | Tristan Da Cunha |
| Caiman Islands | Kuwait | Pacific Islands | Tunisia |
| Campione D´italia | Labuan | Palau | Turks and Caicos Islands |
| Canaria | Liberia | Panama | Tuvalu |
| Chipre | Liechtenstein | Pitcairn | Vanuatu |
| Christmas Islands | Luxemburgo | Puerto Rico | Virgin Islands (British) |
| Cocos Island or Keeling | Macao | Qatar | Virgin Islands of the United States |
| Commonwealth of Dominica | Madeira (Portugal) | Qeshm Islands | Yemen |

## *Income determination*

### *Inventory valuation*
The valuation of inventories is not specifically treated in the tax law, so Ecuadorian accounting standards must be applied. Inventories are carried at acquisition cost. Last in first out (LIFO), first in first out (FIFO), and average cost methods are used, with average cost being the preferred method.

### *Capital gains*
Occasional gains from stock sales are tax exempt, and gains from investment funds and investment trusts are income tax exempt, as long as the income has been taxed at source. Gains on the sale of fixed assets are added to the taxable base and levied at regular income tax rates, except gains derived from occasional sales of real estate, which are tax exempt.

### *Dividends*
Dividends received by a resident company or foreign company, not domiciled in a tax haven, from a resident company are tax exempt.

### *Foreign income*
Foreign-source income is considered exempt for tax purposes; companies must demonstrate the income tax payment abroad. Tax haven countries are not considered to be part of this exemption.

## Deductions

As a general rule, operations that exceed USD 5,000 should be performed through an institution of the Ecuadorian financial system, otherwise such operations will become non-deductible.

### Depreciation and amortisation

Straight-line depreciation applies, at rates specified by law. The director of the Internal Revenue Service of Ecuador authorises higher rates of depreciation in cases such as obsolescence, excessive use, and faster than expected wear-out of assets.

Depreciation rates are as follows:

| Asset | Depreciation % |
|---|---|
| Real estate (except land), aircraft, naval crafts, and similar property | 5 |
| Facilities, machinery, equipment, and furniture | 10 |
| Vehicles, trucks, and tractors used for construction | 20 |
| Computer equipment and software | 33.33 |

Depreciation rates apply to the cost of assets.

Intangible assets are amortised either within the terms specified in the contract or over a 20-year period.

### Interest expenses

Interest on debts incurred for business purposes are deductible.

Foreign loan interests are deductible, to the extent that they are registered with the CBE and do not exceed the maximum rates established by CBE. Interest on foreign loans that are not registered with the CBE are non-deductible.

### Organisational and start-up expenses

Organisation, experimentation, and preoperational expenses are to be amortised over five years at the rate of 20% per year.

### Statutory profit sharing

According to the Ecuadorian Labour Code, companies must distribute 15% of their pre-tax earnings amongst their employees. This profit sharing is a deductible expense for corporate income tax purposes.

### Taxes

Taxes, rates, levies and contributions to the social security system related to the generation of taxable income are deductible.

### Fines and penalties

Interest and fines paid as penalties imposed on late payments of tax obligations and on income tax payments are not deductible for income tax calculation purposes.

### Net operating losses

The carryforward of losses is allowed to a maximum of five years, with an amortisation limit of 25% per year over the taxable base. There is no loss carryback.

### *Payments to foreign affiliates*
In most cases, payments made abroad are deductible, as long as income taxes have been withheld (at the rate of 24% over the taxable base). Professional fees, royalties, commissions, or any payment made abroad is subject to withholding at a rate of 24% over the taxable base. Payments on imports are deductible and are not subject to withholding of income taxes.



## *Group taxation*

Group taxation is not permitted in Ecuador.

### *Transfer pricing*
The transfer pricing regime in Ecuador is based on the Organisation for Economic Co-operation and Development (OECD) guidelines. Related party transactions must be carried out at arm's length. Formal documentation requirements exist.

### *Thin capitalisation*
A thin capitalisation rule on foreign loans granted by related parties at a 3:1 ratio over equity must be considered. For branches of a foreign corporation, only capital must be considered.

## *Tax credits and incentives*

### *Handicapped employee and new employee increases*
An amount equivalent to 150% and 100% remunerations of handicapped and new employees, respectively, can be considered an additional deduction for income tax calculation purposes. New employees must be working with the company for at least six months.

### *Income tax exemptions*
Investments made by new companies located outside the cities of Quito and Guayaquil, in specific sectors determined by law, will have five years of income tax exemption.

### *Foreign tax credit*
There are no provisions in Ecuador for a foreign tax credit. In general terms, income taxed abroad is considered as an exempt income, with some special exceptions.

## *Withholding taxes*

Dividends prepaid are subject to a 24% income tax withholding.

Dividends paid to non-resident entities generally are not subject to WHT. However, dividends paid to non-resident entities in tax haven countries are subject to 10% WHT at source.

Interest paid on loans obtained from non-residents is subject to a 24% WHT unless reduced by tax treaty. Royalties paid to a non-resident are subject to 24% WHT unless reduced by tax treaty.

Revenues from occasional services provided by non-resident individuals are levied at 24% WHT. Payments made abroad to non-resident individuals and companies are subject to a 24% WHT. Other payments made abroad, other than dividends or profits, are subject to a 24% WHT.

Periodically, the Internal Revenue Service of Ecuador establishes withholding percentages on local payments, which are not greater than 10%. Local payments (including interest paid by financial institutions) are subject to 1%, 2%, 8%, and 10% withholding.

### *Tax treaties*

As a member of the Andean Community, Ecuador has adopted Decision 578, which provides relief from double taxation for individual or company members. Furthermore, Ecuador has similar tax treaties with Belgium, Brazil, Canada, Chile, France, Germany, Italy, Mexico, Romania, Spain, and Switzerland.

Withholding rates could vary from 0% to 15%, depending on the nature of the payment.

## *Tax administration*

### *Returns*

The fiscal year is the calendar year from 1 January to 31 December. The tax system operates on the basis of self-assessment, with subsequent inspection by the tax authorities.

Tax filing deadlines begin on 10 April and continue up to 28 April. The tax return due dates are determined by the ninth digit of the company's Tax Identification Number (TIN).

### *Payment of tax*

Corporations are required to keep accounting records and must make advance income tax payments, in two equal instalments in July and September, based on the following calculation:

The sum of 0.4% of the taxable income, 0.4% of total assets, 0.2% of total equity, and 0.2% of deductible expenses less WHT held on the last fiscal year.

Differences between advance payments and the income tax returns must be paid with the tax return. If the difference is in favour of the taxpayer, the taxpayer could request a reimbursement from the Internal Revenue Service.

# Egypt

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## Significant developments

Transfer Pricing Guidelines were finally launched in Egypt, and the first part of which was issued in final version to the public provides guidance on the arm's-length principle, how to establish comparability, choosing the most appropriate transfer pricing method(s), and documentation requirements.

Due to the current political and economic circumstances in Egypt, the Military Supreme Council, which is in power until presidential and parliamentary elections later this year, has issued a decree (decree no. 8 of 2011) whereby an Egyptian company could pay the corporate tax due in three equal installments, providing certain procedures to be followed for that purpose. This installment regime should not result in any interests or delay fines on the taxpayer. It has not been mentioned if this decree will apply in future years, and we are still waiting for any formal announcement in this regard.

On 22 February 2011, the Egyptian Tax Authority issued a circular (circular letter no. 3) dictating that tax inspection for financial year 2005 is closed, in consideration of the current political circumstances. Accordingly, inspection will apply to the financial years 2006, 2007, and 2008.

Ministerial decree no. 363 of 2009 provided the procedures to be followed in order to conclude specific tax court cases between taxpayers and the Egyptian Tax Authority. This ministerial decree specifies the topics of arguments to which it applies. Another ministerial decree has been issued on 3 April 2011, amending the part of ministerial decree no. 363 of 2009 which specifies the topics of arguments, making it more comprehensive covering arguments related to income taxes for years preceding, applying the income tax law no. 91 of 2005, as well as arguments related to stamp taxes for the years preceding, applying law no. 143 of 2006. Further, it dictates that the amended ministerial decree applies to natural persons as well as juridical persons.

The monthly social insurance thresholds shall increase from 850 Egyptian pounds (EGP) to EGP 875 for basic salaries, and from EGP 900 to EGP 1050 for variable salaries. This should be effective 1 July 2011. However, in order to be effective, an official proclamation must be made, which still has not taken place.

It has been decided to grant expatriates working in Egypt a renewable work permit for a maximum limit of three years. In order to allow granting a work permit, an expatriate should prove a relevant experience in the position one will be filling in the local company, and this requires presenting the relevant experience certificates reflecting this fact. Finally, this regulation is newly introduced and we expect to be amended if the concerned parties demonstrated a clear opposition towards it, on the grounds of being in need to specific expatriates' experience which might require staying in Egypt beyond the three year limit.

## *Taxes on corporate income*

The corporate tax rate is 20% for income generated from all types of business activities except for oil exploration companies, whose profits are taxed at 40.55%. In addition, the profits of the Suez Canal Authority, the Egyptian Petroleum Authority, and the Central Bank of Egypt are taxable at a rate of 40%.

Resident companies are taxed on worldwide income. Non-resident corporations and partnerships pay tax on income derived from their permanent establishments (PE) in Egypt.

## *Corporate residence*

Foreign corporations and partnerships are classified as residents of Egypt if they meet one of the following conditions:

- The entity is established according to the Egyptian law.
- The government or a public authority owns more than 50% of the capital of the entity.
- The effective place of management is in Egypt.

The executive regulations of the law indicate that Egypt is considered as the effective place of management if the entity meets any two of the following conditions:

- Daily managerial decisions take place in Egypt.
- Members of the board of directors hold their meetings in Egypt.
- At least 50% of the board members or managers reside in Egypt.
- The major shareholders (owners of more than 50% of the shares or voting rights) reside in Egypt.

### *Permanent establishment (PE)*

The PE concept was introduced in the income tax law 91 of 2005 and defined as follows:

- Headquarters.
- Branch.
- Building used as sale outlet.
- Office.
- Factory.
- Workshop.
- Places of extraction of natural resources.
- Farms.
- Building site, construction or assembly point, installations, supervisory activities of the same, which exists for more than six months.
- An agent who has the power to ratify contracts on behalf of a foreign company.
- An independent broker or agent who is proved to have dedicated most of one's time during the year in the interest of a foreign company.

A foreign company that is deemed to have a PE risk, according to the Egyptian Companies Law, should incorporate a legal entity in Egypt.

There are several legal forms existing under the Egyptian Companies Law from which a foreign company can choose to incorporate, and these are: joint-stock company, limited liability company, branch, or a representative office.



## *Other taxes*

### *Sales tax*

The standard sales tax rate is 10% of the value of commodities (except for those referred to in special schedules of the law) and 5% to 10% for specific services. Some examples of the commodities subject to sales tax rates other than the standard 10% rate are as follows:

- Cement: 5%.
- Specific types of televisions and fridges: 25%.
- Air conditioners: 25%.

The Sales Tax Department is responsible for assessing the tax on the sales of locally produced goods and imported goods, except for those exempted by a special decree.

Consequently, all natural persons and legal entities are required to collect general sales tax and remit it to the Sales Tax Department. This includes manufacturers and providers of taxable services and every importer of commodities or taxable services.

In addition, there are plans to introduce a newly developed sales tax law; however, after the social unrest that has taken place in Egypt, it is difficult to predict when this new law will be introduced.

### *Customs duties*

The liability for customs duty rests with the person who is importing the goods from abroad.

Customs duty rates on imported goods range from 5% to 40%, with the exception of vehicles for which different rates apply.

Where entities import machines and equipment as capital assets, and to establish the company's project, the machines and equipment will be charged customs duty at 5%.

Component parts, which are imported to be assembled in Egypt, are assessed customs duty based on the complete product. Then, it is reduced by a percentage ranging from 10% (if the local content of the final product is less than 30%) to a maximum of 90% (if the local content exceeds 60%).

Machines, equipment, and similar capital assets (with the exception of private motor cars) imported on a temporary basis, are subject to fees at 20% of the original customs duty for each year or fraction of a year during which they remain in Egypt until they are exported.

There is also a proposed new law regarding this issue, which is currently at the draft stage.

### Excise taxes
There are no excise taxes in Egypt.

### Stamp tax
There are two distinct types of stamp tax, which are imposed on legal documents, deeds, banking transactions, company formation, insurance premiums, and other transactions, as follows:

- The nominal stamp tax is imposed on documents, regardless of their value. The tax rate for items such as contracts is EGP 1 for each paper.
- Percentage or proportionate stamp tax is levied based on the value of transactions.

A proportional tax at the rate of 0.4% is imposed on the balances of credit facilities and loans and advances provided by Egyptian banks or branches of foreign banks during the financial year, with the bank paying 0.1% on the balance at the end of each quarter of the year. The bank and the customer each bear half of the tax.

Loans from other establishments are not subject to this tax.

### Real estate taxes
The new real estate tax law was effective from January 2010. The new law takes into consideration the different variables that can affect the value of a property, such as location, value of similar buildings, and the economic situation of the district in which the property is located. This is to be updated every five years.

Real estate tax is levied on all constructed real estate units. This covers land and building, excluding plant and machinery.

Such tax is assessed based on the rental value of the land and building, and these value assessments are set by the committees, after approval of the Minister or whomever the Minister delegates, and published in the Official Journal. Based on the announcement, any taxpayer can appeal the rental value assessment.

The real estate tax rate is 10% of the rental value, and the calculation of the rental value differs for residential units and non-residential units. Specific percentages of deductions are provided by the law to account for all the expenses incurred by the taxpayer, including maintenance costs.

## Branch income

Branches of foreign corporations operating in Egypt receive tax treatment identical to that of corporate entities for the results of their activities in Egypt.

A branch, but not a subsidiary, may deduct a 'head office charge' of an amount up to 7% of its taxable income.

## Income determination

### Capital gains
A foreign company is taxed on all capital gains realised in Egypt. However, capital gains on the sale of Egyptian securities listed on the Egyptian Stock Exchange are not taxable.

Capital gains are not taxed separately; they are considered as part of the company's income and taxed accordingly (i.e. at the 20% corporate tax rate) after deducting all tax deductible expenses.

### Dividend income
Dividends distributed by a company residing in Egypt are not subject to corporate taxes. Conversely, dividends that non-resident companies distribute are subject to the Egyptian corporate tax, after deducting foreign taxes paid abroad.



### Stock dividends
Stock dividends receive the same treatment as ordinary dividends.

### Interest income
Interest expenses are deducted from interest income when calculating the interest income to be included in taxable income.

### Rent/royalties income
Rent/royalties income are not taxed separately; they are considered as part of the company's income and taxed accordingly (i.e. at the 20% corporate tax rate).

### Foreign income
Income from any source, domestic or foreign, received by a corporation within Egypt is subject to corporate tax. The scope of tax covers the activities carried out inside and outside Egypt, which are administered or managed within Egypt.

## Deductions

In order for expenses to be acceptable for tax deduction, such expenses must be:

- actual and supported by documents
- business related, and
- necessary for performing the company's activity.

### Depreciation and amortisation
The tax law set the depreciation and amortization rates for tax purposes to the following:

- 5% of the cost of purchasing, establishing, developing, and renovating buildings and establishments is deductible based on the straight-line method.
- 10% of the cost of purchasing, developing, and improving intangible assets is deductible based on the straight-line method.
- Computers, information systems, software, and data storage sets are depreciated at a 50% rate on a declining balance method.
- All others assets are depreciated at a rate of 25% of the depreciation basis for each fiscal year, on a declining-balance method.

### Accelerated depreciation
A company may deduct 30% accelerated depreciation from the cost of new or used machines and equipment used in industries during the first fiscal year of their employment.

### Interest expense

Interest expenses are deductible for tax purposes after offsetting any tax-exempt interest income.

Interest expense deductions are only allowed if the following conditions are fully met:

- The interest rate does not exceed twice the discount rate as determined by the Central Bank of Egypt at the beginning of the calendar year in which the tax year ends.
- The interest expense is in return for loans complying with the local thin capitalisation rule: 4:1 debt to equity ratio.
- The Egyptian transfer pricing rules (i.e. arm's-length principle) must be followed. In case of a tax audit, if the interest rate wasn't proven to be at arm's length, the Tax Authority would have the right to adjust this price to arrive at a 'neutral price' and re-calculate the taxes due accordingly.
- The loan is business related.

### Charitable contributions

Donations to the government are tax deductible. Donations to Egyptian charities are also deductible, but only up to 10% of taxable income.

### Non-deductible costs

The following items are not tax-deductible:

- Reserves and appropriations of all different types.
- Financial fines and penalties paid by the taxpayer because they or one of their subordinates has committed a deliberate felony or misdemeanour.
- Income tax payable according to the income tax law.
- Profit shares, distributed dividends, and the attendance fees paid to shareholders for attending the general assembly's meetings.
- Compensation and allowances obtained by the chairmen and board members.
- Workers profit share to be distributed according to the law.

### Net operating losses

A company may carry losses forward for a period not to exceed five years. Nevertheless, if a change occurs in the ownership of its capital exceeding 50% of the shares, stocks, or the voting rights, if the company is either a Joint Stock Company or a Company Limited by Shares whose shares are not listed on the Egyptian Stock of Exchange, and if the company changes its activity, the company cannot carry the losses forward.

In general, companies cannot carry losses back, except for contracting companies, which are allowed a loss carryback period of five years.

### Payments to head office

A branch may deduct head-office charges up to 7% of its taxable income. Moreover, the branch or subsidiary should withhold taxes before the payment of interest, royalties, and service fees to non-resident foreign corporations or affiliates.

## Group taxation

The Egyptian tax law treats every company in a group of companies as a separate legal entity. Thus, affiliated companies or subsidiaries cannot shift the profits/ losses within the group.

### *Transfer pricing*
Transfer pricing rules were introduced in Egypt for the first time by Law No. 91 for the year 2005. The law introduced the arm's-length principle (ALP), specifying that any transaction between related parties should be at arm's length (i.e. market value).

The law does not specify penalties with regard to transfer pricing. However, the law states that the Egyptian tax authorities may adjust the pricing of transactions between related parties if the transaction involves elements that would not be included in transactions between non-related parties, and whose purpose is to shift the tax burden to tax exempt or non-taxable entities. Where this is the case, the tax authorities may determine the taxable profit on the basis of the neutral price. The acceptable methods for determining such neutral price, according to the rule of the law, are as follows:

- Comparative free price same as Comparable Uncontrolled Price method (CUP).
- Total cost with an added margin of profit (same as Cost Plus method).
- Resale price.

On 29 November 2010, the Egyptian Tax Authority launched the Transfer Pricing Guidelines ('the TP Guidelines'). The TP Guidelines are being issued as a series of parts, the first part of which was issued in final version to the public and provides guidance on the ALP, how to establish comparability, choosing the most appropriate transfer pricing method(s), and documentation requirements. The coming parts should cover more complex transfer pricing topics, specifically transactions involving intellectual property, intra-group services, cost contribution arrangements, and advanced pricing agreements.

The Egyptian Tax Authority noted that this launch does not represent an inauguration of transfer pricing rules in Egypt because transfer pricing law has existed since 2005. Accordingly taxpayers are required to prepare contemporaneous documentation studies to support the arm's-length nature of their controlled transactions since issuance of transfer pricing law in Egypt in 2005. The Egyptian Tax Authority specified, however, that they didn't require the submission of transfer pricing documentation studies with the tax return; rather, they are required to be available upon request in a tax audit. Studies are acceptable in English, but a translation may be requested from the taxpayer.

The Egyptian Tax Authority explained that TP Guidelines will be utilized as a practical guide to assist taxpayers and tax inspectors in understanding how to implement and examine transfer pricing transactions. Egyptian TP Guidelines were compared to the Organisation for Economic Co-operation and Development (OECD) by an OECD representative and were found to be similar.

### *Thin capitalisation*
The Egyptian thin capitalisation rule provided by the Egyptian income tax law dictates that the debt to equity ratio starting from the year 2009 going forward is 4:1. Accordingly, the law disallows the deductibility of debit interests of Egyptian companies on loans and advances if such loans and advances are in excess of fourfold the equity average (which is calculated according to the financial statements prepared pursuant to the Egyptian accounting standards).

The debit interest includes all amounts chargeable by the company in return for the loans; advances of any kind obtained thereby, bonds and bills. The loans and advances include, for purposes of this item, bonds and any form of financing by debts through securities with fixed or variable interest.

For determining the equity, the following items represent the basis for the calculation: the paid up capital in addition to all reserves and dividends reduced by retained losses, provided that the differences of the adjusted account is not included in the reserves account and is determined to be non-taxable. In case of retained or carry-forward losses, they must be used to reduce retained profits and reserves solely; the percentage is calculated on basis of total loans and advances in proportion to the remaining equity amount, after deducting the retained losses with a minimum of the paid up capital.

## *Tax credits and incentives*

Egypt offers no specific tax incentives.

### *Foreign tax credit*

The foreign tax paid by a resident company on its profits earned abroad is deductible from the tax payable in Egypt; however, losses incurred abroad are not deductible.

## *Withholding taxes*

A corporation paying invoices must withhold 0.5% to 5% of payments, depending on the services and commodities, to local taxpayers and remit them quarterly to the Tax Department.

Payments of interest, royalties, and services by a domestic corporation to foreign or non-resident bodies are subject to withholding tax (WHT) as follows.

### *Interest*

Interest on loans with a three-year term or more entered into by private sector companies are exempt from WHT, while loans of less than three years are subject to 20% WHT on interest. However, an applicable double tax treaty (DTT) between Egypt and the foreign country may result in the reduction of such tax rate. *Please see below for the new ministerial decree affecting the treatment of interest and royalty payments.*

### *Royalties*

Royalty payments are subject to the 20% WHT. However, an applicable DTT signed between Egypt and the foreign country may result in a reduction in this rate. *Please see below for the new ministerial decree affecting the treatment of interest and royalty payments.*

### *Service payments*

Service payments are subject to the 20% WHT. However, an applicable DTT signed between Egypt and the foreign country may result in the elimination of this rate.

### *Tax treaties*

Egypt has concluded DTTs with about 50 countries, which could change the tax treatment of transactions carried out between Egyptian entities and residents of a treaty country.

| Recipient | Interest (%) | Royalties (%) |
|---|---|---|
| Non-treaty | 20 | 20 |
| Treaty: | | |
| Algeria | 5 | 10 |

| Recipient | Interest (%) | Royalties (%) |
|---|---|---|
| Austria | 15 | - |
| Bahrain | - | - |
| Belarus | 10 | 15 |
| Belgium | 15 | 15 |
| Bulgaria | 15 | 15 |
| Canada | 15 | 15 |
| China | 10 | 8 |
| Cyprus | 15 | 10 |
| Czech Republic | 15 | 15 |
| Denmark | 15 | 20 |
| Finland | 15 | 20 |
| France | 15 | 15 (franchise) |
| | | 15 (for other royalties) |
| Germany | 15 | 15 |
| Holland | 12 | 12 |
| Hungary | 15 | 15 |
| India | 20 | 20 |
| Indonesia | 15 | 15 |
| Iraq | 20 | 16 |
| Italy | 20 | 15 |
| Japan | 20 | 15 |
| Jordan | 15 | 20 |
| Korea | 15 | 15 |
| Lebanon | 10 | 5 |
| Libya | - | - |
| Malaysia | 15 | 15 |
| Malta | 10 | 12 |
| Morocco | 20 | 10 |
| Norway | 20 | 15 |
| Oman | 12.50 | 15 |
| Pakistan | 15 | 15 |
| Palestinian Territories | 15 | 15 |
| Poland | 12 | 12 |
| Romania | 15 | 15 |
| Russia | 10 | 15 |
| Serbia & Montenegro | 15 | 15 |
| Singapore | 15 | 15 |
| South Africa | 12 | 15 |
| Sudan | 20 | 10 |
| Sweden | 15 | 14 |
| Switzerland | 15 | 12.50 |
| Syria | 15 | 20 |
| Tunisia | 10 | 15 |
| Turkey | 10 | 10 |
| Ukraine | 12 | 12 |
| United Arab Emirates | 10 | 10 |

| Recipient | Interest (%) | Royalties (%) |
| --- | --- | --- |
| United Kingdom | 15 | 15 |
| United States | 15 | 15 |
| Yemen | 10 | 10 |

### *New ministerial decree*
A new ministerial decree was issued on 29 December 2009, declaring that the reduced rate of WHT on interest or royalties provided by an applicable DTT should be ignored when withholding the tax. However, under certain conditions, the foreign recipient of payments would be able to get a refund for the amount resulting from the variance between the normal rate of 20% and the reduced treaty rate.

## *Tax administration*

### *Returns*
The tax year is the financial year of the taxpayer. The taxpayer is required to assess taxes due for every financial year and settle them with the tax return.

The corporate tax return is due within four months from the end of the financial year; so if a company's financial year ends 31 December, then the tax return has to be filed before the end of April of the following year.

### *Payment of tax*
Advance payments are deducted from taxes assessed per the tax return, and the balance is payable in a lump sum at the date of submitting the tax return.

The advance payment (i.e. WHT) is submitted on a quarterly basis.

# El Salvador

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## Significant developments

As of January 2011, a 10% withholding tax (WHT) has been established on interests paid for loans from foreign banks. This WHT is 20% if the transaction takes place between related parties.

As of February 2010, there was a decrease in the percentage of anticipated income tax payment for corporations that sell fuels (gasoline and diesel) from 1.5% to 0.75% monthly.

The Export Reactivation Law was recently derogated, which included a 6% drawback for the exporters. In January 2011, a return mechanism was approved for duties paid on raw and input materials imported that were definitively exported out of the country.

## Taxes on corporate income

The corporate income tax (CIT) rate is 25%.

Income tax is based on the principle of territoriality, and, by general rule, taxes are paid on goods located, activities realized, and capital invested in El Salvador as well as on services rendered or utilized in the country. Nevertheless, there is a special rule regarding securities and financial instruments, since income is considered to be obtained in El Salvador if the issuing entity is domiciled in El Salvador.

Taxable income is equal to gross income net of costs and expenses considered necessary for generating and maintaining the related source of income and other deductions allowed by law. Gross income is comprised of income or profits collected or accrued, either in cash or in kind, from any sources in El Salvador.

Corporations are required to follow the accrual method of accounting, and income is computed for 12-month periods beginning on 1 January and ending on 31 December of each year.

### Income tax advance payment

A 1.5% tax is applied to gross revenues accrued. This tax is paid monthly as an advance payment which is applied against the CIT at the end of the year.

# El Salvador

## Corporate residence

A company incorporated in El Salvador is a resident entity in the country for tax purposes and subject to CIT on Salvadorian source income. Also, branches from foreign companies authorised in El Salvador and entities operating as a permanent establishment are considered resident entities for tax purposes and subject to CIT on Salvadorian source income.

## Other taxes

### Value-added tax (VAT)

VAT (i.e. Impuesto al Valor Agregado or IVA) is levied at a rate of 13% over the taxable amount. As a general rule, the taxable amount is the price or remuneration agreed upon by the parties. For imports, the taxable amount is the customs value.

The following transactions are subject to VAT when performed within the Salvadoran territory:

- transfer/sale of tangible movable goods
- withdrawal of tangible movable goods from the inventory made by the company for self-consumption by its partners, directors, or personnel
- import of goods and services
- the supply of services of any type whether permanent, regular, continuous, or periodic, including technical advice and project designs; lease and sublease agreements over tangible goods; lease and sublease agreements over real estate for commercial purposes; lease of services in general; construction of real estate properties or building contracts; auctions; freight, whether inland, air or maritime; lease, sublease, and any form of use regarding trademarks.

The following imports are exempt from VAT:

- imports made by diplomats and consulate representatives of foreign nations with presence in the country according to international agreements adopted by El Salvador
- imports made by international organisations to which El Salvador is a party
- traveller's luggage according to customs regulations
- donations to non-profit organisations
- imports made by municipalities, if the goods imported are for the public benefit of the community
- imports of machinery by taxpayers duly registered for this purpose, which will be part of the taxpayer's fixed assets
- vehicles for public transportation, which can only be transferred after five years.

The following services are exempt from VAT:

- health services rendered by public institutions
- lease and sublease of real estate properties for housing
- services rendered under a labour relationship as well as those rendered by public and municipal employees
- cultural public performances authorised by competent authorities
- educational services rendered by authorised entities, i.e. Ministerio de Educación (the Ministry of Education)

- interest on deposits and loans provided by local financial institutions or entities registered at the Salvadoran Central Bank (BCR)
- interest on securities issued by the government and / or private entities traded through a stock exchange
- water supply by public institutions
- public transportation
- insurance premiums covering individuals, and reinsurance in general.

VAT is levied on exports at a rate of 0%. Foreign source income is not subject to VAT.



VAT taxes paid by a registered taxpayer company on its purchases (tax credits) are credited against VAT taxes charged to its customers (tax debits), on a monthly basis.

### *Tax on transfer of real estate property*
A 3% tax is applied to transfers of real estate property. This tax is applied to the amount by which the value of the real estate exceeds 28,571.43 US dollars (USD).

### *Tax on simple or sweetened soft drinks*
An *ad valorem* tax on simple or sweetened soft drinks is levied at the rate of 10% over the selling price to the public as suggested by the manufacturer, importer, or distributor, excluding VAT and returnable bottle taxes.

### *Tax on the production and importation of alcohol and spirits*
A tax is levied on domestically produced or imported alcohol and spirits at rates ranging from USD 0.0825 to USD 0.15 for each 1% of alcohol volume per litre or in proportion thereof. Spirits and alcohol also have an *ad valorem* tax levied at the rate of 5% over the suggested selling price to the public, excluding VAT.

### *Tax on tobacco products*
A tax is levied at USD 0.005 per cigarette, cigar, little cigarette, or other tobacco product. Also, an *ad valorem* tax is levied at the rate of 39% over the suggested consumer selling price to the public, excluding VAT.

### *Annual business tax*
Companies are required to register themselves with the Registry of Commerce and pay an annual business licence fee assessed on the company's assets, as follows:

| Assets (USD) | Fee (USD) |
|---|---|
| 2,000 to 57,150 | 91.43 |
| 57,151 to 114,286 | 137.14 |
| 114,287 to 228,572 | 228.57 |
| An additional charge for each office, branch, or agency property of a company | 34.29 |

If the assets exceed the amount of USD 228,572, there is an additional duty of USD 11.43 for each additional USD 100,000 in assets or fraction thereof. In any case, the relevant duties are limited to USD 11,428.57.

### *Social security contributions*
Social Security contributions (ISSS) are mandatory for both employee and employer and are destined to public health services. The employee's contributions are withheld from the employee's monthly salary and are transferred by the employer to the

Salvadorian Institute of Social Security through monthly payrolls. The contribution amounts are summarized in the table below:

| Monthly employee's salary (USD) | Employee's rate | Employer's rate |
|---|---|---|
| 0 to 685.71 | 3% | 7.50% |
| Over 685.71 | 0% | 0% |

Contributions to Pension Fund (AFP) are mandatory for both employee and employer. The employee's contributions are withheld from the employee's monthly salary and are transferred by the employer. The employer's contributions are paid to the AFP. Both contributions are reported to the Pension Fund Administrator through a monthly payroll. The percentages are summarized below:

| Monthly employee's salary (USD) | Employer's rate |
|---|---|
| 0 to 5,354.52 | 6.75% |
| Over 5,354.52 | 0% |

Entities with more than ten employees must also pay a payroll tax which is destined to INSAFORP (National Institute of Professional Development), this institute promotes professional development through courses and complementary studies. The percentages are summarized below:

| Monthly employee's salary (USD) | Employer's rate |
|---|---|
| 0 to 685.71 | 1% |
| Over 685.71 | 0% |

### *Municipal taxes*
Municipal taxes are assessed according to a progressive tariff list issued by each municipality. The taxes are applicable to the company's assets located in each municipality, and are paid on a monthly basis. The tariff lists are applied separately to commercial, industrial, and financial sectors.

### *Stamp taxes*
No stamp taxes are assessed as the pertinent law was abrogated in 1992.

## *Branch income*

In El Salvador, tax rates on branch profits are the same as for domestic corporations. No tax is withheld on transfers of profits to the head office provided the entity distributing them reports the payments and pays the corresponding income tax thereon.

### *Administrative offices*
The law does not provide separate treatment for administrative offices located in El Salvador. The general regulations indicate that branches, agencies and / or establishments permanently operating in the country, with owned or leased installed infrastructure, employing domestic staff, and performing their economic activities in a material and perceptible manner in the country, are subject to the same taxes as companies duly incorporated.

## Income determination

In El Salvador, income is considered taxable if it is obtained from goods located in the country, activities undertaken within the national territory, or services rendered or utilized in the country.

### Inventory valuation

For tax purposes, taxpayers are authorised to use any one of the following inventory methods, provided they are technically appropriate for the particular business, consistently applied, and easily audited:



- Purchase or manufacturing costs.
- Last purchase costs.
- Direct average allocation costs.
- Average costs.
- Last in first out (LIFO).
- First in first out (FIFO).
- Specific methods for fruits and farm products.
- Specific method for cattle.

Other than the methods enumerated above, taxpayers are not permitted to use other methods for valuing their inventories except with prior authorisation of the tax office, provided that in the latter's judgement the method in question contains clear determination and bona fide elements available to the office. Once an inventory valuation method is adopted, the taxpayer may not change it without the tax office's prior authorisation.

### Capital gains

Capital gains are taxed at a flat rate of 10% of net profits, except when gains are realised within 12 months following the purchase date, in which case they are taxed as ordinary income. Capital losses can only be offset against capital gains. Whenever capital losses exceed capital gains, the remaining balance may be carried forward to future capital gains within a five-year period.

### Dividend income

Cash profits or dividends remitted or credited to shareholders are non-taxable provided the entity distributing them reported and paid the corresponding income taxes.

Stock dividends are also not taxable provided the entity distributing them reported and paid the correspondent income taxes.

### Interest income

Interest income is taxable in El Salvador when the entity paying the interest is resident in El Salvador, when the capital is invested in the country, and when the risk is assumed in El Salvador.

### Partnership income

Partnership income is taxable if it is Salvadorian-source income; nevertheless, no specific provisions exist in El Salvador regarding partnership income.

### Rent/royalties income

Rent and royalties income is taxable if it is Salvadorian-source income; nevertheless, no specific provisions exist in El Salvador regarding rent and royalties income.

### Condoned debts
Condoned debts are considered taxable income and must be included as part of the income generated in that fiscal period.

### Foreign income
Under the territoriality source of income principle, extraterritorial income is not taxable in El Salvador, with the exception of income and other benefits from securities and other financing operations. In this case, interest arising from loans granted to a resident of El Salvador is considered as taxable income, and the person or entity paying the loan must withhold 10% of the interest. If the financial services are rendered between related parties, the withholding must be of 20%.

## Deductions

All business expenses considered necessary to produce taxable income and / or maintain income sources (e.g. freight, marketing, power, telecommunications, water, salaries, lease contracts, merchandise and transport insurance, fuel, and interest paid on loans used by income generating sources) are deductible for income tax purposes.

### Depreciation and amortisation
Depreciation is calculated using the straight-line method, which results in the following maximum annual rates for determining depreciation deductions.

| Assets | Rate (%) |
|---|---|
| Buildings | 5 |
| Machinery | 20 |
| Vehicles | 25 |
| Other movable assets | 50 |

Depreciation of new software is permitted at a rate of 25% of purchase or production costs.

Amortisation of goodwill, trademarks, and other similar intangible assets are not deductible for income tax purposes.

### Charitable contributions
The deductibility of charitable donations is limited to 20% of the donor's net income after deducting the donation amount.

### Fines and penalties
Penalties and interest charges on unpaid taxes are deductible.

### Taxes
Taxes paid are not deductible.

### Net operating losses
Operating losses cannot be carried forward to future years or carried back. Capital losses, however, may be carried forward to offset capital gains for five years.

### Payments to foreign affiliates
Remittance of royalties, interest income, and service fees to foreign affiliates are deductible provided proper contracts are in place, a 20% withholding tax (WHT) is applied, and these services have actually been received. Note that payments to entities located in tax haven regimes are subject to a 25% WHT.

## Group taxation



There are no grouping rules in El Salvador between independent entities. Each entity, even if related, is treated separately and must report and pay their taxes independently.

### Transfer pricing
In El Salvador, it is mandatory for entities that have operations with related parties or with entities resident in tax havens to undertake these operations according to the rules of market prices.

Local tax authorities can establish the value of the operations according to market prices rules if, according to their point of view, these operations have not been undertaken according to the arm's-length principle.

### Thin capitalisation
No specific provision for thin capitalisation exists in El Salvador.

## Tax credits and incentives

El Salvador offers a wide range of incentives to attract foreign investment and drive new commercial and industrial developments. There are also no restrictions on foreign ownership or on mergers, acquisitions, or joint ventures.

There are three specific laws in El Salvador that seek to encourage foreign investment by improving the country's competitiveness in all areas involving the granting of tax incentives. These laws are the Industrial and Commercial Free Zone Law, the Law of International Services, and the Export Reactivation Law.

The Industrial and Commercial Free Zone Law No. 405, dated 3 September 1998, grants companies the following incentives:

- income tax exemption
- VAT exemption
- municipal tax exemption
- exemption from real estate transfer taxes when land is intended to be used for productive activities
- exemption from duties for imports on machinery, raw materials, equipment, and intermediate goods used for production
- an option to sell merchandise or services linked to international trade produced in the free zone in the Salvadoran market as long as the corresponding import taxes, income tax, VAT, and municipal taxes are paid on the final goods or services.

Any foreign company may establish and function in a free zone or bonded warehouse and benefit from these incentives if they are engaged in production, assembly, manufacturing, processing, transformation, or commercialisation of goods and services and/or rendering of services linked to international or regional trade, such as gathering, packaging and repackaging, cargo consolidation, distribution of merchandise, and other activities connected or complementary to them.

The Law of International Services No. 431, dated 11 October 2007, grants the same benefits as the Free Zone Law, but the beneficiaries are companies operating in Service Centres specially created according to this law and dedicated to international services as defined therein.

The Export Reactivation Law No. 460 (i.e. Ley de Reactivación de las Exportaciones), dated 15 March 1990, grants reimbursement of 6% free on board (FOB) value of exports destined outside the region.

## *Withholding taxes*

Payments or amounts credited to non-residents arising from income obtained in El Salvador are subject to a 20% WHT. Income earned in El Salvador covers income from assets located in the country, from any activities performed or capital invested in the land, and from services rendered or used in the national territory, regardless of whether they are provided or paid outside the country. Income from services used in the country is income earned in El Salvador by the service provider, irrespective of whether the relevant income generating activities are performed abroad. Note that payments to foreign entities located in tax haven regimes are subject to a 25% WHT.

Payments to resident individuals with respect to services rendered, other than under a labour relationship, are subject to a 10% WHT.

The acquisition of intangible goods among resident entities in the country is subject to a 10% WHT.

Certain transactions are subject to a reduced WHT rate of 5%, such as the following:

- International Transport services paid to non-residents.
- Insurance services, re-insurances, and bondings paid to non-residents.
- Payments for transfer of intangible assets or use of the rights to intangibles and tangible assets related to films, movies, music records, cable TV, satellite, etc.

Moreover, a treaty to avoid double taxation exists between El Salvador and Spain, this treaty established reduced WHT, such as the following:

- 12% WHT made to dividend payments.
- 10% WHT made to interest payments.
- 10% WHT made to rent and royalties payments.
- 10% WHT made to payments for services.

## *Tax administration*

National taxes, fees, and other contributions on all types of goods, services, and income in El Salvador are levied by the National Congress. Local governments (municipalities) may suggest contribution rates and propose their approval to the National Congress by way of a specific law.

The Ministry of Finance (Ministerio de Hacienda) controls the State's finances and defines and guides the government's financial policy. It also harmonises, directs, and implements its policies on taxation through its agencies.

### *Returns*

CIT annual returns must be filed each year no later than 30 April, following the end of the year under taxation. In El Salvador, the fiscal year is from 1 January to 31 December.



VAT returns are filed on a monthly basis within the first ten working days of each month following the period under taxation.

### *Payment of tax*

Taxes are due on the date established for filing the tax returns. In El Salvador, tax payments are made together with the filing of tax returns, and payments must be made at the banks of the local financial system.

In addition, public and private legal entities resident in the country for tax purposes, other than farm and cattle concerns, are required to make advance income tax payments at 1.5% of gross revenues. These advance payments are due, together with the corresponding return, within ten working days following the corresponding calendar month and are ultimately applied against the CIT at the end of the year.

# Equatorial Guinea

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## Significant developments

There have been no significant tax regulatory developments regarding corporate taxation in the past year in Equatorial Guinea.

## Taxes on corporate income

The corporate income tax (CIT) must be paid by any resident entity.

Taxable profit is determined by deducting from gross income all expenses tied to the performance of taxable activities in Equatorial Guinea.

In principle, all expenses are deductible, but the Tax Code provides rules of deductibility for some of them.

Resident companies are subject to CIT on their worldwide income. Non-resident entities are subject to a 10% withholding tax (WHT) on gross income derived from sources in Equatorial Guinea.

The CIT rate is 35% on taxable profits.

### Minimum income tax

Minimum income tax is 1% of the turnover of the company for the previous year.

This amount cannot be lower than 800,000 CFA francs (BEAC) (XAF) (even if the company does not have revenues). The minimum income tax can be totally or partially deducted from the CIT to be paid.

## Corporate residence

A legal entity present in Equatorial Guinea more than three months within a calendar year, or more than six months within two consecutive calendar years, and performing an economic activity or providing paid services in the country is considered as a resident for taxation purposes and is liable for CIT on its taxable profits. On the contrary, a non-resident company is only subject to a 10% WHT on gross income from Equatorial Guinea (in the non-oil and gas and the oil and gas sector).

The notion of residence applies equally to any kind of activity (even if there is some specificity in the oil and gas sector).

## Other taxes

### Value-added tax (VAT)

VAT is an indirect tax on consumption based on turnover.

All operations performed in Equatorial Guinea are subject to VAT, unless they are included in the list of exemptions provided by the Equatorial Guinea Tax Code or a specific tax regime.



VAT is generally chargeable on the following:

- Goods sold or assigned for valuable consideration.
- Services provided.
- Self-consumed goods and services.
- Imports.
- Other operations carried on by individuals or legal entities in their sphere of business, professional, and individual activities, including extraction activities.

The standard VAT rate is 15%.

A rate of 0% is applicable to a specific list of products and equipment provided in the Tax Code (e.g. certain medical products, some equipment for construction).

A reduced rate of 6% is applicable to a limited list of basic consumables and books.

### Social security contributions

Employers contribute 1% of gross salary to the Work Protection Fund (Fondo de Protección al Trabajo) and 21.5% to the National Social Security Fund (INSESO) on a monthly basis.

Employees contribute 0.5% of net salary to the Work Protection Fund and 4.5% to the INSESO on a monthly basis.

### Transfer tax

For the transfer of goods between residents and non-residents, and between non-residents, there is a 3% tax on the value of the goods.

Real estate transfers between residents are taxed at the rate of 5% on the value of the real estate. The rate increases to 25% on real estate transfers between residents and non-residents, and between non-residents.

### Real property tax

A 1% urban property tax applies to 40% of the value of the land and the buildings on such land. Urban property is defined by the Tax Code as “any land with or without buildings and the buildings built thereon, whenever located in urban areas”.

### Stamp taxes

Stamp duties are payable on a variety of instruments and transactions and vary depending on the concerned legal act.

## Branch income

Branch income is subject to CIT. We understand that there is no branch remittance tax even if sometimes challenged by Tax Authorities.

## Income determination

### Inventory valuation

Inventory is evaluated at cost price for tax purposes.

### Capital gains

Capital gains are, in principle, subject to CIT.

Some exemptions and specific tax regimes can apply, as follows:

- The capital gains that come from the assignment, in the ongoing operation, of the components of the fixed assets will not be included in the taxable profit of the fiscal year in course of which they have been obtained, if the taxpayer puts them in a special account named 'capital gains to be reused' and is committed to reinvesting in new fixed assets in its company before the expiration of a period of time of three years, starting from the close of this fiscal year, an amount equal to the amount of these capital gains plus the cost of the assigned components.
- The capital gains different from those obtained on goods, resulting from free assignment of stock, corporate portions, or liabilities, as a consequence of the merger of corporations, limited partnerships by shares, or limited companies, will be exempt from the tax regarding the profits made by those corporations, on condition that the take-over company or the new company has its corporate headquarters in Equatorial Guinea.

### Dividend income

All dividends received by a resident company are subject to CIT.

A personal income WHT of 25% is applicable on dividends paid to individuals or companies not having their usual domicile or headquarters in Equatorial Guinea. This tax is a final tax for those taxpayers.

The net products of the shares owned and earned by the parent company from its subsidiary can be deducted from the total net profits of the parent company after offsetting from this amount 25% (expenses and charges lump sum amount) if the:

- shareholder holds at least 25% of shares of the subsidiary and
- shareholder guarantees the shares have always been registered in the name of the participating company and commits it will hold these shares for at least two consecutive years.

This proportional part is established at 10% of the amount of these products and represents the management expenses already deducted from overhead costs.

### Foreign income

Resident companies are subject to CIT on their worldwide income.

## Deductions

### Depreciation

A straight-line method of computation of the depreciation should be applied to fixed assets. The depreciation rates provided by the Tax Code are as follows (non-binding translation from Spanish):

| Assets | Rate (%) |
|---|---|
| **Structures:** | |
| Commercial, industrial buildings, garages, workshops and hangars | 5 |
| Processing booth | 5 |
| Dams and dykes | 5 |
| Factories | 5 |
| Residential houses | 5 |
| Removable or temporary buildings | 20 |
| Electric ovens | 10 |
| **Material and permanent tools:** | |
| Steam boiler | 10 |
| Cement vat | 5 |
| Electric transmission cables – in final material | 15 |
| Electric transmission cables – in temporary material | 20 |
| Oil refinery machines | 20 |
| Hydraulic dams | 10 |
| Compression dams | 10 |
| Motors or heavy oils | 10 |
| Oil deposits | 10 |
| High output heavy-duty transformers | 10 |
| Steam turbines and machines | 10 |
| **Mobile material:** | |
| Mechanical kneaders | 15 |
| Excavators | 15 |
| Hogsheads, brewery, distillation, or experimentation vats | 10 |
| Wood-carving machines or devices | 20 |
| Purification machines or devices | 10 |
| Lamination machines | 10 |
| Light machinery, lathes, and similar items | 20 |
| Manufacturing material, including its tools | 20 |
| Drills | 20 |
| Small tools | 100 |
| **Transportation material:** | |
| Roads | 25 |
| Naval and air material | 20 |
| Containers | 20 |
| Automobile material: Light, used in city | 25 |
| Automobile material: Light rental or school vehicle | 33.33 |
| Automobile material: Heavy (trucks) | 33.33 |
| Tractors | 20 |
| Tractors used by foresters | 33.33 |

| Assets | Rate (%) |
|---|---|
| Material for port manipulation: Lift vehicles | 20 |
| Material for port manipulation: Cranes | 10 |
| **Furnishings and facilities:** | |
| Facilities, layouts, and development | 20 |
| Office furnishings | 10 |
| Office material | 15 |
| Computer material | 25 |
| Reprographic material | 33.33 |
| Ships or fishing boats | 15 |
| **Hotels, coffee shops, and restaurants:** | |
| Pots, glassware, and kitchen utensils | 50 |
| Laundry | 33.33 |
| Silverware | 20 |
| Decorative material | 20 |
| Carpeting, curtains, and painting | 25 |
| Refrigerators and air conditioning | 25 |
| Kitchen ovens | 20 |
| **Material subjected to the action of chemical products:** | |
| Buckets, containers, receptacles, or diffusers of chemical products | 20 |
| Product recycling devices | 20 |
| Bleaching devices | 20 |
| Baking devices | 20 |
| Fixed asset expenses | 20 |

### *Net operating losses*
Net operating losses can be carried forward for three years. Losses cannot be carried back. Losses of one entity cannot be transferred to another entity in a reorganisation.

In theory, when the results of a company, no matter the kind of the company, are negative during a maximum period of three consecutive years, this company will immediately be removed from the register by the Tax Administration for the practice of the activity for which it was registered, except when the company is newly created.

### *Payment to foreign affiliates*
The deductibility of the technical assistance made by the parent company to its subsidiary is limited to 50% of the intermediary tax result (accounting result plus potential fiscal reintegration).

In case of a deficit, the relevant basis for the evaluation of the foreign technical assistance amount to be reintegrated will be the intermediary result of the last beneficiary fiscal year.

## *Group taxation*

Equatorial Guinea law does not provide specific provisions for taxation of groups.

### Thin capitalisation

According to the Tax Code:

"Interest paid to the partners for amounts made available to the company, in addition to their capital contributions, no matter the form of the company, will be admitted within the limits established for the advances of the Central Bank.

In the incorporated or limited companies, the deduction of interest will not be allowed for partners or shareholders that have the right to hold, or actually hold, the company management except to the extent that the amounts deposited do not exceed the combination of the contributions of these partners or shareholders."



## Tax credits and incentives

Some tax and customs exemptions can be granted by the government for some specific economic sectors (e.g. oil and gas sector, public work sector). These exemptions shall be negotiated in the contract signed between the company and the administration (e.g. Production Sharing Contract, Public Work Contract).

### Foreign tax credit

There is no foreign tax credit in Equatorial Guinea.

## Withholding taxes

### WHT in the non-oil and gas sector

There is a 10% tax withheld on the gross incomes obtained in Equatorial Guinea by non-residents.

There is a 25% WHT on royalties for non-Economic and Monetary Community of Central Africa (CEMAC) residents.

Dividends and interests paid to non-residents are subject to 25% WHT.

### WHT on the oil and gas sector

In Equatorial Guinea:

- a 6.25% WHT is imposed on payments made to a resident entity within the oil and gas sector and
- a 10% WHT is imposed on payments made to a non-resident entity within the oil and gas sector.

In practice, the tax authorities consider this tax only applies to sales of services.

The tax basis is composed of the gross amount paid to the provider.

## Tax administration

### Returns

CIT returns must be filed within the first four months of the year following the taxable fiscal year.

### *Payment of tax*
Payment of CIT must be made within 15 days from the day following the date of receipt of the tax liquidation issued by the Ministry of Finance and Budget.

The minimum company tax of 1% of the previous year's turnover is payable by 31 March.

### *Penalties*
Penalties of XAF 200,000 per month late, up to 75% of the tax owed, apply for late filing of CIT returns.

A penalty of 50% to 100% of the undeclared amount applies in case of shortfall in the return and in case of arbitrary settlement, 50% of the total amount if the good faith of the taxpayer is established or assumed and 100% wherever the taxpayer does not prove good faith.

# Estonia

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## Significant developments

Estonia is regarded as offering a relatively favourable income tax regime, as all undistributed corporate profits are tax exempt. Estonia levies a corporate income tax only on profits that are distributed as dividends, share buy-backs, capital reductions, liquidation proceeds, or deemed profit distributions. Distributed profits are generally subject to 21% corporate tax (21/79 on the net amount of the profit distribution). According to the new programme of the coalition government, it is expected that the income tax rate will be reduced to 20% in 2015.

On 1 January 2011, the tax treaties with Albania, Serbia, and Republic of Korea became effective.

## Taxes on corporate income

All undistributed corporate profits are tax exempt. This exemption covers both active (e.g. trading) and passive (e.g. dividends, interest, royalties) types of income. It also covers capital gains from the sale of all types of assets, including shares, securities, and immovable property. This tax regime is available to Estonian resident companies and permanent establishments (PE) of non-resident companies that are registered in Estonia.

The taxation of corporate profits is postponed until the profits are distributed as dividends or deemed to be distributed, such as in the case of transfer pricing adjustments, expenses and payments that do not have a business purpose, fringe benefits, gifts, donations, and representation expenses.

Distributed profits are generally subject to the 21% corporate income tax (CIT) at 21/79 of the net amount of profit distribution. For example, a company that has profits of 100 euros (EUR) available for distribution can distribute dividends of EUR 79, on which it must pay CIT of EUR 21.

From the Estonian perspective, this tax is considered a CIT and not a withholding tax (WHT), so the tax rate is not affected by an applicable tax treaty. Certain distributions are exempt from such tax *(see the Income determination section)*.

In Estonia, resident companies are taxed on profits distributed from their worldwide income, while PEs of non-residents are taxed only on profits distributed from income derived from Estonian sources. Other Estonian-source income derived by non-residents may be subject to final WHT or income tax by way of assessment.

## Corporate residence

A legal entity is considered resident in Estonia for tax purposes if it is established under Estonian law. There is no management and control test for the purpose of determining corporate residency. Most tax treaty tie-breakers for legal entities are based on competent authority procedures.

### Permanent establishment (PE)

A PE (including a branch registered in the Commercial Register) of a foreign entity is deemed to be a non-resident taxpayer. Under the domestic law, which deviates from the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, a PE is defined as an enterprise through which the permanent business activities of the non-resident are conducted in Estonia. A PE is deemed to be created as a result of the business activities conducted in Estonia which are geographically linked or having movable character or as a result of the business activities of an agent which is authorized to conclude contracts in the name of the non-resident.

## Other taxes

### Value-added tax (VAT)

The following transactions are subject to Estonian VAT:

- Taxable supplies of goods and services (the place of supply of which is Estonia).
- Taxable imports of goods.
- Taxable intra-community acquisitions of goods.

The standard VAT rate is 20%. A reduced rate of 9% is applied to books, periodicals with few exceptions, hotel accommodation services, and listed pharmaceuticals.

The VAT rate on the export of goods and certain services is 0% (i.e. exempt with credit). Some services, such as health care, insurance, certain financial, and transactions with securities, are exempt (i.e. exempt without credit).

Transactions in real estate are generally exempt from VAT, but there are certain significant exceptions (e.g. transactions in new and significantly renovated buildings). Taxpayers can elect to add VAT to real estate transactions if certain conditions are met.

As of 2011, the reverse charge mechanism has been extended to the supply of waste metal and real estate, under which VAT is accounted for by the VAT liable purchaser and not by the supplier. For real estate, the reverse charge applies only when the seller has opted for taxation of real estate.

If the taxable supplies of Estonian resident businesses or a PE of a non-resident business in Estonia exceed EUR 16,000 in a calendar year, VAT registration is required. Voluntary registration is also possible. Certain transactions of non-resident businesses require Estonian VAT registration without any threshold.

The VAT accounting period is generally a calendar month, and VAT should be declared and paid on or before the 20th day of the following month.

Under certain conditions, a European Union (EU) taxable person that is not registered for VAT in Estonia will be entitled to a refund of input VAT paid in Estonia. Non-EU taxable persons are entitled to claim VAT refunds based on reciprocity.

Estonia has implemented a system that allows, under certain conditions, a company to account for VAT on imports on the VAT return without paying VAT to the customs authority.

### *Excise duties*
Excise taxes are levied on tobacco, alcohol, electricity, some packaging materials, and motor fuel.

### *Customs duties*
After becoming a member of the European Union, Estonia also became a member of the Customs Union. The Community Customs Code and related implementation regulations apply, meaning that:



- trade between Estonia and other EU countries is customs-free
- imports from non-EU countries are subject to EU customs tariffs, and
- numerous free trade agreements concluded between EU and non-EU countries apply to Estonia.

### *Social security and unemployment insurance*
Employers operating in Estonia (including non-residents with a PE or employees in Estonia) must pay social tax on certain payments to individuals at the rate of 33% (where 20% is used for financing public pension insurance and 13% is used for financing public health insurance). Social tax paid by employers is not capped and mainly applies to salaries, directors' fees, and service fees paid and fringe benefits granted to individuals. According to the new program of the coalition government, it is expected that the monthly social tax (except its public health insurance component) will be capped at EUR 4,000 per individual from the year 2014.

In addition to social tax, employers are also required to pay and withhold unemployment insurance contributions. Employers must pay 1.4% and employees must pay 2.8% (collected by employers through payroll withholding). The contributions mainly apply to salaries and service fees paid to individuals.

### *Compulsory accumulative pension scheme*
Employers' payroll withholding includes 2% or 1% contributions to the compulsory accumulative pension scheme, if the employee has joined that pension scheme.

### *Land and property taxes*
Land is subject to an annual land tax, which is calculated on the assessed value of land at rates between 0.1% and 2.5%, depending on the municipality. The tax is paid by the owners of land, or sometimes by the users of land, in three instalments between 31 March and 1 October.

There is no property tax (i.e. tax on the value of buildings).

Property transfers are generally subject to state and notary fees.

### *Heavy goods vehicle tax*
The heavy goods vehicle tax is paid for the following classes of vehicles that are registered with the Estonian National Motor Vehicle Register and are intended for the carriage of goods:

- Lorries with a maximum authorised weight or gross laden weight of not less than 12 tons.

- Road trains composed of trucks and trailers with a maximum authorised weight or gross laden weight of not less than 12 tons.

The tax is paid by the owners or users of the vehicles. The quarterly tax rates range from EUR 0 to EUR 232.60 per heavy goods vehicle.

### *Gambling tax*

Gambling tax is imposed on amounts received from operating games of skill, totalisator, betting, lotteries, and promotional lotteries. Tax is also charged on gambling tables and machines used for games of chance located in licensed premises. The tax is paid monthly by authorised operators.

### *Local taxes*

Local taxes can be imposed by rural municipalities or city councils; however, the fiscal significance of local taxes is almost non-existent. Local taxes include sales tax, boat tax, advertisement tax, road and street closure tax, motor vehicle tax, tax on keeping animals, entertainment tax, and parking charges. Note that the sales tax and boat tax will be abolished from the list of local taxes effective from year 2012.

## *Branch income*

Registered PEs of non-residents, much as with resident companies, are subject to CIT only in respect of profit distributions, both actual and deemed, as defined in domestic law.

Transactions and dealings between a head office and its PE(s) should be conducted on arm's-length terms. Thus, such profits should be attributed to a PE of a non-resident taxpayer that the PE would be expected to make if it were a distinct and separate taxpayer engaged in the same or similar activities, and under the same or similar conditions, and dealing in a wholly independent manner with its head office.

## *Income determination*

Distributable profits are determined based on financial statements drawn up in accordance with Estonian Generally Accepted Accounting Principles (GAAP) or International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS), and there are no adjustments to accounting profits for tax purposes (e.g. tax depreciation, tax loss carryforward or carryback).

The CIT liability associated with the distribution of dividends is accounted for as an expense at the time the dividends are declared, regardless of when the profits were generated or distributed.

Dividends paid by Estonian companies are generally subject to 21/79 CIT at the level of the distributing company. However, dividends distributed by Estonian companies are exempt from CIT if the distributions are paid out of:

- dividends received from Estonian, EU, European Economic Area (EEA), and Swiss tax resident companies (except tax haven companies) in which the Estonian company has at least a 10% shareholding
- profits attributable to a PE in the EU, EEA, or Switzerland

- dividends received from all other foreign companies in which the Estonian company (except tax haven companies) has at least a 10% shareholding, provided that either the underlying profits have been subject to foreign tax or if foreign income tax was withheld from dividends received, or
- profits attributable to a foreign PE in all other countries provided that such profits have been subject to tax in the country of the PE.

In addition, stock dividends (bonus shares) distributed to stockholders are exempt from 21/79 CIT charge.



Certain domestic and foreign taxes can also be credited against the 21/79 CIT charge under domestic law or tax treaties.

## Deductions

Distributable profits are determined based on financial statements drawn up in accordance with Estonian GAAP or IAS/IFRS, and there are no adjustments to accounting profits for tax purposes (e.g. tax depreciation, tax loss carryforward or carryback).

### Payments to foreign affiliates

Payments to foreign affiliates are deductible for tax purposes (i.e. not subject to 21/79 CIT as deemed profit distributions) if the payment serves a business purpose, provides a benefit to the payer, is at arm's length, and is substantiated by sufficient documentation.

Payments to foreign affiliates may also be subject to various WHT. Certain payments to affiliates located in tax haven countries are always subject to 21/79 CIT or a 21% WHT rate.

### Taxes

All taxes paid are deductible for CIT purposes. In certain circumstances, domestic or foreign taxes may be creditable against the 21/79 CIT charge under domestic law or an applicable tax treaty.

### Fringe benefits

Employers operating in Estonia (including non-resident companies that have a PE or employees in Estonia) are liable to Estonian taxation on any fringe benefits granted to their employees (including directors).

Fringe benefits are subject to an exceptional tax treatment in Estonia, as only the employer is obliged to pay taxes on the fringe benefits furnished to the employee. Taxable fringe benefits received by a resident employee are generally not included in the taxable income of the employee for Estonian tax purposes. Fringe benefits are subject to 21/79 CIT and 33% social tax. For example, where the amount of the benefit is EUR 100, the CIT due by the employer would be EUR 26.58 (21/79 x 100) and the social tax due EUR 41.77 (0.33 x 126.58), for a total fringe benefit tax charge of EUR 68.35.

### Gifts, donations, and representation expenses

The 21/79 CIT is generally due on gifts and donations. Gifts and donations made to certain qualifying recipients are only subject to 21/79 CIT if such expenses exceed one of two limitations:

- 3% of the calculated social tax base for the existing calendar year or
- 10% of the profit of the last financial year according to statutory financial statements.

Representation expenses, those expenditures whose character and primary purpose is for representational or entertainment related activities, are generally subject to 21/79 CIT only if they exceed the threshold of EUR 32 per month plus 2% of the calculated social tax base of the calendar month in which the expenses are paid.

### *Other significant items*

The 21/79 CIT is generally due on expenses and payments that do not have a business purpose and that are regarded as deemed profit distributions. These may include, for example, late payment interest on tax arrears, penalties imposed by law, bribes, purchase of services, or settlement of obligations not related to taxpayer's business and acquisition of assets not related to taxpayer's business.

Furthermore, there are specific anti-tax haven rules treating certain transactions and dealings with tax haven companies as deemed profit distributions, which are therefore subject to 21/79 CIT. These include the following:

- Acquisition of securities issued by a tax haven entity (exception for certain listed securities).
- Acquisition of an ownership interest in a tax haven entity.
- Payment of fines or penalties to a tax haven entity, unless settled by court or arbitrage.
- Granting loans or making prepayments to a tax haven entity or otherwise acquiring a claim against a tax haven entity.

## *Group taxation*

There is no form of consolidation or group taxation for CIT purposes in Estonia.

### *Transfer pricing*

Transfer pricing rules are applicable to all types of transactions between related parties. Both domestic and cross-border transactions with related parties must be conducted at arm's length. Estonian tax legislation includes a relatively broad definition of related parties. Under the present corporate tax system, if the transactions between related parties do not follow the arm's-length principle, then the subsequent transfer pricing adjustments are treated as hidden profit distributions subject to 21/79 monthly CIT.

As a general rule, Estonian group companies and PEs of foreign companies are obliged to prepare transfer pricing documentation to prove the arm's-length nature of the inter-company transactions with all related parties.

However, this documentation requirement does not apply to small and medium-size enterprises (SME), unless they have conducted transactions with entities located in low-tax territories. A company or PE is deemed to be an SME provided that the consolidated results of the previous financial year of an Estonian company or a PE together with its associated enterprises or head office (i.e. at the group level) are below all of the following criteria:

- Annual sales below EUR 50 million.
- Balance sheet below EUR 43 million.

- The number of employees below 250.

Apart from the formal transfer pricing documentation and general requirement to disclose the transactions with the related parties in the annual reports, there are no additional reporting requirements related to transfer pricing in relation to inter-company transactions.

### Thin capitalisation

There are no thin capitalisation rules in the Estonian tax legislation.



### Controlled foreign company (CFC) regime

Estonia has no CFC rules for corporate taxpayers.

## Tax credits and incentives

There are no special tax incentives in Estonia. However, the entire Estonian corporate tax system, which provides for an indefinite deferral for taxing corporate profits, may be viewed as a tax incentive that promotes reinvestment of profits and thus stimulates economic growth.

### Foreign tax credit

Dividends distributed by Estonian companies are exempt from 21/79 CIT if the distributions are paid out of:

- dividends received from Estonian, EU, European Economic Area (EEA), and Swiss tax resident companies (except tax haven companies) in which the Estonian company has at least a 10% shareholding
- profits attributable to a PE in the EU, EEA, or Switzerland
- dividends received from all other foreign companies in which the Estonian company (except tax haven companies) has at least a 10% shareholding, provided that either the underlying profits have been subject to foreign tax or if foreign income tax was withheld from dividends received, or
- profits attributable to a foreign PE in all other countries provided that such profits have been subject to tax in the country of the PE.

In certain circumstances, domestic or foreign taxes may be creditable against the 21/79 corporate income tax charge under domestic law or an applicable tax treaty.

## Withholding taxes

Withholding agents must withhold income tax from certain payments. Withholding agents include resident legal entities, resident individuals registered as sole proprietorships or acting as employers, and non-residents having a PE or acting as employers in Estonia. The tax must be reported and paid by the tenth day of the month following the payment. Income tax is not withheld from payments to resident companies, registered sole proprietorships, and registered PEs of non-resident companies. The following rules are in place with respect to payments that are subject to WHT:

- There is no WHT on dividends.
- There is no WHT on interest payments to non-residents on the condition that the interest charged does not significantly exceed the arm’s-length rate at the time the

debt is incurred and the interest payments are made. A 21% Estonian WHT rate will thus apply only to the part of interest that significantly exceeds the arm's-length amount.
- Royalties (including payments for the use of industrial, commercial, or scientific equipment) paid to non-residents are generally subject to a 10% WHT rate under domestic law, but reduced rates may be available under double tax treaties (DTT). Certain royalty payments to associated EU and Swiss companies that meet certain conditions are exempt from WHT.
- Rental payments to non-residents for the use of immovable property located in Estonia and movable property subject to registration in Estonia (excluding payments for the use of industrial, commercial, or scientific equipment) are subject to a 21% WHT rate under domestic law, but DTTs may exempt payments for the use of movable property from WHT.
- Royalties and rental payments to resident individuals are subject to a 21% WHT rate.
- Payments to non-resident companies for services provided in Estonia, including management and consultancy fees, are subject to a 10% WHT rate under domestic law, but may be exempt under DTTs. Service fee payments to tax haven entities are always subject to a 21% WHT rate.
- Salaries, directors' fees, and service fees paid to individuals are subject to a 21% WHT rate under domestic law, but DTTs may exempt service fee payments to non-resident individuals from WHT.
- Payments for the activities of non-resident artistes or sportsmen carried out in Estonia are subject to a 10% WHT rate.
- Certain pensions, insurance benefits, scholarships, prizes, lottery winnings etc. paid to non-residents and resident individuals are subject to a 21% WHT rate under domestic law.

For non-residents without a PE in Estonia, the tax withheld from these payments at domestic or treaty rates constitutes final tax in terms of their Estonian source income and they do not have any tax reporting requirements in Estonia.

For certain types of Estonian-source income, non-residents are liable under Estonian domestic law to self assess their Estonian tax and submit a tax return to the Estonian tax authorities. These types of income include:

- Taxable capital gains.
- Profits derived from business conducted in Estonia without a registered PE.
- Other items of income from which tax was not withheld but should have been withheld.

Estonia has effective tax treaties with: Albania, Armenia, Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, the People's Republic of China, Croatia, the Czech Republic, Denmark, Finland, France, Germany, Georgia, Greece, Hungary, Iceland, Ireland, Isle of Man, Israel, Italy, Kazakhstan, the Republic of Korea, Latvia, Lithuania, Luxembourg, Macedonia, Malta, Moldova, the Netherlands, Norway, Poland, Portugal, Romania, Serbia, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the United States. Treaties have also been concluded with Russia, United Arab Emirates, and Jersey, but these are not yet effective.

The following WHT rates apply to dividends, interest, and royalties paid to a recipient or beneficial owner resident in a tax treaty country. The lower of the domestic or the treaty rate is given.

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Non-treaty | 0 | 0/21 | 0/10 |
| Treaty: | | | |
| Albania | 0 | 0/21 | 5 |
| Armenia | 0 | 0/21 | 10 |
| Austria | 0 | 0/21 | 0/5/10 (4) |
| Azerbaijan | 0 | 0/21 | 10 |
| Belarus | 0 | 0/21 | 10 |
| Belgium | 0 | 0/21 | 0/5/10 (4) |
| Bulgaria | 0 | 0/21 | 0/5 |
| Canada | 0 | 0/21 | 10 |
| China, People's Rep. of | 0 | 0/21 | 10 |
| Croatia | 0 | 0/21 | 10 |
| Czech Republic | 0 | 0/21 | 0/10 |
| Denmark | 0 | 0/21 | 0/5/10 (4) |
| Finland | 0 | 0/21 | 0/5/10 (4) |
| France | 0 | 0/21 | 0/5/10 (4) |
| Germany | 0 | 0/21 | 0/5/10 (4) |
| Georgia | 0 | 0/21 | 10 |
| Greece | 0 | 0/21 | 0/5/10 (4) |
| Hungary | 0 | 0/21 | 0/5/10 (4) |
| Iceland | 0 | 0/21 | 5/10 (4) |
| Ireland, Rep. of | 0 | 0/21 | 0/5/10 (4) |
| Isle of Man | 0 | 0/21 | 0 |
| Israel | 0 | 0/21 | 0 |
| Italy | 0 | 0/21 | 0/5/10 (4) |
| Kazakhstan | 0 | 0/21 | 15 |
| Korea, Rep. of | 0 | 0/21 | 5/10 (4) |
| Latvia | 0 | 0/21 | 0/5/10 (4) |
| Lithuania | 0 | 0/21 | 0/10 |
| Luxembourg | 0 | 0/21 | 0/5/10 |
| Macedonia | 0 | 0/21 | 5 |
| Malta | 0 | 0/21 | 0/10 |
| Moldova | 0 | 0/21 | 10 |
| Netherlands | 0 | 0/21 | 0/5/10 (4) |
| Norway | 0 | 0/21 | 5/10 (4) |
| Poland | 0 | 0/21 | 0/10 |
| Portugal | 0 | 0/21 | 0/10 |
| Romania | 0 | 0/21 | 0/10 |
| Serbia | 0 | 0/21 | 5/10 (5) |
| Singapore | 0 | 0/21 | 7.5 |
| Slovakia | 0 | 0/21 | 0/10 |
| Slovenia | 0 | 0/21 | 0/10 |
| Spain | 0 | 0/21 | 0/5/10 (4) |
| Sweden | 0 | 0/21 | 0/5/10 (4) |
| Switzerland | 0 | 0/21 | 0/5/10 (4) |
| Turkey | 0 | 0/21 | 5/10 (4) |

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Ukraine | 0 | 0/21 | 10 |
| United Kingdom | 0 | 0/21 | 0/5/10 (4) |
| United States | 0 | 0/21 | 5/10 (4) |

Notes

1. Under the domestic law, the rate is nil for all non-resident individual and corporate shareholders.
2. The rate is nil on the condition that the interest paid to a non-resident does not significantly exceed the arm's-length rate at the time the debt is incurred and the interest payments are made. Estonian WHT at the domestic rate of 21% will thus apply only to the part of interest that significantly exceeds the arm's-length amount. This WHT could be reduced under tax treaties.
3. The rate is nil for arm's-length royalties paid to an associated EU or Swiss company if certain conditions are met.
4. The lower 5% rate applies to royalties paid for the use of industrial, commercial, or scientific equipment.
5. The lower 5% rate applies to royalties paid for the use of copyright royalties, excluding software royalties.

## Tax administration

### Returns

The tax period is a calendar month. The combined CIT and payroll tax return (form TSD with appendices) must be submitted to the local tax authorities by the tenth day of the month following a taxable distribution or payment. Tax returns may be filed electronically via the Internet.

### Payment of tax

CIT and payroll taxes must be remitted to the local tax authorities by the tenth day of the month following a taxable distribution or payment. No advance CIT payments are required.

### Advance rulings

An advance ruling system became available in Estonia on 1 January 2008. The aim of the procedure is to provide certainty on the tax consequences of specific transactions or combination of transactions taking place in the future. The ruling is binding on the authorities (and not on the taxpayer) if the transaction was made within the deadline and the description provided in the ruling and the underlying legislation has not been substantially changed in the meantime. Estonian legislation specifically excludes obtaining rulings when the interpretation of the legislation is objectively clear, the situation is hypothetical, or the main purpose of the planned transaction is tax avoidance. In addition, transfer pricing valuation issues are excluded from the scope of the binding ruling system.

## Other issues

### Company restructurings

In accordance with the EC Directive 2009/133/EC on mergers, divisions, partial divisions, transfers of assets, and exchanges of shares concerning companies of different member states, the mergers, divisions, and re-organisations of companies are generally tax-neutral in Estonia. The principle of going concern is applied in taxation of referred restructuring transactions.

# Fiji Islands

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## Significant developments

The following changes became effective 1 January 2011:

- The export income deduction has been extended to 2015 but with reduced rates *(see the Tax credits and incentives section)*.
- A 150% deduction is available for expenditure not exceeding 250,000 Fijian dollars (FJD) on marketing goods and services for export to some South Pacific Island countries.
- The Sixth Schedule of the Income Tax Act in relation to film-making and audiovisual incentives has been repealed and replaced.
- The value-added tax (VAT) rate has increased from 12.5% to 15%.

As of 1 August 2010, the supply of certain insurance services is subject to VAT.

As of 1 May 2011, certain capital gains are subject to capital gains tax of 10%, and land sales tax is no longer applicable.

## Taxes on corporate income

Normal tax is payable and assessed on the chargeable income of the business calculated by subtracting deductible expenses from all assessable income specified under Section 11 of the Income Tax Act.

Normal tax is payable on taxable income at the following rates:

| Type of company | Rate (%) |
|---|---|
| Non-resident shipping companies in respect of outgoing business from Fiji | 2 |
| Companies listed on the South Pacific Stock Exchange that have at least 40% resident shareholding are eligible for this tax rate for at least three years | 20 |
| Other companies, including non-resident companies carrying on business in Fiji (e.g. branch profits) | 28 |

## Corporate residence

A company incorporated in Fiji is considered a 'resident' in Fiji. A company not incorporated in Fiji is resident in Fiji if it carries on business in Fiji and either its practical management and control are in Fiji or its voting powers are controlled by shareholders who are residents of Fiji.

## Other taxes

### Value-added tax (VAT)

VAT generally applies on the supply of goods and services in Fiji by a registered person in the course or furtherance of a taxable activity carried on by that person. As of 1 January 2010, the threshold amount for VAT registration is FJD 50,000 for the supply of goods and /or services.

As of 1 January 2011, the VAT rate increased from 12.5% to 15%.

The supply of financial services, residential accommodation, and education by an approved institution is exempt. However, as of 1 August 2010, the supply of certain insurance services is subject to VAT.

The sale of edible oil, tin fish, rice, flour, tea, powdered milk, and kerosene are zero-rated. Exports of goods and services and international transportation are zero-rated. The export of services, however, is zero-rated only under certain conditions.

The due date for lodgement of VAT returns and payment of any VAT payable is the end of the month following the taxable period.

VAT refunds can no longer be transferred or assigned to another registered entity.

Under certain conditions, Directors of companies with insufficient funds may be held liable for any outstanding VAT or income tax liability of the company and may be sued in their personal capacity.

### Land sales tax

The land sales tax is no longer applicable as of 1 May 2011.

### Excise taxes

Excise tax is payable on tobacco, alcohol products, and carbonated soft drinks manufactured in Fiji.

### Customs duties/import excise tax

The government has introduced a new import excise tax (in addition to the existing fiscal duties imposed on importation) that will be levied on selected goods, such as the following:

- Alcohol and tobacco.
- Used or second hand LPG powered motor vehicles.
- New or used licensed mini buses.
- Some goods which are also locally manufactured.
- Certain white goods and luxury items.

### Stamp duties

Under the Fiji Stamp Duties Act, stamp duty is payable in respect of instruments including, but not limited to, declaration of trusts, leases, mortgages, transfer of property (or interest therein), shares, etc.

### Hotel turnover tax (HTT)

Under the Hotel Turnover Tax Act of 2006, HTT is imposed on hotel charges at the rate of 5%.

For ease of administration to both hoteliers and the Fiji Revenue and Customs Authority (FRCA), the due date for payment is aligned with the VAT Decree requirements (i.e. end of the following month). The HTT Act includes a seven year record keeping requirement.

Directors of companies have been included in the definition of accountable persons in the HTT Act. An accountable person is a person who is operating a licensed hotel which has levied the HTT on hotel charges and must account for it.

### *Gambling turnover tax (GTT)*

Under the Gambling Turnover Tax Decree of 1991, GTT is imposed on the value of consideration paid or payable in respect of the provision of prescribed gambling services (i.e. acceptance of bets and provision of tickets for any lottery) at the rate of 15%.



## *Branch income*

The profits of a foreign company's branch operating in Fiji are subject to the same tax rate as the tax rate levied on profits of a resident corporation (i.e. 28% in 2010 and subsequent years).

## *Income determination*

Normal tax is payable and assessed on taxable income of the business. Taxable income is calculated by subtracting allowable deductions from all assessable income (i.e. all sources of income).

### *Inventory valuation*

Inventories are normally valued at the lower of cost and net realisable value. While the first in first out (FIFO) method is acceptable, the last in first out (LIFO) method is not, for either book or tax purposes. Conformity between book and tax reporting is not required, and there are no special provisions for valuing inventories or determining inventory flows.

### *Capital gains*

Effective from 1 May 2011, capital gains may be subject to capital gains tax of 10%.

### *Dividend income*

Transfers of property by private companies to shareholders and associates may be deemed to be a dividend paid by that company.

Resident corporations may exclude from taxable income dividends received from a company incorporated in Fiji. There are no ownership requirements for this exclusion.

### *Stock dividends*

Bonus shares are tax-free, except where paid out of the revenue or profits of investment or service-type companies. Tax-free stock dividends issued by private companies may be taxable upon sale of the shares.

### *Partnership income*

The income of the partners from a partnership for any income year is equal to each partners' respective share of income from that partnership. Each partner declares income separately and is individually liable for filing a tax return for each applicable year.

### *Liability of directors/shareholders*
Directors/shareholders of companies in liquidation may be held liable for any outstanding tax liability of the company. Directors/shareholders of private companies or companies with insufficient assets may also be held liable for any outstanding tax liability of the company under certain conditions.

### *Other significant items*
Where a foreign-controlled business in Fiji produces less income than might be expected, the revenue authorities may determine the income for tax purposes.

A person normally residing outside Fiji, which disposes of an interest in land in Fiji held directly or through a shareholding in a company, may be assessed to income tax on the profit on that disposal.

### *Foreign income*
Resident corporations are taxed on their worldwide income. Foreign income derived from a treaty country is taxed according to the treaty. Foreign income sourced from a non-treaty country is subject to income tax in Fiji. A credit is allowed in Fiji for foreign tax paid on foreign income, limited to the lesser of the Fiji tax payable or the overseas tax paid on such income. There are no special provisions for taxing undistributed income of foreign subsidiaries.

## *Deductions*

Generally, expenses wholly and exclusively incurred in deriving assessable income are allowable deductions. Expenditures, capital or domestic in nature, are generally not deductible.

### *Depreciation and depletion*
Depreciation is calculated on the cost of an asset on a straight-line basis. The rates of depreciation are based on the estimated life of the asset. Upon disposal of an asset, either recoupment of depreciation claimed is taxable or the excess of tax written-down value over sale proceeds is deductible. The taxpayer has an option to set-off recoupment of depreciation against the cost of replacement assets. Conformity between book and tax depreciation is not required.

There are seven broad bands of depreciation rates for assets acquired after 1 January 1998, and the prescribed effective life of the asset is used to determine the relevant depreciation rate. The seven broad bands and the depreciation rates are as follows:

| Band | Effective life (years) | Standard rate (%) | Maximum rate (%) |
|---|---|---|---|
| 1 | 2 to less than 3 | 50 | 60 |
| 2 | 3 to less than 5 | 33 1/3 | 40 |
| 3 | 5 to less than 6 2/3 | 20 | 24 |
| 4 | 6 2/3 to less than 10 | 15 | 18 |
| 5 | 10 to less than 20 | 10 | 12 |
| 6 | 20 to less than 40 | 5 | 6 |
| 7 | 40 and over | 2.5 | 3 |

An optional 20% loading, which applies on the broadband rate, may be claimed. Assets acquired before 1 January 1998 continue to be depreciated at the former rates.

Accelerated depreciation is available for (i) buildings constructed between 1999 and 2012 that are to be used for agricultural, commercial, or industrial purposes, (ii) multi-storey, multi-unit residential buildings, and (iii) other capital expenditure considered of benefit for the economic development of Fiji. Up to one-fifth of the expenditure may be claimed in each of any five years of an eight-year period.

Renewable energy plant and water storage facilities also qualify for a 100% write-off.



Capital expenditure aimed at economising on the consumption of fuel, electricity, or its derivatives or on an asset using energy sources indigenous to Fiji may be eligible for accelerated depreciation at varying rates.

The cost of the acquisition of a mining lease or tenement and the cost of development of mines may be written off in equal instalments in any five of the first or last eight years of a nine-year period, commencing with the year in which the expenditure was incurred.

A deduction for depletion of other natural resources is not available.

### *Bad debt*
Provisions for expenses not yet incurred (e.g. bad debts) are not tax-deductible. A deduction is permitted in respect to amounts that are subsequently paid or written off.

### *Charitable contributions*
The deduction threshold for contributions to approved charitable organisations is FJD 100,000.

There are certain other specific donations which qualify for varying levels of deductions, including:

- Donations to the Fiji Heritage Foundation, which qualify for a deduction of 150%.
- Cash donations exceeding FJD 50,000 to the Poverty Relief Fund for Education, which qualify for a deduction of 200%.
- Cash donations exceeding FJD 100,000 to a Sports Fund (as approved by the Commissioner of Inland Revenue) for purposes of sports development in Fiji, which qualify for a deduction of 150%.

### *Taxes*
Taxes levied on income are not deductible.

### *Net operating losses*
Losses may be carried forward for eight years, provided the company can demonstrate a minimum 51% continuity of shareholding between the year of loss and the year of claim. Notwithstanding the change in ownership, losses may also be carried forward where a company carries on the same business in the carried forward year as it did in the loss year. Loss carrybacks are not permitted.

Losses incurred in agricultural or pastoral pursuits may be carried forward indefinitely.

### *Payments to foreign affiliates*
Subject to the normal rules of deductibility, a deduction can be claimed for royalties, management service fees, and interest charges paid to foreign affiliates. However, as

of 1 January 2010, any deductions claimed by any company carrying on business in Fiji (whether incorporated in Fiji or not) in respect of head office charges or any other like payments shall not exceed 3% of total gross Fiji income.

## *Group taxation*

Group taxation is not available in Fiji.

### *Thin capitalisation*

There are no thin capitalisation rules in Fiji.

## *Tax credits and incentives*

The tax incentives in Fiji are designed primarily to promote export sales and to encourage the development of industries that are considered of benefit to the economic development of Fiji.

### *Export income deduction*

A deduction for export income is allowed in accordance with the following:

| Year of assessment | Percentage of export income to be deducted |
|---|---|
| 2008 to 2011 | 50% (100% on the island of Vanua Levu until 2010) |
| 2012 | 40% |
| 2013 | 30% |
| 2014 | 20% |
| 2015 | 10% |

'Export income' means net profit derived by a taxpayer from the business of exporting goods and services; and the Commissioner of Inland Revenue may, where separate records for export income are not maintained, determine such income on the basis of a formula as set out in the legislation.

The 5th Schedule of the Income Tax Act – 'Export Incentives' – has been repealed. However, the existing beneficiaries are expected to continue to enjoy the incentives under this schedule until the expiry of the incentives granted.

### *Information communication technology (ICT) tax incentives*

The income of an information communication technology operator may be exempt from income tax, provided that the business employs 50 employees or more for six months within the income year and 60% or more of the total value of its services in that income year is exported, if it is:

- operating on or before 1 January 2009 in the declared Kalabu Tax Free Zone (exempt from 1 January 2007 to 31 December 2016) or
- granted a licence after 1 January 2009 (exempt for a period of 13 years from the date of issue of the licence).

The following tax incentives are available to taxpayers engaged in new ICT business and for existing taxpayers so engaged who are able to show a significant increase in capacity and number of employees:

- 80% tax exemption for businesses employing more than 101 employees.
- 60% tax exemption for those that employ between 60 and 100 employees.
- 40% tax exemption for those employing 10 to 59 employees.

A 150% deduction is available for costs incurred for the development of an ICT business by any taxpayer employing 500 or more employees. This deduction is available till 31 December 2012.

'Information communication technology business' means an entity engaged in software development, call centres, or internet service provision. It does not include an internet café, any retail or wholesale of information technology products, or the repair, sale, or service of any such products.



### *Employment incentives*
Salary and wages paid to first-time employees for the first 12 months of employment qualify for a 150% deduction. This deduction is available until 31 December 2012.

### *Hotel industry incentives*
Approved capital expenditure incurred in building, renovating, or expanding a hotel is subject to an investment allowance of 55% of the approved expenditure, in addition to normal depreciation.

Under the Short Life Investment Package (SLIP) the following concessions are available:

- Exemption from income tax for a period of ten years, provided that the capital investment in the hotel is more than FJD 7 million.
- Duty-free entry of all capital equipment, plant, and machinery upon receiving provisional approval from the Minister.
- Permission to generate own electricity, the excess to be sold to the Fiji Electricity Authority.

The recipients of provisional approval for hotel investment tax incentives are required to commence implementation of the hotel projects within one year from the date provisional approval is granted.

### *Filmmaking and audio-visual incentives*
A tax exemption or reduced tax rate is available on the income of non-resident employees of an approved non-resident company engaged or intending to be engaged in making a film in Fiji.

A resident entity (excluding an entity holding a broadcast license in television or radio in Fiji or with substantial shareholdings in the same) may deduct of up to 150% of expenditures on audio-visual production in respect of income in the year of the expenditures. 'Audio-visual productions' include production for exhibition or sale of theatrical films, broadcast television, direct-to-video and video disk programme, audio recording, computer software, and interactive websites.

A tax exemption is available on the income derived by a taxpayer from the commercial exploitation of a copyright until the taxpayer has received from the commercial exploitation a return of up to 60% of the expenditure. The expenditure must be of capital nature and in relation to the audio-visual production costs in respect of a qualifying audio-visual production.

Tax concessions are also available for residents of areas declared as studio city zones by the appropriate government Minister.

### *Other tax incentives*

An investment allowance of 55% is available for the construction of a vessel, in addition to normal depreciation. Effective 1 January 2011, investment allowance is available for refurbishment and renovation of a vessel subject to certain conditions.

An approved mining company may, for a specified period, be exempt from income tax or taxed at a lower rate. The holder of a valid prospecting license may write off approved expenditure on prospecting for minerals against income from all sources.

A 150% deduction is available for direct capital expenditures incurred by commercial banks in rural banking programmes.

Prior to 1 January 2011, a 200% deduction was available for capital expenditures incurred by entities in the agriculture and fisheries sector not enjoying other concessions under the Income Tax Act.

Investors engaged in value adding processes in the food processing, agricultural processing, fisheries, or forestry business may be able to claim a 100% deduction with respect of amounts invested or re-invested (for expansion), provided that the businesses meet the 50% local content rule.

An income tax exemption may be available to a taxpayer engaged in commercial agricultural farming and agro-processing subject to certain conditions:

- any new activity approved and established between 1 January 2009 and 31 December 2009, for a period of four to ten consecutive fiscal years, depending on the level of capital investment, or
- any new activity approved and established between 1 January 2010 and 31 December 2014, for a period of ten consecutive fiscal years with a capital investment of at least FJD 2 million.

Income derived by a taxpayer from a new activity in processing agricultural commodities into bio-fuels may be exempt from income tax for a period of ten years under certain conditions.

An exemption from income tax for a period of five years may be available to a taxpayer engaging in renewable energy projects and power cogeneration.

Entities in the agriculture, fisheries, and tourism industries, with a maximum turnover threshold of FJD 300,000, may also be exempt from income tax.

An investment allowance equal to 60% of the qualifying expenditure is available as a deduction for investment in Fixed Line Next Generation Networks. A qualifying expenditure means an expenditure of FJD 50,000 or more incurred for the purpose of acquiring a capital asset in any of the years from the 2009 year of assessment to the 2012 year of assessment.

A 150% deduction is available on expenses incurred in reorganising a company for the purpose of listing on the South Pacific Stock Exchange.

### Foreign tax credit
A credit is allowed in Fiji for foreign tax paid on foreign income, limited to the lesser of the Fiji tax payable or the overseas tax paid on such income.

## Withholding taxes

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Know-how, management fees (%) | Professional fees (%) |
|---|---|---|---|---|---|
| Resident corporations | 0 | 31 (1) | 0 | 0 | 0 |
| Non-resident corporations: | | | | | |
| Non-treaty | 15 | 10 | 15 | 15 | 15 |
| Treaty: | | | | | |
| Australia | 20 (5) | 10 | 15 | 15 | 0 to 15 (4) |
| Japan | 15 | 10 | 15 | 15 | 0 to 15 (4) |
| Korea, Republic of | 10/15 (2) | 10 | 10 | 10 | 0 to 15 (4) |
| Malaysia | 15 | 15 | 15 | 15 | 0 to 15 (4) |
| New Zealand | 15 | 10 | 15 | 15 | 0 to 15 (4) |
| Papua New Guinea | 17 (5) | 10 | 15 | 15 | 0 to 15 (4) |
| Singapore | 5/15 (3) | 10 | 10 | 10 | 0 to 15 (4) |
| United Kingdom | 15 | 10 | 15 | 15 | 0 to 15 (4) |

Notes

1. Applies to interest (over FJD 200) on savings and deposits with commercial banks and other financial institutions.
2. 10% of gross amount of dividends if beneficial owner is a company (other than a partnership) that holds directly at least 25% of the capital of the company paying the dividends; 15% in all other cases.
3. 5% of gross amount of dividends if beneficial owner is a company (other than a partnership) that holds directly at least 10% of the capital of the company paying the dividends; 15% in all other cases.
4. Depending on the provisions of the applicable double taxation agreement.
5. The maximum withholding tax rate imposed on dividends under the Fiji Income Tax Act is 15%.

## Tax administration

The Tax Administration Decree (TAD) was promulgated effective 1 January 2010 with the stated intention of harmonising the administration of the various tax laws, including income tax and VAT.

Effective 1 January 2011, if a due date falls on a Saturday, Sunday, or holiday, the due date is the last working day before the due date.

### Returns
Tax is assessed on income derived during the calendar year preceding the year of assessment. Returns are therefore generally accepted on a calendar-year basis, although approval is also given to use an alternative fiscal-year basis. For purposes of assessment of returns completed on a fiscal-year basis, the calendar year in which more than one-half of the fiscal year falls is deemed to be the calendar year in which the income is derived. The Fiji tax system is not based on self-assessment. Returns of income contain information on the basis of which assessments are raised by the tax authorities.

The due date for lodgement of income tax returns is three months after the end of the income year. However, under the Tax Agent Lodgement Programme, an extension of time may be granted to lodge the income tax returns.

### *Payment of tax*

Advance tax payments are required in three equal instalments after the end of the taxpayer's fiscal year-end as follows:

- First advance: due on the last day of the financial/fiscal year.
- Second advance: due three months after the end of the taxpayer's fiscal year-end.
- Third advance: due seven months after the end of the taxpayer's fiscal year-end.

The advance payments are allowed as credits against the tax due on assessment.

The TAD provides for various ways to ensure the collection of taxes including, but not limited to, the following:

- Departure prohibition order: A departure prohibition order may be used by the tax office to prevent taxpayers from leaving the country without settling outstanding taxes.
- Garnishee orders: The tax office may garnish bank accounts for outstanding taxes.
- Registration of charges on personal and real properties of the taxpayer.
- Distress and sale of personal property.
- Temporary closure of business.

### *Penalties*

Administrative penalty provisions have been amended and increased by the TAD. Some of the penalties are as follows:

- Failure to register: Every person who fails to apply for registration as required pursuant to the Decree, commits an offence against the Decree, and will on conviction be liable to a fine not exceeding 50% of the tax payable, where the delay does not exceed six months; or a fine not exceeding the tax payable, where the delay exceeds six months.
- Late filing of a return: A registered person who fails to lodge a VAT return is liable for a penalty of 20% of the tax payable in the case where tax is payable or, in any other case, FJD 1 for each day of default.
- Late payment of tax payable: Where any tax remains unpaid on the expiry of the due date, a penalty of 25% of the tax payable in respect of that taxable period will apply.
- Failure to maintain proper records: A registered person who fails to keep, retain, or maintain account, documents, or records is liable for a penalty of 75% (knowingly or recklessly made) or 20% (in other cases).

### *Topics of focus for tax authorities*

The TAD has introduced a binding ruling system. However, the provisions will only apply after the Minister of Finance has appointed a date by notice in the Gazette.

The tax authorities may void any transaction, agreement, or arrangement made or entered into for the purpose of altering the incidence of tax; relieving any person from tax liability; or defeating, evading, or avoiding any tax imposed.

# Finland

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## Significant developments

The Finnish income tax system is expected to undergo some changes in the coming years. A group nominated by the Ministry of Finance has evaluated the current tax system and suggested amendments to it. The outcome of the possible tax reform is uncertain due to the parliamentary elections which took place in April 2011. Possible changes in corporate income taxation will be decided by the new government. However, at this stage, no decisions with respect to the possible changes have been made.

## Taxes on corporate income

Finnish resident companies are subject to Finnish corporate income tax (CIT) on their worldwide income (i.e. unlimited tax liability). Also, Finnish permanent establishments (PE) of non-resident companies are subject to Finnish CIT on their worldwide income attributable to the PE.

The CIT rate is 26%.

## Corporate residence

A company is deemed to be resident on the basis of incorporation. Consequently, a company is deemed to be resident in Finland if it is incorporated (registered) in Finland.

### Permanent establishment (PE)

A PE is, in general, formed in line with the Organisation for Economic Co-operation and Development (OECD) Model Convention.

## Other taxes

### Value-added tax (VAT)

The general VAT rate is 23%. A reduced rate of 13% is applied to food and animal feed. The reduced VAT rate of 13% also applies to restaurant and catering services. A reduced VAT rate of 9% is applied to books, accommodation, and passenger transport.

A zero rate applies in certain instances (e.g. subscriptions to newspapers and periodicals, intra-Community supplies of goods, and exports of goods). Additionally, certain services (e.g. financial services, insurance services, and certain educational services) are exempted from VAT.

# Finland

### *Customs duties*
Many goods imported into Finland from outside the European Union are subject to customs duties. The rates of duty are provided by the EU's Common Customs Tariff and vary widely.

### *Excise duties*
Alcohol and alcoholic beverages, tobacco products, liquid fuels, electricity, natural gas, and coal are subject to EU harmonised excise duties. National excise duties are levied in Finland on waste delivered to landfill sites, lubricating oil, oil imported into or through Finland, ice cream, sweets, soft drinks, beverage containers, and tall oil.

### *Stamp tax*
No stamp taxes are levied in Finland.

### *Real estate tax*
Municipalities impose an annual real estate tax. The tax is levied on the taxable value of buildings and land. The municipal council determines the applicable tax rates, although the minimum and maximum tax rates are set by tax legislation (e.g. 0.32% to 0.75% for permanent dwellings, 0.6% to 1.35% for other real estate). The tax is deductible from taxable business income if the real estate is used for business purposes. The tax is deductible from taxable income of the so-called other source of income if the real estate is used to acquire other taxable income than business income.

### *Transfer tax*
A transfer tax of 4% of the sales price is payable on the transfer of real estate situated in Finland. The transfer of shares in Finnish companies and other domestic securities is subject to a transfer tax of 1.6%. Generally, the transfer tax is payable by the transferee.

No transfer tax is payable on the transfer of securities made through the stock exchange. Similarly, no transfer tax is payable if both the seller and the transferee are non-residents. Transfer tax is, however, always payable on transfers between non-residents if the transferred shares are shares in a Finnish housing or real estate company.

### *Social security contributions*
According to the Finnish social security legislation, both Finnish and foreign employers have a liability to pay several social security payments in Finland in cases where an employee performs one's tasks partly or wholly in Finland. The liability concerns all employers, regardless of the form of the company and whether the foreign company has a PE in Finland. The percentage rates for the employer's (and employee's) social security contributions are revised on an annual basis.

Compulsory social security contributions payable by the employer in 2011, according to the paid salaries, are as follows:

- Employer's social security charge: 2.12% (no cap).
- Employer's pension insurance contribution: 17.10% (on average, no cap).
- Employer's unemployment insurance contribution: 0.80% for the first 1,879,500 euros (EUR) of gross salaries and 3.20% for the portion of the gross salaries exceeding EUR 1,879,500 (no cap).
- Group life insurance premium: 0.07% (on average, no cap).
- Accident insurance premium: 1.00% (on average, no cap).

The new rates for employer's social security charge are applicable to salaries paid as of 1 January 2011. The employer's social security charge is paid to the regional tax office, and the other contributions are paid to the insurance company. All of these contributions are tax deductible as salary cost.

Compulsory social security contributions payable by the employee in 2011 are as follows:

- Employee's pension insurance contribution: 4.70% or 6.00% used for employees of age 53 or over (no cap).
- Employee's unemployment insurance contribution: 0.60% (no cap).



Abovementioned contributions are tax deductible for the employee. These contributions are withheld from the gross salary at the time of salary payment and remitted by the employer to the appropriate insurance company together with the employer's pension and unemployment contributions.

- Employee's sickness insurance contribution: 2.01% (no cap).

The sickness insurance consists of two payments, daily allowance contribution 0.82% and medicare contribution 1.19%. From these two contributions, only the daily allowance contribution is tax deductible for the employee. The medicare contribution is not tax deductible. Unlike other employee's social security contributions, the sickness insurance contribution is included in the withholding tax rate of the employee's personal withholding tax card and, thus, withheld and remitted to the tax authorities together with the withheld income taxes and is finally settled in the final assessment.

If an employee is regarded as a foreign-posted employee and has an E-101 certificate or a certificate of coverage from one's home country, neither the aforementioned employer's social security contributions nor the employee's social security charges are payable in Finland.

## *Branch income*

As a general rule, a branch is taxed like a corporation (tax rate 26%) on the profits attributable to it, provided the branch constitutes a PE in Finland. No tax is withheld on transfers of (taxed) profits to the head office.

## *Income determination*

Companies and other legal entities may have income from three different sources: income from business activities, agricultural income, and personal source income. The net taxable income is calculated separately for each source. The expenses of one source of income cannot be deducted from the taxable income of another source, and a loss from one source of income cannot offset taxable income from another source. All taxable income received by a company is taxed at the CIT rate of 26% irrespective of the source to which it is attributable.

Income from business and professional activities falls into 'business source' income (taxed in accordance with Business Income Tax Act or BITA), while income from non-business activity is 'personal income'. Typically, personal income is passive income derived, for example, from investments. As an example, rental income from real estate let to non-related companies is usually regarded as 'personal source' income. The same can apply to a dividend received from stock exchange quoted companies, where the recipient of the dividend is a passive holding company. Farming and forestry income are, as a main rule, treated as agricultural source income.

In general, Finland has a very broad income concept, and taxable income includes all income derived from a company's activities, though there are some significant exceptions, including (among others):

- Capital contributions by shareholders.
- In most cases, dividends from unlisted companies *(see Dividend income below)*.
- Liquidation gains and capital gains qualifying for the participation exemption *(see Capital gains below)*.
- Proceeds from disposal of company's own shares.
- Merger gain.

There is no general distinction between capital gains and other income; capital gains of a company are taxed as part of its general income either in the 'business income' basket or the 'other income' basket. No rates other than the general CIT rate of 26% are applied to any part of taxable income of a company.

Taxable income of a company generally is computed on an accrual basis (i.e. income is taxable in the year it is earned). However, exemptions to this main rule do exist, including unrealised exchange gains and losses, which are taxable/deductible in the year of the rate change.

### *Inventory valuation*
Inventories may be written down to the lower of direct first in first out (FIFO) cost, replacement cost, or net realisable value. Conformity between book and tax reporting is required.

### *Capital gains*
Capital gains and losses are generally included in the taxable business income (i.e. sales proceeds are included in the taxable income, and the undepreciated balance of the asset sold is deducted in the sales year) and treated as ordinary income. However, the entire stock of machinery and equipment is treated as a single item, and the capital gain on machinery and equipment is entered as income indirectly by deducting the selling price from the remaining value of the stock of machinery and equipment.

Capital gains arising from the sale of shares are tax exempt via a participation exemption, under certain circumstances. Specifically, capital gains arising from the sale of shares are tax exempt if:

- the seller is not a company carrying out private equity activities (as defined by BITA)
- the seller has owned continuously, for a period of at least one year, at least 10% of the share capital of the target company, and
- the shares are part of the seller's fixed assets and the shareholding is included in the seller's business income source for tax purposes.

For the participation exemption to apply, the target company cannot be a real estate company, a housing company, or a company the activities of which mainly include owning of real estates. The target company must also be a Finnish company, a company referred to in the European Commission (EC) Parent-Subsidiary Directive, or a company resident in a country with which Finland has concluded a tax treaty which applies to the target company's dividend distribution.

Note that a capital gain is taxable to the extent that the gain corresponds with a previous tax-deductible write-down or provision made in connection with the acquisition cost of shares, subsidies received for acquiring shares, or previous capital losses deducted for Finnish tax purposes from intragroup transfer of the shares.

Capital losses are non-deductible in situations where capital gains are exempt from tax.

### *Dividend income*



Dividends received by a Finnish company are tax exempt in most cases. However, dividends received are partly (75%) taxable if:

- the dividend is received on shares belonging to 'investment assets' and the receiving company does not own at least 10% of the equity of the distributing company that is resident in another European Union (EU) member state and covered by the EC Parent-Subsidiary Directive (note that only financial, pension, and insurance institutions may have assets which are considered as 'investment assets')
- the dividend is received from a company other than a Finnish or EU resident, and
- the dividend is received from a publicly quoted company, the receiving company is not a publicly quoted company, and the shareholding is less than 10% of the equity of the distributing company.

Dividends that a Finnish company receives from other than a company resident in Finland or another EU member state are, however, fully taxable (100%) if there is no applicable tax treaty. Note that most of the Finnish tax treaties include provision enabling tax exempt dividends from the tax treaty country in case of at least a 10% shareholding.

### *Stock dividends*

Stock dividends (bonus shares) may be distributed to stockholders, which are corporations and other legal entities with some exceptions, free of tax on the shareholder *(see Dividend income above)*.

### *Foreign income*

A Finnish corporation is taxed on foreign dividends when the decision to distribute dividends is made and on foreign branch income and other foreign income (e.g. interest and royalties) as earned. The principal method of avoiding double taxation is the credit method, although the exemption method is still applied in a few older treaties *(see the Tax credits and incentives section for more information)*.

## *Deductions*

As with taxable income, the concept of deductible costs is wide and covers, in general, all costs incurred in the pursuance of taxable income. Significant exceptions to this rule include (among others):

- Income taxes *(see below)*, tax late payment interests, and punitive tax increases.
- Fines and other punitive payments.
- 50% of entertainment costs.

- Capital losses and liquidation losses if capital gains from the sale of shares of a target company would qualify for the participation exemption *(see Capital gains in the Income determination section)*.
- Losses from the disposal of a company's own shares.
- Merger losses.

As the accrual method is applied to calculation of taxable income, expenses are usually deductible in the year they are realised (i.e. the year the obligation to pay has arisen).

### *Depreciation, amortisation, and depletion*
Maximum annual rates of depreciation calculated on net book value (declining-balance method) are 25% for machinery and equipment and from 4% to 20% for buildings and other constructions, depending on the type and estimated life of the asset. Net book value is defined as cost less accumulated depreciation and, in the case of machinery and equipment, proceeds on disposal of the assets. The straight-line method is applied to certain intangible assets and capitalised expenditures and to assets with long economic use, such as dams. Tax depreciation is limited to the cumulative charges made in the books.

Costs related to qualifying intangible property are usually amortisable over a period of ten years or a shorter period if the economic life is proven to be less than ten years.

The capital cost of mines, sandpits, quarries, and peat bogs is written off in proportion to the quantities extracted. Short-lived items (the economic life of which is three years or less) may be written off immediately.

Land is not a depreciable asset.

### *Goodwill*
Acquired goodwill is amortisable for tax purposes over its economic life, up to a maximum of ten years.

### *Taxes*
No income taxes are deductible when determining taxable income. However, the real estate tax is deductible.

### *Net operating losses*
Losses may be carried forward for ten subsequent years. However, the right to carryforward may be forfeited in certain instances, such as in cases where there is a direct or indirect change in the ownership of the company operating at a loss. Loss carrybacks are not allowed.

### *Payments to foreign affiliates*
A Finnish corporation may claim a deduction for royalties, service fees, and interest charges paid to foreign affiliates, provided the underlying transaction is beneficial to it and the amounts paid are at arm's length.

## *Group taxation*

Companies within a group are not consolidated for CIT purposes. However, via group contributions (i.e. lump sum payments of cash based on annual taxable profits), group companies may even out their taxable profits and losses, which leads effectively to the same result as consolidation would. A group contribution is a deductible cost for the granting company and taxable income for the receiving company, provided that all of the following are true:

- Both companies belong to a structure where there is a direct or indirect common ownership of at least 90%, and the structure has existed for the entire tax year.
- Both companies are Finnish resident for tax purposes.
- Both companies are limited liability companies or co-operatives with business activities (i.e. have a source of income from business activities, *see the Income determination section)* and are not financial, insurance, or pension institutions.
- The contribution is recorded in the annual statutory accounts of both companies involved and must affect their annual net income.
- The accounting period for both companies ends at the same date.
- The amount of contribution does not exceed the taxable business income of the granting company.
- The contribution is not considered a capital investment.



Based on case law, the ownership chain may also be traced via foreign entities, provided there is a tax treaty between Finland and the country wherein the ultimate parent for the group is resident.

### *Transfer pricing*
All transactions between related parties must happen at arm's length. The requirement is imperative even in relation to purely domestic transactions. If the arm's-length requirement is not followed, income or deductions of a company may be adjusted for tax purposes, in addition to which a risk for substantial penalties exists.

A Finnish company is obliged to prepare transfer pricing documentation to support transactions between its non-Finnish related parties. Documentation is subject to statutory requirements regarding content, which vary depending on the volume of related party transactions. The documentation requirement does not concern small and medium-sized companies that have less than 250 employees and feature a turnover of no larger than EUR 50 million or a balance sheet of no more than EUR 43 million.

Thresholds are calculated at the group level. Failure to present appropriate documentation may lead to a punitive tax increase.

### *Thin capitalisation*
There is no special legislation governing thin capitalisation. A Finnish company may deduct interest payments to affiliates provided that the amount of debt and rate of interest are at arm's length. If not, a possibility for application of the general anti-avoidance provision may exist.

### *Controlled foreign company (CFC) regime*
The Finnish CFC regime was amended in 2009 for the purpose of bringing the regime into compliance with European Community law.

The CFC rules are applicable with respect to foreign entities in low tax jurisdictions controlled by Finnish residents. The undistributed profits of such foreign entities may be taxed as profit of the Finnish resident direct or indirect shareholders. The entity is deemed to be controlled by Finnish residents if at least 50% of the capital or total voting rights are directly or indirectly held by Finnish residents or if Finnish residents have the right to at least 50% of the profits of the entity. The taxable person in such a case is the Finnish resident shareholder who owns directly or indirectly at least 25% of the capital of the corporate body or have right to at least 25% of the profits of the entity. A foreign entity is considered to be low taxed if the actual income tax burden of the foreign corporation in its country of residence is lower than three-fifths of the tax burden of a comparable Finnish corporation (i.e. an effective rate of less than 15.6%, which is three-fifths of the Finnish tax rate of 26%).

Foreign PEs of non-resident companies can be regarded as equal to foreign companies provided that the PE's profits are not taxed in the head office state. Due to the transitional period, the PE provision would be applicable to PEs of foreign entities only as of 1 January 2015.

Certain types of businesses are excluded from the scope of the CFC rules (e.g. income principally from industrial, manufacturing, or shipping activities, as well as sales or marketing activities related to such activities, if they are directed principally to the country of residence of the sales or marketing company). Also, companies resident in a country with which Finland has a double tax treaty (DTT) generally are outside the scope of the CFC rules if the company does not benefit from any special tax incentives in that treaty country. Tax treaty countries that are not covered by this rule are exhaustively mentioned in a specific 'black list' provided by the Ministry of Finance. These countries are Barbados, Bosnia-Herzegovina, Georgia, Macedonia, Malaysia, Moldova, Montenegro, Serbia, Singapore, Switzerland, United Arab Emirates, and Uzbekistan.

In addition to these two mentioned exclusions, the Finnish CFC rules are not applicable in cases of genuine economical establishment in a foreign country, which is either an EU/European Economic Area (EEA) member state or a tax treaty state not on the 'black list'. The genuine economical establishment is evaluated in light of the requirements of the business in question and paying special attention to capable personnel and office space located in the low tax jurisdiction.

## *Tax credits and incentives*

### *Foreign tax credit*

The principal method of avoiding double taxation is the credit method, although the exemption method is still applied in a few older treaties. Foreign tax can be credited against taxes payable in Finland on the same income over the same period on a pro-rata basis. The credit is given for taxes paid to a foreign state and covered by the relevant double tax treaty. The maximum credit is the lesser of either the amount of the foreign tax or an amount equal to the Finnish tax payable on the income from a foreign state. This maximum is calculated on a source-by-source basis. Unused credit of foreign tax paid may be carried forward for five years on an income basket basis.

### *Research and development (R&D) activities*

Qualifying R&D related costs may be deducted annually under certain circumstances, despite the fact that they should be capitalised under general rules.

## *Withholding taxes*

Finnish corporations paying certain types of income are required to apply a 28% withholding tax (WHT) on payments to foreign corporations and non-resident individuals.

According to domestic legislation, interest paid to a non-resident is usually tax exempt in Finland. Dividends paid to a company referred to in the EC Parent-Subsidiary Directive, owning at least 10% of the capital of the dividend distributing company, are also tax exempt.

No WHT is levied on dividend payments received by companies resident in the EU/EEA area (other than in Liechtenstein), which would have been tax-free if paid to a Finnish corporate body, if the WHT cannot be credited in the company's country of residence.

See the table below for tax to be withheld at source, by countries of residence (of recipient).

For countries not included in table, the WHT rate is 28%.

Note that each tax treaty should be studied carefully because there are often exceptions to general rules.

| **Recipient** | **Dividend (portfolio)/ interest on cooperative capital (%)** | **Dividend (direct investment) (%) *** | **Investment fund profit share (%) **** | **Royalty (%) ***** |
|---|---|---|---|---|
| Argentina | 15 | 10 (25%) | 28 | 15 (18) |
| Armenia | 15 | 5 (25%) | 0 | 10 (6) |
| Australia | 15 | 5 (10%)(6, 14) | 28 | 5 (8) |
| Austria | 10 | 0 (10%)(14) | 0 | 5 |
| Azerbaijan | 10 | 5 (25%)(8) | 28 | 5 (4) |
| Belarus | 15 | 5 (25%) | 0 | 5 |
| Barbados | 15 (5) | 5 (10%)(14) | 28 | 5 (1, 5) |
| Belgium | 15 | 0 (10%) | 0 | 5 (1) |
| Bosnia-Herzegovina | 15 | 5 (25%) | 0 | 10 |
| Brazil *(see protocol)* | 28 | 28 | 28 | 28 |
| Bulgaria | 10 | 0 (10%) | 0 | 5 (1) |
| Canada | 15 | 5 (10%) (14) | 28 | 10 (1) |
| China, P.R. of | 10 | 5 (25%) | 28 | 10 (9) |
| Croatia | 15 | 5 (25%) | 0 | 10 |
| Cyprus | 28 (23) | 0 (10%) | 28 | 28 |
| Czech Republic | 15 | 0 (10%) | 0 | 10 (1, 16) |
| Denmark (including the Faroe Islands) | 15 | 0 (10%) | 0 | 0 |
| Egypt | 10 | 10 | 28 | 25 |
| Estonia | 15 | 0 (10%) | 28 | 10 (12) |
| France | 0 | 0 | 0 | 0 |
| Germany | 15 | 0 (10%) | *See dividend* | 5 (1) |
| Georgia | 10 | 0 (50%)/ 5 (10%)(8) | 0 | 0 |
| Great Britain | 0 (5) | 0 | 0 (5) | 0 (5) |
| Greece | 13 | 0 (10%) | 0 | 10 (1) |
| Hungary | 15 | 0 (10%) | 0 | 5 (1) |
| Iceland | 15 | 0 (10%) | 0 | 0 |
| India | 10 | 0 (10%) | 28 | 10 |

# Finland

| Recipient | Dividend (portfolio)/ interest on cooperative capital (%) | Dividend (direct investment) (%) * | Investment fund profit share (%) ** | Royalty (%) *** |
|---|---|---|---|---|
| Indonesia | 15 | 10 (25%) | 28 | 15 (4) |
| Ireland, Rep. of | 0 (5) | 0 (10%)(14) | 0 (5) | 0 (5) |
| Israel | 15 | 5 (10%) | 0 | 10 |
| Italy | 15 | 0 (10%) | 0 | 5 (1) |
| Japan | 15 | 10 (25%)(8) | 0 | 10 |
| Kazakhstan | 15 | 5 (10%) | 0 | 10 |
| Korea, Rep. of | 15 | 10 (25%) | 0 | 10 |
| Kyrgyzstan | 15 | 5 (25%) | 0 | 5 |
| Latvia | 15 | 0 (10%) | 28 | 10 (12) |
| Lithuania | 15 | 0 (10%) | 28 | 10 (12) |
| Luxembourg | 15 (10) | 0 (10%)(10) | 0 | 5 (1, 10) |
| Macedonia | 15 | 0 (10%)(14) | 0 | 0 |
| Malaysia | 15 | 5 (10%) | 28 | 5 |
| Malta | 15 | 0 (10%) | 0 | 0 |
| Mexico | 0 | 0 | 28 | 10 |
| Moldova | 15 | 5 (25%) | 0 | 7 (6) |
| Morocco | 15 | 15 | 0 | 10 |
| Netherlands | 15 | 0 (15%) | 0 | 0 |
| New Zealand | 15 | 15 | 28 | 10 |
| Norway | 15 | 0 (10%) | 0 | 0 |
| Pakistan | 20 (20) | 12 (25%) | 28 | 10 |
| Philippines | 28 | 15 (10%)(14) | 28 | 25 (3) |
| Poland | 15 | 0 (10%) | 0 | 5 |
| Portugal | 15 | 0 (10%) | 0 | 10 |
| Romania | 5 | 0 (10%) | 0 | 5 (19) |
| Russia | 12 | 5 (30%)(7) | 0 | 0 |
| Serbia and Montenegro | 15 | 5 (25%) | 0 | 10 |
| Singapore | 10 (15) | 5 (10%)(14, 15) | 28 | 5 (15) |
| Slovak Republic | 15 | 0 (10%) | 0 | 10 (1, 16) |
| Slovenia | 15 | 0 (10%) | 0 | 5 |
| South Africa | 15 | 5 (10%) | 0 | 0 |
| Spain | 15 | 0 (10%) | 0 | 5 |
| Sri Lanka | 15 | 15 | 0 | 10 |
| Sweden | 15 | 0 (10%) | 0 | 0 |
| Switzerland | 10 | 0 (20%) | 0 | 0 |
| Tanzania | 20 | 20 | 0 | 20 |
| Thailand | 28 | 20 (25%)(13) | 28 | 15 |
| Turkey | 20 | 15 (25%) | 28 | 10 |
| Ukraine | 15 | 5 (20%) | 0 | 10 (17) |
| United Arab Emirates | 28 (22) | 28 (22) | 28 (22) | 28 (22) |
| United States | 15 (21) | 5 (10%)(14, 21) | 0 | 0 |
| Uzbekistan | 15 | 5 (10%)(14) | 0 | 10 (6) |
| Vietnam | 15 | 5 (70%)/10 (25%) | 28 | 10 |

| Recipient | Dividend (portfolio)/ interest on cooperative capital (%) | Dividend (direct investment) (%) * | Investment fund profit share (%) ** | Royalty (%) *** |
|---|---|---|---|---|
| Zambia | 15 | 5 (25%) | 28 | 15 (1, 11) |

Notes

* The recipient is a company whose share in the company making the payment is at least the percentage indicated in parentheses.

** No tax on profit shares meant in EC Directive 2003/48/EC (§ 3.7, Act on Tax at source).

*** No tax on royalties between associated companies meant in EC Directive 2003/49/EC (§ 3 b-f, Act on Tax at source).

1. Tax is not levied on literary, scientific, or artistic royalties *(for film royalties, see text of treaty).*
2. The tax rate is 10% on use of films, literary, scientific, or artistic works and 25% on use of trademark or royalties paid for usufruct.
3. The tax rate is 15% on films, tapes used in television or radio broadcasts, use of copyright of literary, artistic, or scientific works or royalty paid for usufruct.
4. The tax rate is 10% on literary, scientific, artistic, and film royalties.
5. The tax rate for an individual is 28% if income is tax exempt in the country of residence.
6. A lower tax in certain cases, *as for India see article V in protocol 1997.*
7. Foreign capital greater than USD 100,000 when dividend becomes due and payable.
8. *See the treaty for additional requirements.*
9. The tax rate is 7% on industrial, scientific, and commercial royalties.
10. The tax rate is 28% if the recipient is a special holding company.
11. The tax rate is 5% on royalties from films and tapes.
12. The tax rate is 5% on royalties paid for the use of industrial, commercial, or scientific equipment.
13. The tax rate is 15% if the payer is also an industrial enterprise.
14. The 10% is calculated on the total voting stock.
15. The tax rate is 28% on an unremitted amount, if free from tax in Singapore.
16. The tax rate is 1% for a finance lease of equipment and 5% for an operating lease of equipment and computer software.
17. The tax rate is 5% for the use of secret process or for know-how, no tax for computer software or patent.
18. The tax rate is 10% on industrial royalty, 3% on royalties to news agency, and 5% on artistic royalty to the author or his mortis causa successor.
19. The tax rate is 2.5% on royalties paid for the use of industrial, commercial, or scientific equipment or computer software.
20. The tax rate is 15% if the recipient is a company.
21. No tax on dividends to qualified parents-subsidiaries and pension funds (Article 10 paragraph 3).
22. No tax if the recipient proves that he has domicile (individual) or is incorporated in the United Arab Emirates.
23. The tax rate is 19.5% if paragraph 3 of Act on Tax at source (RP 113/2008) is applicable.

Non-treaty areas include Andorra, Antigua and Barbuda, Bahama Islands, Bahrain, Belize, Cayman Islands, Channel-Islands, Cyprus, Gibraltar, Grenada, Greenland, Hong Kong, the Spitzbergen, Jan Mayen, Liberia, Macao, Mauritius, Monaco, Netherlands Antilles, Panama, Samoa, San Marino, Vanuatu, and Virgin Islands.

## *Tax administration*

### *Returns*

The tax year is generally the calendar year. A company having an accounting period other than the calendar year is taxed for the accounting period or the accounting periods ending during the calendar year. A company must file a CIT return within four months from the end of the accounting period.

### *Payment of tax*
Income taxes are levied as prepayments during the tax year. After the assessment of the taxes, any excess prepayments are refunded without application. If the total prepayments are less than the actual income tax to be paid, the remaining amount is levied by the local tax office.

### *Topics of focus for tax authorities*
Current issues in special focus of tax audits are transfer pricing and permanent establishments.

### *The Tax Account system*
As of the beginning of 2010, a new system for reporting and paying unprompted taxes (e.g. VAT and employer's social charges) was introduced. The Tax Account system is a taxpayer-specific information system under which unprompted taxes are declared on a monthly basis. There are changes in the existing system of monthly returns, due dates, payments, and refunds. Payments are made through regular payment channels.

Tax types not covered by the Tax Account system are income tax, real estate tax, inheritance tax, gift tax, forestry fees, and transfer tax. It is important to note that WHTs are henceforth declared through the Tax Account system.

## *Other issues*

### *Company restructurings*
In accordance with the EC directive 2009/133/EC on mergers, divisions, partial divisions, transfers of assets, and exchanges of shares concerning companies of different EU member states, it is possible to carry out the said restructurings tax neutral, if statutory conditions are met. In cross-border situations, both parties should be resident in the European Union. The principal of going concern is applied in taxation (i.e. the receiving company receives the assets with the values the transferring company had for those assets in its taxation).

# France

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## Significant developments

### The use of patented or patentable technologies in manufacturing

New provisions, effective from 1 January 2011, enable companies which are involved in the manufacturing of products in France containing patented or patentable technologies, or companies which incorporate such technologies into goods which are manufactured in France, to benefit from a reduced effective rate of tax.

To date, the reduced 15% tax rate applicable to royalty income from the licensing of patents or patentable inventions was 'neutralised' in the event that such an arrangement existed between two connected French companies. If the licensor company benefitted from a 15% tax rate, the licensee company would, conversely, only be entitled to claim a reduced tax deduction for amounts paid under the licence (i.e. 15/33.33 of the amounts paid). Therefore, to truly benefit from this provision in a group context, it was necessary for the licensee company to be an overseas company.

Article 216 of the Finance Act removes this capping of the tax deduction for licensee companies, where the licensing arrangement is between connected French companies.

These new provisions will apply equally to existing licensing arrangements as well to new agreements.

It follows, therefore, that in the case of a licensing arrangement between connected French companies, the licensor will benefit from a reduced 15% tax rate on royalty income, whereas the licensee company will benefit from a tax deduction at 33.33%.

In order for a licensee company to benefit from full deductibility for royalties paid, the new rules require that the licensee company 'effectively exploits' the rights available to it.

### Thin capitalisation

In the specific case where the repayment of a loan granted by a third party (including banks) is guaranteed by a related party or by a third party whose commitment is itself secured by a related one, then the proportion of interest which is payable on that part of the loan which is secured in this way is potentially subject to thin capitalisation rules.

The new provisions will not apply where the loan:

- takes the form of a bond issued by way of a public offering or under equivalent foreign regulations, although this excludes private placements
- is guaranteed by a related party solely by way of a pledge of shares in the debtor, security over the debtor's receivables, or shares in a company directly or indirectly

owning the debtor so long as the holder of such shares and the debtor are members of the same tax group; as a result, this exception will not apply where a foreign company grants a pledge of shares in its French subsidiary to guarantee the bank loan granted to it
- is obtained in the context of a refinancing to allow the debtor to complete the mandatory repayment of a pre-existing debt, which is required as a result of a direct or indirect takeover of the debtor (allowed up to the amount of the loan principal repaid and accrued interest to that date), or
- has been obtained prior to 1 January 2011 in connection with an acquisition of securities or the refinancing of such acquisition debt.

These new anti-abuse provisions are applicable to fiscal years ending on or after 31 December 2010. As a result, companies (except those benefitting from the last exception mentioned above) may be subject to the new rules for their 2010 accounting periods.

### *Distribution followed by absorption or sale of subsidiary*
The new rules abolish the possibility for a company to accumulate the exemption of dividends received from its subsidiaries (under the participation exemption regime or the tax consolidation regime) and the deduction of a loss in value resulting from the dividends' distribution due to previous distributions at the time of the securities exchange or sale of shares.

In principle, the subsidiary's shares must be kept by the parent company for at least two years in order to benefit from the participation exemption regime. However, some operations lead to a break of the two-year holding period. In that case, the exchanged shares are deemed withheld until the sale of the securities received in exchange.

For fiscal years ending after 31 December 2010, the exchanged shares will be deemed kept for the application of the participation exemption regime only if the gain or loss is not taken into account in the result of that exchange. If the gain or loss is included in the result, the dividends received may not benefit from the participation exemption regime and will be taxed.

### *Tax consolidation*
There will be no neutralisation of dividends received from other companies in a tax-consolidated group that cannot benefit from the participation exemption regime if the shares have not been held for more than two years. In order to determine the capital gain or loss in this case, the companies' costs will be reduced by the amount of the received dividends whose amount was deducted from the overall consolidated result.

### *Capital gains on shares sold to a related company*
In accordance with the article 13 of the Finance Act for 2011, in the specific case where shares held for less than two years in a subsidiary are sold to a related company, the capital gain/capital loss deriving from this disposal is not immediately taxable/deductible. In such a case, the gain/loss will be taxed/deducted when:

- the vendor stops being subject to corporate income tax (CIT)
- the shares concerned are held by a non-related entity, or
- the shares concerned are held for at least two years by the related buyer.

### *Systemic risk tax*
As of 2011, a bank tax known as a systemic risk tax has been implemented to prevent excessive risk behavior by banks. The new tax is payable by certain financial institutions (including credit institutions).

It should be noted that 'fund' entities (e.g. hedge funds or securitisation vehicles) are outside the scope of the tax.

French banks are subject to the bank tax on their worldwide business activities. The equity requirements which are used as the taxable basis for the calculation of the bank tax are calculated on a consolidated basis. Therefore, institutions which fall within the scope of the tax and which belong to a consolidated group are not subject to the tax on an individual basis. Where they are not part of such a group, institutions pay a contribution calculated on their individual position. The taxable basis is made up of the minimum equity required of the institution, as set out by the Prudential Control Authority to meet reserve ratio requirements in accordance with Basel II standards and specified during the previous calendar year.



The rate of the bank tax amounts to 0.25% of the taxable basis, and any amounts paid in that respect will be deductible for CIT purposes.

The bank tax is due on 30 April annually. A tax return must be filed by 30 June every year, and the total balance due must be settled at the same time.

Subject to the principle of reciprocity, it should be noted that taxpayers for which the registered office or the group parent company is located in a country which has enforced a similar tax on systemic risk, can benefit from a tax credit. This tax credit can be used to settle the tax due or can be reimbursed.

### *Capitalisation reserve*

#### Exit tax

The Finance Act for 2011 provides for an exit tax assessed on the amount of capitalisation reserve booked by French insurance companies and French branches of foreign insurance companies.

The exit tax should be equal to 10% of the global amount of capitalisation reserve booked on 1 January 2010.

Nonetheless, the tax could be capped at 5% of the net equity of the company (including the capitalisation reserve) booked on 1 January 2010.

50% of the exit tax has to be paid before 30 April 2011 (i.e. filing's date of the special form) and 50% has to be paid before 30 April 2012 if FB promulgated before year end.

The exit tax is not CIT deductible.

#### New tax treatment of the provision booked

As of 1 January 2010, any new provision booked to the capitalisation reserve is not tax deductible and the release of such provision is not taxable.

### *Allocation of the tax charge within a tax consolidated group*

In an important decision dated 12 March 2010 ('Wolseley Centers France'), the French Supreme Court disagreed with the French Tax Authorities by ruling that the tax charge of the group can be freely allocated between members of the consolidated tax group.

Following this decision, group companies are free to enter into a tax consolidation agreement stating the conditions for the allocation of the group tax charge or, where applicable, the tax savings arising from the group arrangement.

The Supreme Court concludes that since the terms of an agreement to allow a re-allocation taking into account the specific results of each of the group companies, the terms of this re-allocation cannot be regarded as an indirect subsidy. However, this allocation should not undermine the corporate benefit of each group member nor the minority shareholders rights otherwise this will result in an abnormal act of management.

### *Underpriced sale of asset between two entities of a same tax consolidated group*

In a decision dated 10 November 2010 ('Société Corbfi'), the French Supreme Court has specified that an underpriced sale of an asset between two entities members of the same tax group must be neutralised at the group level only after the computation of the entities results on a standalone basis.

First, on a standalone basis, the seller has to add back the advantage given to the buyer (i.e. the difference between the fair market value and the amount paid) and the buyer adds back this advantage as if it was a dividend. Second, when reprocessing the different entities results, the advantage added back by the buyer has to be neutralised at the group level.

### *Transfer pricing documentation*

As of 1 January 2010, the Amended Finance Act of 2009 introduced new French transfer pricing documentation requirements concerning large corporations located in France (i.e. with annual turnover or amount of gross assets in excess of 400 million euros (EUR)).

According to this new provision, the documentation must contain general information regarding the relevant group of companies, including notable activities, operational and legal structures of the related companies, functions performed and risks borne, main intangible assets, and group transfer pricing policy, amongst others.

### *Anti-avoidance rules applicable to Non-Cooperative States or Territories (NCST)*

For French tax purposes, a state or territory is considered non-cooperative if it meets at least one of the following criteria:

- It is not a member of the European Community.
- It has been reviewed and monitored by the Organisation for Economic Co-operation and Development (OECD) Global Forum on Transparency and Exchange of Information.
- It has not concluded at least 12 administrative assistance agreements/treaties that allow a complete exchange of information for tax purposes.
- It has not concluded an administrative assistance agreement/treaty with France.

Under the new tax regime, the French parent-subsidiary regime is no longer applicable to dividends paid from entities located in an NCST with respect to tax years beginning on or after 1 January 2011.

As of 1 January 2010, withholding tax (WHT) on passive income increased to 50% for transactions with an NCST person or entity.

Payments (e.g. interests, royalties, payments for services) made to an NCST person or entity are, as a general rule, not tax deductible. In addition, it is no longer possible to offset WHT in France with any foreign WHT borne by the entity located in a NCST.

Moreover, concerning shareholders (individuals and companies) located in a NCST, a tax amounting to 50% is levied on capital gains derived from the disposal of shares in French companies whatever the level of shareholding.

## *Taxes on corporate income*

France levies CIT at a rate of 33.33%. No tax is levied on income at the regional or local level.

A resident company is subject to CIT in France on its worldwide income, with the exception of income attributable to foreign business activity (if there is no treaty in force between France and the relevant foreign country) or to a foreign permanent establishment (PE) (if a tax treaty does apply).



A non-resident company is subject to CIT in France on income attributable to French business activity or to a French permanent establishment (PE), as well as on income from real estate located in France.

### *Social contribution tax*

Concerning large size companies, a social contribution tax amounting to 3.3% is assessed on the CIT amount from which a EUR 763,000 allowance is withdrawn.

### *Patent box regime*

Under certain conditions, income derived from the sale or license of patents or patentable inventions is taxed at a reduced 15% rate.

### *Capital gains*

Reduced tax rates of 15% or 8% apply to certain capital gains. *See Capital gains in the Income determination section for more information.*

## *Corporate residence*

France is defined as metropolitan France (excluding Monaco, but including the continental shelf), Corsica, and the overseas departments (French Guyana, Guadeloupe, Martinique, Reunion).

As a general rule, a resident company is a company that is incorporated under French commercial laws.

## *Other taxes*

### *Turnover taxes*

Turnover taxes are assessed on goods sold and services rendered in France, and operate much like a value-added tax (VAT). The normal rate is 19.6%. Restaurants, transports of travellers, and sales of books are taxable at a 5.5% reduced rate. Other specific sales and services are taxable at a 2.1% reduced rate. Exports and certain specific services invoiced to non-French residents are zero-rated.

As of 1 January 2010, business-to-business (B2B) suppliers of services are taxable at the location of the customer and no longer at the location of the supplier. For business-to-consumer (B2C) suppliers of services, the place of taxation remains where the supplier is established.

Turnover taxation applies only to taxable persons, partly taxable persons, and non-taxable legal persons that are registered for turnover taxes.

Specific new turnover taxation rules apply to transportation leases, cultural, arts and sports services, electronic and telecommunication services, and transportations of goods.

### *Territorial and economic contribution*

As of 1 January 2010, the business tax has been replaced by the territorial and economic contribution, known in French as Contribution Economique Territoriale (CET). CET is comprised of two different taxes: the companies' land contribution, known in French as Cotisation Foncière des Entreprises (CFE), and the companies' added value contribution (CVAE). Although they have a similar scope, the taxes are subject to very different rules.

The CFE tax is based on the rental value of assets that are subject to the real estate tax, excluding movable goods and equipment. For industrial plants, the taxable base is reduced by 30%. There is a specific rental value for each town and an upgrading ratio is set forth at the national level each year.

The CVAE is based on a company's added value. Only taxpayers which are not exempt from the CFE and whose turnover is greater than EUR 152,500 are subject to CVAE. However, tax relief equal to the amount of the tax is provided for companies whose turnover is under EUR 500,000. The tax rate for companies whose turnover ranges from EUR 500,000 to EUR 50 million is assessed according to a progressive scale, which ranges from 0 to 1.5%.

There is an upper ceiling on the added value that applies to the CET. As a consequence, tax relief applies and is equal to the excess of the sum of CFE and CVAE over 3% of the added value of the company.

### *Registration duties*

Registrations duties mentioned hereafter are imposed on the purchaser. However, the seller may be liable for these duties in case of non-settlement by the purchaser.

#### Transfer of goodwill

The transfer of goodwill is subject to a registration duty at a rate of 3% on the part of the transfer price amounting from EUR 23,000 to EUR 200,000 and at a rate of 5% on the part exceeding EUR 200,000.

#### Transfers of shares

The transfer of shares of Société anonyme (SAs, which are corporations) and Société par Actions Simplifiées (SASs, which are simplified corporations) is subject to registration duty at a rate of 3%, with a maximum of EUR 5,000 per transfer.

The transfer of interests or quotas in legal entities whose capital is not divided into shares (e.g. Société à responsabilité limitée or SARLs, which are a form of private limited liability corporate entity) is subject to a registration duty of 3%.

The transfer of shares in non-quoted companies whose assets consist principally of immovable property is subject to a registration duty of 5%.

### Transfer of real estate
The sale of land and buildings is subject to registration duty at a rate of 5.09% on the transfer price, including expenses.

### *Real estate tax*
All properties located in France are subject to a 3% real estate tax. The tax is assessed on the fair market value of the real estate, in proportion to the direct or indirect interest held. All entities in the chain of ownership are jointly liable for the payment of the tax.

Automatic exemptions apply in three situations. First, to entities whose French real estate assets represent less than 50% of their total French assets. Second, to entities listed on a regulated market whose shares, units, or rights are significantly traded on a regular basis. Third, to entities having their registered office in France, in a European Union (EU) member state, or in a country that has concluded a double tax treaty (DTT) with France providing for an administrative assistance or a non-discrimination clause, where:



- their direct or indirect interest in the French real estate is less than either EUR 100,000 or 5% of the fair market value of the French real estate
- they are pension funds or public charities recognised as fulfilling a national interest whose activities justify the need to own French real estate, or
- they are non-listed French real estate funds (société de placement à prépondérance immobilière à capital variable (SPPICAV) or fonds de placement immobilier (FPI)) or foreign funds subject to equivalent regulations.

Where an automatic exemption does not apply, a claim may be submitted for conditional exemption.

## *Branch income*

Tax rates on branch profits are the same as on corporate profits. However, as a principle, branch profits are deemed to be distributed to the head office.

A WHT is levied on French branches of non-resident non-EU corporations at the rate of 25%, or a reduced tax treaty rate (e.g. for the United States, 5%) on net profits. Refund (limited or full) of tax may be claimed to the extent that the taxable amount exceeds the dividend(s) actually distributed by the foreign corporation during the 12 months following the close of the fiscal year concerned, or to the extent the dividends are distributed to residents of France.

Profits realised in France by non-resident corporations whose head offices are located in a EU country are not subject to branch WHT, provided that certain conditions are met (e.g. effective head office in a EU country or non-resident corporation subject to corporate taxation).

## *Income determination*

### *Inventory valuation*
Inventories must be valued at the lower of cost or market. Cost must be determined in accordance with the first in first out (FIFO) or the average-cost method. The last in first out (LIFO) method is prohibited.

### *Capital gains*
Capital gains generally are taxable as ordinary income and subject to CIT at the standard rate of 33.33%, regardless of the duration of ownership of the assets sold.

However, a reduced rate of 15%, increased by the social contribution tax, is applied to capital gains on the disposal of patents or patentable inventions, as well as on income from the licensing of patents or patentable inventions.

Gains on the sale of shares in subsidiaries held for at least two years benefit from significant relief (95% of such capital gains are excluded from CIT, with the remaining 5% portion being taxed at the standard 33.33% rate).

#### Capital gains of non-residents
As a general rule, non-resident companies are not taxable in France regarding capital gains which derive from the disposal of French assets.

There are two main exceptions to this principle:

- Capital gains derived from the disposal of real estate assets located in France or derived from the disposal of French real estate non-listed companies are subject in France to WHT at a 33.33% rate.
- Capital gains deriving from the disposal of shares held in a French company subject to CIT are subject in France to WHT at a 19% rate in the specific case where the seller has owned, at any point in time during the five years preceding the sale, at least 25% of the rights in the profits of the French company.

Note that in the specific case where the non-resident company is located in a non-cooperative state or territory (NCST), all capital gains deriving from the disposal of French assets are subject to WHT in France at a specific rate of 50%.

### *Inter-company dividends*
French parent companies (i.e. companies incorporated in France and holding qualifying shares that represent at least 5% of the issued capital of subsidiaries, French or foreign) have the option of excluding 95% of the subsidiaries' net dividends from CIT (5% of charges and expenses must be added back to the parent company's taxable results). The French parent-subsidiary regime extends to certain shares without voting rights. There is no formal commitment to hold the shares for at least two years, and companies can benefit from this regime from the acquisition date of the shares. However, the obligation remains to hold the shares over this period of time. Certain shares of listed real estate companies are not eligible to the French parent-subsidiary regime.

Regarding fiscal years ending on or after 31 December 2010, the taxation of dividends received by a parent company from its subsidiary cannot be capped at the amount of the expenses actually incurred by the parent company. Thus, the tax liability will be equal to 5% of the dividends received, tax credits included.

As of 1 January 2011, the French parent-subsidiary regime is no longer applicable to dividends paid from entities located in an NCST.

### *Foreign income*
Resident corporations are not taxed on foreign source income derived from activities carried out abroad through foreign branches. Other foreign income is not taxable until actually repatriated to French resident corporations. As a result, undistributed income of foreign subsidiaries is not taxable. The only exception to the territoriality principle is

provided by Article 209 B of the Tax Code, known as the Controlled Foreign Company (CFC) rules *(see the Group taxation section for more information)*.

## Deductions

### Depreciation

The depreciation of fixed assets has to be carried out component by component. The components of a fixed asset have to be depreciated separately according to their own lifetime.



Declining-balance depreciation is allowed for certain new and renovated assets whose useful life is more than three years.

For assets bought or manufactured between 4 December 2008 and 31 December 2009, the rate is computed by multiplying the rate of straight-line depreciation by:

- 1.75, if the useful life of the asset is three or four years
- 2.25, if the useful life of the asset is five or six years, or
- 2.75, if the useful life of the asset is more than six years.

For assets bought or manufactured after 31 December 2009, the rate is computed by multiplying the rate of straight-line depreciation by:

- 1.25, if the useful life of the asset is three or four years
- 1.75, if the useful life of the asset is five or six years, or
- 2.25, if the useful life of the asset is more than six years.

### Goodwill

Under French tax rules, goodwill (e.g. clientele, trade-marks) cannot be amortised.

### Research and development (R&D) and software expenses

Concerning R&D and software expenses, a business may elect to immediately deduct costs incurred in R&D of software or to amortise their cost straight-line over a maximum period of five years.

The cost of acquiring software may be written off straight-line over 12 months.

The cost of patents acquired can be amortised over a five years period.

### Bad debts

Bad debts which are definitively non-recoverable are treated, from a tax point of view, as losses.

Under certain conditions, a tax deductible reserve can be established for debts whose recovery is uncertain.

### Charitable donations

Charitable donations made by companies to certain foundations or societies are deductible up to 60% of their amount (limited to EUR 5,000 of the turnover before taxes).

### *Taxes*
Most taxes, including unrecoverable turnover taxes, registration duties, and CET, are deductible. The major exceptions are CIT and tax penalties.

### *Net operating losses (NOLs)*
For tax purposes, the distinction between ordinary losses and losses corresponding to deferred depreciation has been eliminated. Companies subject to CIT can carryforward their losses for an unlimited period of time.

Corporations may also elect to carry back NOLs. Losses of a given fiscal year may be offset against undistributed taxable profits of the three preceding years. The lower of the tax paid on these profits or the potential tax savings represented by the tax loss of the fiscal year is a tax credit. Such credit may be offset against CIT of the following five fiscal years; thereafter, any excess credit may be refunded.

### *Payments to foreign affiliates*
Payments to foreign affiliates are allowed, as long as they meet the arm's-length test. If they do not, article 57 of the French Tax Code provides that income directly or indirectly transferred to the foreign affiliate, through either the increase or the reduction of the purchase or sales price of goods and services, or through any other means, must be added back to taxable income. For the purpose of this provision, foreign affiliates are defined as parent or sister companies.

Where the payments are made to companies located in a country with a privilege tax regime, the French taxpayer must prove that the transaction is bona fide and that the amount due is not exaggerated *(see the Group taxation section for more information on countries with a privilege tax regime).*

## *Group taxation*

French corporations and their 95% owned domestic subsidiaries may elect to file one single tax return, thus allowing offset of losses of one group corporation against the profits of a related corporation. CIT is then levied on the aggregate income after certain adjustments for intra-group provisions (e.g. debt waivers, dividend distributions) have been made.

Other group consolidation systems are available with the prior authorisation of the Ministry of Finance, as follows:

- Bénéfice consolidé: The 50% owned subsidiary consolidation system allows the combined reporting of profits and losses of all controlled branches, subsidiaries, and partnerships, whether French or foreign.
- Bénéfice mondial: Worldwide tax consolidation allows French corporations to include in their French tax return the results of their foreign activities carried out by branches.

When shares in a company that will be integrated into the group are acquired by a group company from individuals or legal entities that control this group, either directly or indirectly, a portion of the group's overall financial expense incurred by the members of the group is progressively added back to the group's taxable income on a straight-line basis over a nine year period.

As of January 2009, a French subsidiary can be included in a tax consolidated group even if its parent company is not located in France. However, at least 95% of the share capital of the foreign company must be held, directly or indirectly, by the French company that is head of the tax consolidated group. In addition, the foreign company must be subject to CIT, be located in the European Union or in a member state of the European Economic Area (EEA) whose tax treaty with France includes a mutual administrative assistance clause to fight tax fraud and tax evasion, and hold 95% of the lower-tier subsidiary's shares.

A PE of a foreign company subject to French CIT can be a member of a French tax consolidated group if the shares of the foreign company are held by other French companies, which are members of the consolidated group.



Provisions on the tax neutrality of intra-group transaction flows (e.g. dividends, provisions, waivers of debts, interest, and capital gains on the sales of shares) have been modified to treat tax consolidated groups with an intermediate foreign company the same as other tax consolidated groups.

### *Thin capitalisation rules*

Under current rules, the tax deduction of interest paid by a French company to its foreign controlling shareholders is subject to the following three restrictions.

#### Interest rate limitation

Under the amended article 212 of the French Tax Code, tax deduction of interest paid to related parties is limited to the higher of (i) the average annual interest rate applied by credit institutions to companies for medium-term variable rate loans or (ii) the interest that the borrowing company could have obtained from independent banks under similar circumstances. This rate is 3.82% for financial years ending on 31 December 2010. Having passed this interest rate test, French indebted companies have to pass a second test: the debt ratio.

#### Debt ratio

That part of interest paid to related parties which is deductible under the rate limitation test is disqualified if it exceeds all of the three following limitations during the same financial year:

- Interest relating to financing of any kind granted by related parties, within the limit of 1.5 times the net equity of the borrower.
- 25% of adjusted net income before tax ('résultat courant avant impôt', defined as the operating income, increased by certain items).
- Interest income received from related parties (i.e. there is no limitation on thin capitalisation grounds when the borrowing company is in a net lending position vis-a-vis related entities).

The portion of the interest which exceeds the three above limits is not deductible, except if it is lower than EUR 150,000.

#### Carryforward of excess interest

That part of the interest which is not deductible immediately by the borrowing company can be carried forward, without time limit, for relief in subsequent years, provided there is an excess capacity during such years. The amount in excess is, however, reduced by 5% each year, from the second financial year following the financial year in which the interest expense has been incurred.

### Exceptions
The thin capitalisation rules do not apply to interest payable by banks and credit institutions, and also to certain specific situations such as interest in connection with intra-group cash pools or with certain leasing operations.

The thin capitalisation rules do not apply if the French indebted company can demonstrate that the debt-to-equity ratio of the worldwide group to whom it belongs exceeds its own debt-to-equity ratio.

Deductibility is also facilitated within a French tax consolidated group. The thin capitalisation rules apply to each company member of the group taken on a stand-alone basis. Any excess interest incurred by such company is, however, not carried forward by it. Instead, it is appropriated at group level.

### *Controlled foreign company (CFC) regime*
The CFC rules provide that:

- French corporations are required to include in their taxable income profits made by their more than 50% owned foreign subsidiaries and branches. The 50% holding is determined by direct and indirect control of shares and voting rights.
- The minimum holding threshold has to be reduced to 5%, if over 50% of the share capital of the foreign entity is indirectly held through French or foreign companies controlled by the French parent company. However, if the shares in the foreign entity are listed on a regulated market, the French tax authorities will have to demonstrate that the French parent company, together with other entities holding shares in such foreign entity, is acting in concert.
- The CFC rules are only applicable if the foreign legal entity or PE in which the French company owns the requisite percentage of shares is in a country with a privileged tax regime. A privileged tax regime is defined by the French tax code as a tax regime in which a foreign jurisdiction subjects taxable income of a foreign entity to at least 50% or lower of the income tax liability which would been incurred in France, had the activity of the foreign entity been performed in France.
- Profits of the foreign entity which fall under the CFC rules are no longer taxed separately. They are now aggregated with the other taxable profits of the French parent company. Consequently, any tax losses incurred by the French parent company may be offset against the foreign entity's profits.
- The French parent company can avoid the application of the CFC rules if it demonstrates that the foreign entity carries an effective trading or manufacturing activity, conducted from its country of establishment or registered office. Furthermore, the CFC rules, in principle, are not applicable with respect of foreign branches or subsidiaries located in another EU country. However, this exception is not applicable if the French tax authorities can demonstrate that the foreign entity located in another EU country constitutes an artificial arrangement, set up to circumvent French tax legislation. This concept is similar to the 'abuse of law' concept, although it does not have all the same characteristics.

## *Tax credits and incentives*

### *R&D tax credit*
The R&D tax credit is determined on the basis of the eligible R&D expenses incurred during the calendar year.

Currently, the R&D credit equals 30% of the R&D eligible expenses incurred during the year, up to EUR 100 million in eligible R&D expenses, and 5% beyond this amount. In addition, eligible R&D expenses incurred by the company can be included in the basis for computation on the tax credit up to 100% of that amount.

Moreover, the 30% ‘standard’ rate is increased to 50% and 40% for the first and the second year, respectively, during which the company incurs eligible R&D expenses, or after the expiration of a period of five consecutive years during which the company did not benefit from the tax credit, provided, in both cases, that the concerned company is not affiliated with another company which benefited from the R&D tax credit within the same time period.



The tax code classifies eligible technical and scientific research operations in three areas: fundamental research, applied research, and experimental development.

The eligible expenditures include the following:

- Tax deductible depreciation expenses relating to fixed assets, created or acquired newly, assigned to eligible R&D works/projects, including patents acquired.
- Costs relating to staff qualifying as scientists and/or engineers (staff costs relating to ‘young graduate doctors’ are retained at up to 200% during the 24 months following their hiring by the company).
- Expenses resulting from outsourced R&D works/projects.
- Expenses incurred for patent registration and/or in connection with the defence of patents.
- Expenses relating to the monitoring of technical developments.
- Premiums paid in connection with insurance contracts relating to the legal defence of patents.

### *Inbound investment incentives*
No particular incentives are available to foreign investors in France. However, the government offers a comprehensive programme of tax incentives and development subsidies to encourage investment in underdeveloped areas.

Capital investment is encouraged through the declining-balance method of depreciation as well as through exceptional depreciation for certain capital expenditures.

## *Withholding taxes*

Payments to resident corporations and individuals are not subject to WHT.

Payments to non-resident corporations and individuals are subject to WHT, as shown below.

| | Dividend WHT (%) | | |
|---|---|---|---|
| **Column 1** | **Column 2** | **Column 3** | **Column 4** |
| **Country of residence** | **Individuals and non-parent companies** | **Parent companies** | **Shareholding required to be a parent** |
| Non-treaty: | 25 | 25 | – |
| Treaty: | | | |
| Algeria | 15 | 5 | 10 |

| | Dividend WHT (%) | | |
|---|---|---|---|
| **Column 1** | **Column 2** | **Column 3** | **Column 4** |
| **Country of residence** | **Individuals and non-parent companies** | **Parent companies** | **Shareholding required to be a parent** |
| Argentina | 15 | 15 | – |
| Armenia | 15 | 5 | 10 |
| Australia | 15 | 0 | 10 |
| Austria | 15 | 0 | 10 |
| Bahrain | 0 | 0 | – |
| Bangladesh | 15 | 10 | 10 |
| Belgium | 15 | 0 (1) | 10 |
| Benin | 25 | 25 | – |
| Bolivia | 15 | 15 | – |
| Botswana | 12 | 5 | 25 |
| Brazil | 15 | 15 (2) | – |
| Bulgaria | 15 | 5/0 (1) | 15/10 |
| Burkina Faso | 15 (25) | 25 (2) | – |
| Cameroon | 15 | 15 | – |
| Canada | 15 | 5 | 10 |
| Central African Republic | 15 | 5 | 10 |
| China | 25 | 25 | 0 |
| Comoro Islands | 15/25 | 15/25 | – |
| Congo, Rep. of | 25 | 15 | 10 |
| Croatia | 15 | 0 | 10 |
| Cyprus | 15 | 10/0 (1) | 10 |
| Czech Republic | 10 | 0 (1) | 10 |
| Denmark | 25/18 (48) | 0 (1) | – |
| Ecuador | 15 | 15 | – |
| Egypt | 0 | 0 | – |
| Estonia | 15 | 5/0 (1) | 10 |
| Finland | 15/0 | 5/0 (1) | 10 |
| Gabon | 15 | 15 | – |
| Georgia | 10 | 10/5/0 | 10/50 |
| Germany | 15 | 0 (3) | 10 |
| Ghana | 15 | 5 | 10 |
| Greece | 25/18 (48) | 25/0 (1) | 10 |
| Hungary | 15 | 5/0 (1) | 10 |
| Iceland | 15 | 5 | 10 |
| India | 10 | 10 | – |
| Indonesia | 15 | 10 | 25 |
| Iran | 20 | 15 | 25 |
| Ireland, Rep. of | 15 | 10/0 (1) | 50/10 |
| Israel | 15 | 5 | 10 |
| Italy | 15 | 5/15 or 0 (1) | 10 |
| Ivory Coast | 15 | 15 | – |
| Jamaica | 15 | 15 | 10 |

| | Dividend WHT (%) | | |
|---|---|---|---|
| Column 1 | Column 2 | Column 3 | Column 4 |
| Country of residence | Individuals and non-parent companies | Parent companies | Shareholding required to be a parent |
| Japan | 10 | 5 | 10 |
| Jordan | 15 | 5 | 10 |
| Kazakhstan | 15 | 5 | 10 |
| Korea, Rep. of | 15 | 10 | 10 |
| Kuwait | 0 | 0 | – |
| Latvia | 15 | 5/0 (1) | 10 |
| Lebanon | 0 | 0 | – |
| Lithuania | 15 | 5/0 (1) | 10 |
| Luxembourg | 15 | 5/0 (1) | 25/10 |
| Holding company (5) | 25 | 25 | – |
| Macedonia | 15 | 0 | 10 |
| Madagascar | 25 | 15 | 25 |
| Malawi | 25 | 25 | – |
| Malaysia | 15 | 5 | 10 |
| Mali | 15/25 | 25 (2) | – |
| Malta | 15 | 0 (1) | 10 |
| Mauritania | 25 | 25 | – |
| Mauritius | 15 | 5 | 10 |
| Mayotte | 15/25 | 25 (6,2) | – |
| Mexico | 15 | 5/0 | 10/5 |
| Monaco | 25 | 25 | 10 |
| Mongolia | 15 | 5 | 10 |
| Morocco | 15/0 | 15/0 (7) | – |
| Namibia | 15 | 5 | 10 |
| Netherlands | 15 | 5/0 (1) | 25/10 |
| New Caledonia | 15 | 5 (46) | – |
| New Zealand | 15 | 15 | – |
| Niger | 25 | – | – |
| Nigeria | 15 | 12,5 (46) | 10 |
| Norway | 15 | 0 | 10 |
| Oman | 0 | 0 | – |
| Pakistan | 15 | 10 | 10 |
| Philippines | 15 | 10 (46) | 10 (47) |
| Poland | 15 | 5 | 10 |
| Polynesia, French | 25 | 25 | 25 |
| Portugal | 15 | 5/0 (1) | 10 |
| Qatar | 0 | 0 | – |
| Romania | 10 | 0 (1) | 10 |
| Russia (10) | 15 | 15/10/5 (11) | – |
| Russian Federation | 15 | 5 | 10 |
| St. Pierre & Miquelon | 15 | 5 | – |
| Saudi Arabia | 0 | 0 | – |

| | Dividend WHT (%) | | |
|---|---|---|---|
| Column 1 | Column 2 | Column 3 | Column 4 |
| Country of residence | Individuals and non-parent companies | Parent companies | Shareholding required to be a parent |
| Senegal | 15 | 15 (5) | – |
| Singapore | 15 | 10 | 10 |
| Slovakia | 10 | 10/0 (1) | 20 |
| South Africa | 15 | 5 | 10 |
| Spain | 15 | 0 | 10 |
| Sri Lanka | 25 | 25 | – |
| Sweden | 15 | 15/0 (1) | 10 |
| Switzerland (12) | | | |
| A (13) | 15 | 0 (12) | 10 (12) |
| B (14) | 15 (12) | 15/0 (12) | 10 (12) |
| C (15) | 25 | 25 | – |
| Thailand | 25 | 15 | 25 |
| Togo | 15/25 | 25 (2) | – |
| Trinidad and Tobago | 15 | 10 | 10 |
| Tunisia | 25 | 25 | – |
| Turkey | 20 | 15 | – |
| Ukraine (17) | 15 | 5/0 | 10/50 |
| United Arab Emirates | 0 | 0 | – |
| United Kingdom | 15 | 5/0 (1) | 10 |
| United States | 15 | 5/0 | 10/80 |
| Uzbekistan | 10 | 5 | 10 |
| Venezuela | 15 | 5/0 | 10 |
| Vietnam | 15 | 5 | 10 |
| Zambia | 25 | 25 | 50 |
| Zimbabwe | 15 | 10 | 25 |

| | Interest WHT (%) | Royalties WHT (%) | Distributions WHT (%) |
|---|---|---|---|
| Column 1 | Column 5 | Column 6 | Column 7 |
| Country of residence | For instruments other than borrowings | | Automatically levied on after-tax profits of permanent establishments |
| Non-treaty: (18, 19, 20) | 0 (21) | 33.33 | 25 |
| Treaty: | | | |
| Algeria | 0 | 10/5 (44) | 0 |
| Argentina | 0 | 18 | 5 |
| Armenia | 0 | 10/5 (44) | 5 |
| Australia | 0 | 5 | 15 |
| Austria | 0 | 0 | 0 |
| Bahrain | 0 | 0 | 25 |
| Bangladesh | 0 | 10 | 15 |
| Belgium | 0 | 0 | 10/0 (28) |
| Benin | 0 | 0 | 25 (22) |

| | Interest WHT (%) | Royalties WHT (%) | Distributions WHT (%) |
|---|---|---|---|
| **Column 1** | **Column 5** | **Column 6** | **Column 7** |
| **Country of residence** | **For instruments other than borrowings** | | **Automatically levied on after-tax profits of permanent establishments** |
| Bolivia | 0 | 15 | 0 |
| Botswana | 0 | 10 | 5 |
| Brazil | 0 | 10/15/25 (23) | 15 |
| Bulgaria | 0 | 5/0 (49) | 5/0 (28) |
| Burkina Faso | 0 | 0 | 25 (22) |
| Cameroon | 0 | 15 (25) | 15 |
| Canada | 0 | 10 (25) | 5 |
| Quebec | 0 | 10 | 5 |
| Central African Republic | 0 | 0 | 25 (22) |
| China | 0 | 10/6 (26) | 0 |
| Comoro Islands | 0 | 33.33 | 25 (22) |
| Congo, Rep. of | 0 | 15 | 15 |
| Croatia | 0 | 0 | 0 |
| Cyprus | 0 | 0 (27, 49) | 10/0 (28) |
| Czech Republic | 0 | 0/5/10 (29, 45, 49) | 0 (28) |
| Denmark | 0 | 33.33/0 (49) | 25/0 (28) |
| Ecuador | 0 | 15 | 15 |
| Egypt | 0 | 15/10 (31) | 0 |
| Estonia | 0 | 5/10/0 (45, 49) | 0 |
| Finland | 0 | 0 | 15/0 (28) |
| Gabon | 0 | 10 | 0 |
| Georgia | 0 | 0 | 0 |
| Germany | 0 | 0 | 0 |
| Ghana | 0 | 10 | 0 |
| Greece | 0 | 5/0 (49) | 25/0 (28) |
| Hungary | 0 | 0 | 5/0 (28) |
| Iceland | 0 | 0 | 5 |
| India | 0 | 0 | 0 |
| Indonesia | 0 | 10 | 10 |
| Iran | 0 | 10 | 15 |
| Ireland, Rep. of | 0 | 0 | 25/0 (28) |
| Israel | 0 | 10/0 (27, 25) | 5/10 |
| Italy | 0 | 5/0 (29, 49) | 0 |
| Ivory Coast | 0 | 10/0 (32) | 0 |
| Jamaica | 0 | 10 | 10 |
| Japan | 0 | 0 | 0 |
| Jordan | 0 | 5/15/25 (23) | 5 |
| Kazakhstan | 0 | 10 | 5 |
| Korea, Rep. of | 0 | 10 | 5 |
| Kuwait | 0 | 0 | 25 |
| Latvia | 0 | 5/10/0 (45, 49) | 0 |

| | Interest WHT (%) | Royalties WHT (%) | Distributions WHT (%) |
|---|---|---|---|
| Column 1 | Column 5 | Column 6 | Column 7 |
| Country of residence | For instruments other than borrowings | | Automatically levied on after-tax profits of permanent establishments |
| Lebanon | 0 | 33.33 | 25 |
| Lithuania | 0 | 5/10/0 (45, 49) | 0 |
| Luxembourg | 0 | 0 | 5/0 (28) |
| Holding company (5) | 10 to 15 | 33.33 | 25 |
| Macedonia | 0 | 0 | 0 |
| Madagascar | 0 | 10/15 (34, 35) | 25 |
| Malawi | 0 | 0/33.33 (25) | 10 |
| Malaysia | 0 | 10 (35) | 15 |
| Mali | 0 | 0 | 25 (22) |
| Malta | 0 | 10/0 (29, 49) | 10/0 (28) |
| Mauritania | 0 | 0 | 25 (22) |
| Mauritius | 0 | 15/0 (29) | 15 |
| Mayotte | 0 | 0 | 25 (22) |
| Mexico | 0 | 10 (26, 29) | 0 |
| Monaco | 0 | 33.33 | 25 |
| Mongolia | 0 | 5 (29) | 0 |
| Morocco | 0 | 10/5 (36) | 0 |
| Namibia | 0 | 10 (29) | 0 |
| Netherlands | 0 | 0 | 0 |
| New Caledonia | 0 | 10 (29) | 10 |
| New Zealand | 0 | 10 | 15 |
| Niger | 0 | 0 | 25 (22) |
| Nigeria | 0 | 12.5 | 25 |
| Norway (5) | 0 | 0 | 0 |
| Oman | 0 | 0 | 25 |
| Pakistan | 0 | 10 | 0 |
| Philippines | 0/50/15 | 15 | 10 |
| Poland | 0 | 10/0 (29) | 25 |
| Polynesia, French | 0 | 33.33 | 25 (22) |
| Portugal | 0 | 5/0 (49) | 15/0 (28) |
| Qatar | 0 | 0 | 25 |
| Romania | 0 | 10/0 (49) | 10/0 (28) |
| Russia | 0 | 0 | 0 |
| Russian Federation | 0 | 0 | 25 |
| St. Pierre & Miquelon | 0 | 10 (29) | 10 |
| Saudi Arabia | 0 | 0 | 25 |
| Senegal | 0 | 0 | 0 |
| Singapore | 0 | 0/33.33 (37) | 15 |
| Slovakia | 0 | 5/0 (29) | 10 |
| South Africa | 0 | 0 | 0 |
| Spain | 0 | 5/0 (38, 49) | 0 |

| | Interest WHT (%) | Royalties WHT (%) | Distributions WHT (%) |
|---|---|---|---|
| Column 1 | Column 5 | Column 6 | Column 7 |
| Country of residence | For instruments other than borrowings | | Automatically levied on after-tax profits of permanent establishments |
| Sri Lanka | 0 | 10/0 (39) | 25 |
| Sweden | 0 | 0 | 0 (28,29) |
| Switzerland (12) | | | |
| A (13) | 0 | 5/0 (12, 40) | 0 (12) |
| B (14) | 0 | 5/0 (12, 40) | 0 (12) |
| C (15) | 0 | 33.33 | 0 (12) |
| Thailand | 0 | 5/15 (36) | 25 |
| Togo | 0 | 0 | 25 (22) |
| Trinidad and Tobago | 0 | 0/10 (26) | 10 |
| Tunisia | 0 | 5/15/20 (41) | 25 (22) |
| Turkey | 0 | 10 | 7.5 |
| Ukraine | 0 | 0/10 | 25 |
| United Arab Emirates | 0 | 0 | 0 |
| United Kingdom | 0 | 0 | 0 (28) |
| United States | 0 | 0 | 5 |
| Uzbekistan | 0 | 0 | 0 |
| Venezuela | 0 | 5 | 0 |
| Vietnam | 0 | 10 | 0 |
| Zambia | 0 | 0/33.33 (25) | 10 |
| Zimbabwe | 0 | 10 | 0 |

Explanation of columns

**Column 2:** Individuals and companies not qualifying as parents are subject to the WHT rates for dividends as indicated in this column.

**Columns 3 and 4:** Column 3 indicates the WHT rate for dividends paid to a foreign 'parent' company. To be considered as a parent company, the foreign company must hold a specified percentage of the French company's share capital or voting rights. These minimum percentages range from 0% to 50%, as indicated in Column 4, and certain other conditions must be met *(see each treaty)*. If no percentage is indicated, either no minimum shareholding is required, or the tax treaty does not reduce the WHT rate of 25%.

No WHT is levied on dividends paid to an EU parent company by a French company that is subject to CIT, provided all the following conditions are met:

- The EU parent company has held a minimum percentage of the share capital of the distributing company, directly and continuously, for at least two years. As of 1 January 2009, the participation required is 10%.
- The EU parent company is the effective beneficiary of the dividends.
- The EU parent company has its effective seat of management in an EU State and is not deemed to be domiciled outside the EU under an applicable tax treaty.

- The EU parent company is one of the legal forms enumerated by the relevant Directive.
- The EU parent company is subject to CIT in the member state where it has its effective seat of management.
- There is an anti-avoidance rule.

**Column 5:** The tax mechanism has been changed so as to exempt the interest from WHT in France except where the interest is paid to a financial institution established in a non-cooperative state or territory (WHT at a rate of 50% applicable). The payer can, however, be exempt if one proves that the main purpose and effect of such a payment is not to take advantage of locating the income in such a jurisdiction.

These provisions apply to income paid as of 1 March 2010. A special provision applies to loans entered into outside of France by French companies and some investments funds prior to this date. Interest paid on these loans and on related loans after 1 March 2010 will continue to be exempt.

**Column 6:** There is no requirement to withhold income tax on royalties paid to EU companies if all the following conditions are met:

- The taxpayer is a French resident company or a French PE of a company resident in another EU member state.
- The recipient of the income is an EU resident company.
- The taxpayer and the recipient are at least 25% associates, which means that either one holds directly 25% or more of the share capital or voting rights in the other, or a third party holds directly 25% or more of the capital or voting rights in them both.

**Column 7:** WHT is automatically imposed on after-tax profits of a PE unless certain conditions are met. The rate is 25% or the reduced tax treaty rate.

Notes

1. *See explanation of Columns 3 and 4.*
2. Exceptions where the dividends are excluded from the taxable income of the company which has received the dividends.
3. A rate of 15% is applicable for dividends distributed by certain companies.
4. The dividend WHT rate is eliminated if the recipient owns 15% or more in votes or value of the distributing corporation and is (a) a company regularly traded on either the Japanese or the French stock market, (b) a company more than 50% owned by the government of either country, (c) an individual or a quoted company resident in either country, or (d) any combination of (a), (b), and (c).
5. The 1929-type Luxembourg holding companies are not entitled to any of the benefits of the France-Luxembourg tax treaty.
6. A 25% rate applies if dividends are not included in the income taxed to either corporate or income tax.
7. No WHT applies if dividends are taxable in Morocco.
8. Full or partial exemption is applicable when specific conditions provided by the treaty are met.
9. These are taxed when attached to a PE in France.
10. The 26 November 1996 tax treaty came into force on 9 February 1999.
11. The 5% rate applies to dividends when three conditions are fulfilled, as follows: (1) the effective recipient of the dividends must have invested at least EUR 76,224.51 in the company that pays these dividends; (2) the recipient must be a company liable for corporate tax; and (3) the latter company must be exempt from corporate tax. The rate is 10% when only condition (1) or conditions (2 and 3) are fulfilled. In all other cases, the rate is 15%.
12. An addendum signed on 22 July 1997 modifies the provisions of the French-Swiss tax treaty relating to dividends, interest, and royalties, and provides for the removal of the 5% WHT on profits realised by French PE of Swiss resident companies.
13. The rate indicated applies to Swiss resident companies controlled by Swiss residents.
14. The rate indicated applies to Swiss resident companies that are controlled by non-Swiss residents (non-UE) (Article 11.2.b ii) and meet the conditions of Article 14 of the tax treaty. In the case of column 3, the 15% rate applies to these companies, provided both the recipient and the distributing company are not quoted on a stock exchange. If these conditions are not met, the tax exemption applies.

15. The rate indicated applies to Swiss resident companies controlled by non-Swiss residents but not complying with Article 14 of the tax treaty.
16. The 15% rate applies to dividends paid to an industrial company.
17. The 5% rate applies to gross dividends if the effective recipient is a Ukrainian company that holds directly or indirectly at least 10% of the French company's capital. The rate is 0% if the participation exceeds 50% and EUR 762,245. It is 15% in all other cases.
18. Non-treaty recipients of royalties and management fees are subject to a 33.33% withholding rate. Where a treaty exists, management fees are exempt from WHT unless they are included in the definition of royalties subject to WHT.
19. In France, the WHT is levied on a provisional basis at 25% of the net profit. This amount is reduced to the extent it exceeds the dividends actually paid by the company during the previous 12 months, and the amount of dividends paid to residents of France. Consequently, if the foreign head office undertakes not to distribute dividends in a given year, the after-tax profits of its French branch are not subject to WHT, even when they are transferred abroad.
20. WHT on interest on loans with a contract is 0%, while withholding on other interest is in a range from 15% to 50%. For treaty rates, consult the individual entry in the table.
21. The WHT rate can be 60% for certain securities if the investor's identity is not disclosed.
22. The WHT is levied on the following amount: French net profit divided by the total foreign company net profit, multiplied by the amount of the distribution.
23. The rate of 10% is applicable on royalties for the use of literary, artistic, or scientific works, including films, 25% on royalties for the use of trademarks, and 15% otherwise.
24. Exemption is granted only to recipients actually subject to income tax on the payment in their own country.
25. No WHT is applicable on a royalty arising from the use of or the right to use literary, artistic, or scientific works (excluding film).
26. WHT is reduced to 6% for royalties paid for the lease of industrial, commercial, or scientific equipment.
27. A rate of 5% (Cyprus) and 10% (Israel) is applicable on royalties paid for the use or the right of the use of films.
28. Profits realised in France by foreign corporations whose head offices are located in a European country are not subject to WHT if certain conditions concerning the foreign corporation are met (effective head office in a European country; foreign corporation subject to corporate taxation).
29. No WHT is applicable on a royalty arising from the use or the right to use literary, artistic, or scientific works.
30. The rate is reduced to 10% in certain circumstances (for equipment or bank loans) mentioned in the treaty, or nil in other circumstances.
31. The rate of 25% is applicable on royalties paid for the use of trademarks.
32. No WHT is levied on certain royalties paid in the field of audiovisual techniques.
33. The 5% rate is levied on royalties paid for the use of literary, artistic, and scientific works. The 25% rate is levied on royalties paid for the use of trademarks.
34. The rate of 15% is applicable on royalties paid for the use of industrial property and trademarks.
35. A rate of 33.33% is applicable on royalties paid for the use of or the right to use films.
36. The rate of 5% is applicable on royalties paid for the use of literary, artistic, or scientific works, excluding films.
37. The rate of 33.33% is applicable on royalties paid for the use of literary and artistic works, including films, and for information concerning commercial experience.
38. No WHT is levied on royalties paid for the use of or the right to use literary or artistic works, excluding films and recordings.
39. No WHT is levied on royalties paid for the use of or the right to use copyrights or films.
40. No WHT is levied on royalties paid for the use of or the right to use industrial, commercial, or scientific equipment.
41. The rate of 20% is applicable on royalties paid for the use of trademarks, 15% for the use of industrial property, and 5% for the use of literary, artistic, or scientific works.
42. Taxed in certain circumstances provided by the treaty.
43. No WHT is applicable on a royalty arising from the use of or the right to use literary, artistic, or scientific works, films, recordings, or computer software.
44. The rate of 5% is applicable on royalties for the use of literary, artistic, or scientific works, not including films.
45. The rate of 5% is applicable on royalties for the use or the right to use industrial, commercial, or scientific equipment.
46. The reduced rate is applicable if the beneficial owner is a company (other than a partnership).
47. Voting shares solely.
48. French domestic law decreases the WHT rate from 25% to 18% concerning individuals who are resident in another EU member state, in Iceland and in Norway.
49. *See explanation of Column 6.*

## Tax administration

### Payment of tax

Payment of tax is made during the fiscal year by way of four instalments totalling 33.33% of the taxable income of the preceding year.

Currently, for companies which have a gross income in excess of EUR 500 millions, the last down-payment is now assessed on the basis of the estimated taxable income of the present year (in case of significant increase of the taxable profits in comparison with the previous fiscal year). This modification leads to an anticipated payment of CIT.

### Late payment interest

For a reassessment after a tax audit, late-payment interest is currently 4.8% per year or 0.4% per month.

### The ruling system

To secure the tax status of a situation, foreign companies and individuals can request a private ruling from the French tax authorities as to whether their activities constitute a PE or fixed base.

The French tax authorities have to provide an answer within three months after the receipt of the request. In the absence of response from the French tax authorities within this period of time, the foreign company or individual will be deemed not to have a PE in France.

## Other issues

### Individual advanced pricing agreements (APAs)

APAs are available for taxpayers only on the basis of international agreements entered into in accordance with Article 25 of the OECD Model Tax Convention. Currently, taxpayers are allowed to enter into APAs with the French tax authorities on a unilateral basis. In practice, taxpayers are entitled to submit their transfer pricing policy to the French tax authorities. Agreement of the tax authorities to the APA precludes a later challenge.

# Gabon, Republic of

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## Significant developments

The Financial Act relating to fiscal year 2011 has been enacted, providing some exemptions of taxes applicable exclusively to authorised companies during the performance of a social housing investment project. *See the Tax credits and incentives section for more information.*

The Financial Act has also instituted a specific tax regime derogatory to the common law tax regime which is applicable, under conditions, to groups of companies. *See the Group taxation section for more information.*

## Taxes on corporate income

Corporate income tax (CIT) is assessed on profits minus deductible expenses and charges. Profits are composed of all operations carried out in Gabon by enterprises during the period of taxation, including notably fixed assets capital gains.

The CIT rate is fixed at 35%.

### Impôt Minimum Forfaitaire (IMF)

The IMF is a lower limit to the CIT and is calculated as 1% of the global turnover carried out during the fiscal-year of taxation. Note that the IMF cannot be less than 1 million CFA francs (BEAC) (XAF), even in the case of a negative turnover.

New companies are exempt from this minimum tax during the first two fiscal years of their existence.

## Corporate residence

Subject to the provisions of international tax treaties, non-resident companies carrying out operations in Gabon are subject to taxation in Gabon.

## Other taxes

### Value-added tax (VAT)

VAT is a cumulative tax levied on the sale of goods and the provision of services rendered or used in Gabon.

There are three rates of VAT:

- Standard rate: 18% (applies to all transactions unless otherwise provided for by the law).
- Reduced rate: 10% (applies to manufacturing operations and sales of products mentioned in a limitative list provided by Article 221 of the new Gabonese Tax Code, including mineral water, chicken, sugar, cement).
- Zero-rate: 0% (applies to exports and international transports).

### *Franchise tax*
The franchise tax is a fixed annual duty varying from XAF 10,000 to XAF 500,000, according to the size, nature, and location of the company. Each company that carries on a trade, business, or activity that is not expressly exempted is liable for franchise tax.

Activities that are expressly exempted from franchise tax are those carried out by companies of provident, craftsmen, teachers and professors, lyrical and dramatic artists, farmers, cattle-breeders, fishers, etc.

### *Tax on property*
Tax on buildings (Contributions Foncières des Propriétés Bâties or CFPB) is at the rate of 15% of the rental value of the building after deduction of 25% for deterioration and maintenance. Tax on non-built property is at the rate of 25% of the taxable revenue corresponding to 4% to 5% of the rental value or 10% of the purchase value.

### *Registration duties*
Registration duties in Gabon are fixed, proportional, or progressive, depending on the nature of the acts and transfers in question.

### *Stamp duty*
A stamp duty is levied on all paperwork relating to civil and judicial actions and to documents which could be produced in court as evidence.

All signatories for mutually binding contracts, lenders and borrowers for loans, and ministerial officials who receive or modify deeds announcing unstamped deeds or books are jointly responsible for the payment of stamp duties and fines.

### *Tax on insurance premiums*
Insurance or annuity agreements made with insurance companies or any other Gabonese or foreign insurer are subject to an annual obligatory tax.

The tax is levied on the sums charged by the insurer and on any accessory payments made to this party by the insured party according to the following rates:

| Nature of the policies | Rate (%) |
|---|---|
| Marine policies | 5 |
| Life policies | Exempt |
| Fire policies | 30 |
| Other (e.g. personal liability, transportation) | 8 |
| Reinsurance | Exempt |

### Social security contributions

Employers must contribute to the social security system (National Social Security Fund or CNSS).

The taxable basis for social security contributions is made up of gross salaries including indemnities having the function of a salary and any benefits in kind. However, there is an annual ceiling of XAF 18 million (or XAF 1.5 million per month).

The social security contributions are determined according to the following rates:

| Contribution | Rate (%) |
|---|---|
| Family allowances | 8 |
| Industrial accidents (work injuries) | 3 |
| Retirement pensions | 5 |
| Health evacuation funds | 0.6 |
| Medication distribution | 2 |
| Hospitalisations | 1.5 |
| Total | 20.1 |



## Branch income

Taxation of branch income is the same as for corporate income. However, a 10% withholding tax (WHT) on profit is due at the time the profit is taken by the head office of the branch located abroad.

### Simplified tax regime for oil subcontractors

There is a simplified tax regime specific to the oil sector which is a lump-sum tax regime granted for a triennial period. The rates for the 2009, 2010, and 2011 fiscal years is 8.68%, corresponding to CIT (5.6%) and personal income tax for expatriate employees (3.08%).

Features of this specific regime are as follows:

- The option for this regime is irrevocable.
- The option is granted by the Director of the General Tax Office to foreign companies.
- The subcontractor must have signed, with an oil company, a temporary agreement for the provisions of services to this company.
- The option is no longer granted to companies that have been in Gabon for more than nine years. The duration of nine years is calculated from the year during which the company started its activities in Gabon.
- The subcontractor must constitute a Gabonese branch office.

### Specific regime for regional offices (quartiers généraux)

A regional office is a company or a branch that renders various administrative services such as management or accounting exclusively to other companies of the same group based in a given geographical area (usually a group of countries).

Taxation is based on the expenses of the regional office. A rate, between 5% and 12%, is applied to operating expenditures to determine the tax basis. The CIT rate is then applied to that basis.

# Gabon, Republic of

## Income determination

### Capital gains
Capital gains arising from the transfer of assets must be used for the calculation of taxable profits. However, the tax on capital gains can be deferred if a company reinvests an amount equal to the capital gain and the sale price of the transferred asset back into its fixed assets within three years.

### Inter-company dividends
Inter-company dividends are taxed at a reduced rate in full discharge of the 10% WHT if paid and received by or from companies with their registered office in a Central African Economic and Monetary Community (CEMAC) country, shares were allotted at the time of issue or kept for two years, and the Gabonese company owns more than 25% of the share capital of the subsidiary.

### Foreign income
Foreign interest, royalties, and dividends are included in taxable income, subject to international tax treaties. Note that tax treaties provide that certain/all types of income are not includable in Gabon taxable income. Gabon has tax treaties with France, Belgium, the other countries of CEMAC, and the African and Malagasy Common Organisation (OCAM).

## Deductions

### Depreciation
The straight-line method and an accelerated depreciation method are permitted in Gabon. Tax and book conformity is obligatory (i.e. annual depreciation must be booked to preserve tax deductibility).

The main depreciation rates provided by the Gabonese tax code are the following:

| Asset | Rate (%) |
|---|---|
| Buildings | 8 |
| Machinery, equipment | 8 to 20 |
| Office furniture | 15 |
| Office equipment | 20 |
| Vehicles | 20 to 33.3 |
| Computing equipment | 25 to 33.3 |

### Other significant items
- To be tax deductible, provisions must relate to existing liability or loss. General provisions are not deductible.
- Fines and third-party taxes borne by companies are not tax deductible.

### Net operating losses
The Gabonese Tax Code does not provide the possibility to carry back losses. It does, however, provide for a three-year carryforward for net operating losses.

Regarding depreciation deferred in the accounts, they can be carried forward indefinitely.

### *Payments to foreign affiliates*
Management fees paid to a foreign parent company are deductible if they meet all of the following conditions:

- They reflect real transactions.
- They do not present an abnormal characteristic.
- They are not exaggerated.

Management fees determined in a lump sum basis are not deductible.

Interests paid to shareholders are deductible only within the limit of the Central Bank's (BEAC) normal rate for advances plus two percentage points, on the condition that the registered capital is entirely paid. The portion exceeding the ceiling is not deductible and is thus subject to taxation.



## *Group taxation*

### *Specific group tax regime*
The Financial Act of 2011 has instituted a specific tax regime derogatory to the common law tax regime which is applicable, under conditions, to groups of companies.

According to the provisions of Article 11 b. of the Law No. 44/2010, groups of companies are those which are organised around a head of the group of companies having its head office located in Gabon and having the control of companies located in Gabon and/or abroad.

To be eligible for this specific tax regime, and without any prejudice of other activities performed to the profit of third parties, the head of the group of companies must perform to the profit of other companies of the group an activity relating exclusively to the following fields:

- Provisions of services of any kind notably technical, accounting, financial, administrative, data processing, legal, human resources, and commercial corresponding to functions of management, coordination, and control of the group's companies.
- Research and development to the sole profit of the group.
- Management of the finance intra-group.

Each company subject to CIT which is a member of the group and fulfils the conditions provided by the law will be subject to a separate taxation of its results according to the rules of common law and subject to amendments expressly provided by the law for the determination of the taxable result.

The express amendments provided in the scope of the specific tax regime applicable to groups of companies are the following:

#### Capital gains
Net capital gains are taxed at a reduced rate of 20% when they are realised in the scope of intra-group operations.

#### Expenses deductible from the taxable result subject to CIT
The following expenses are deductible within the group:

- Head office fees and management fees determined in a lump sum basis, according to the conditions of allocation of the expense between the companies members of the group defined in a previous ruling with the Tax Authorities.
- The whole of the interests on partners' current accounts (i.e. on the sums put, by the partners, at the disposal of a company of the group) within the sole limit of the intervention rate on invitation to tender (TIAO) of the Bank of the Central African States (equivalent to 4%) raised by 2%.
- Rentings of movables carried out within the group by the mother company or between companies of the same group.

**10% WHT**

Sums subject to CIT according to the provisions of Article 206 of the Gabonese Tax Code paid by a Gabonese debtor member of a group of companies to a foreign company member of the same group are exempted from the 10% WHT even though no double tax treaty (DTT) aiming to avoid double taxation has been concluded between Gabon and the country of residence of the beneficiary of the remunerations.

### Transferable securities income tax (IRCM)

Companies of the group which benefit from transferable securities income originating from Gabon are exempted from IRCM when the said revenues are paid by a company member of the group.

In return, payments carried out by the head of the group of companies to the profit of its partners (individuals or legal entities) are subject to IRCM at a unique and at source rate of 10% (instead of 20% for individuals and 15% for legal entities).

It is to be noted that the transferable securities incomes having their source abroad and which gave rise to taxation in their country of origin give the right in Gabon to a tax credit of the amount of the taxation which is deductible from the CIT of the fiscal year of perception of the incomes. The aforesaid tax credit applies even though no DTT aiming to avoid double taxation has been concluded between Gabon and the country of origin of the incomes.

**VAT**

The head of the group of companies is liable for VAT.

Members of a group of companies could, however, on option, consider the following provisions of services performed within the group as being out of the scope of application of VAT.

- Provisions of services of any kind, notably technical, accounting, financial, administrative, data processing, legal, human resources, and commercial.
- Fees relating to studies.
- Putting at disposal of personal.
- Management of finance.

The option for the subjection of the abovementioned operations must be formulated by the concerned taxpayers on express request addressed to the General Tax Manager.

### Registration duties

Deeds relating to incorporation, increase or reduction of share capital, breaking up with or without clearance, merger, scission, partial contribution of assets, and transfer of shares of a company member of a tax group, are subject to a fixed duty of XAF 20,000.

In the absence of a more favourable duty provided by the common law of registration, the changes of ownership and use which are not provided at Article 6 of the Gabonese Tax Code are subject to a proportional rate of 1% when carried out by members of the same tax group.

**Business licence tax**
The head of the group of companies is exempted from the payment of the business licence tax.

**Requirements relating to declaratory obligations**
The adherence to the group tax regime must be notified in writing by the head of the group of companies to the General Tax Manager accompanied by the list of the companies included in the tax perimeter of the group.



Each company remains liable for the periodical returns applicable to its activity.

For the purpose of calculation and verification of the returns, each tax return relating to the CIT of each company of the group will be gathered and filed at the same time by the head of the group of companies before the Tax Office.

### *Transfer pricing*
The Gabonese Tax Code provides rules regarding transfer pricing issues.

According to these rules, any payment considered to be a result of mismanagement will be subject to the CIT rate at 35% plus penalties.

Indeed, Article 12 of the Code provides that “By virtue of law or in fact, for companies which are dependent of companies or groups of companies located outside the CEMAC area, or for those which possess the control of companies located outside the CEMAC area, payments or expenses realized by any mean whatsoever, comparable to abnormal act of management, constitute transfer of profits subject to corporate income tax.”

It is applicable for the following:

- Payments constituting increase or decrease of purchases or sales.
- Payments of excessive royalties or royalties without compensation.
- Relinquishment of revenues (underestimated sale price, free of charge service provision, granting of a free loan or a loan with low interests).

The abnormal act of management is not limited to expenses; it also includes any form of advantages or allowances granted to third parties without any equivalent compensation for the company.

Article 13 of the Gabonese Tax Code provides that “The advantages or assistance granted by companies belonging to the same group can only be considered as resulting from a normal management if the company which grants these advantages or assistance demonstrates the existence of its own interest in acting as such. The general interest of the group is not sufficient to justify such practices.”

## Tax credits and incentives

### Foreign tax credits
DTTs include provisions relating to the attribution of foreign tax credits. Such tax credits aim to limit the double taxation of profits that are subject to taxation in both Member States of the treaty.

### Tax credits for job creation
There is a mechanism in place for granting corporate tax credits for any salaried appointments of Gabonese personnel.

This tax credit is equal to 20% of the gross salary paid to new employees and is subject to the creation of a minimum number of jobs, according to the size of the company as follows:

- Two jobs, for companies with less than 20 employees.
- Three jobs, for companies with 20 to 50 employees.
- Five jobs, for companies with more than 50 employees.

Note: The tax credit is granted only on newly created jobs since the preceding fiscal year. Contracts concluded with the employees must also be for an undetermined duration, and the new jobs must not result from the diminution of existing jobs.

### Inbound investment incentives
Due to the provisions of the Investments Law, any private investment in Gabon can benefit from:

- A common law framework.
- Privileged frameworks.
- Specifically agreed frameworks.

Depending on the frameworks it is eligible for, a company can benefit from customs privileges and tax breaks.

Industrial companies already set up in Gabon and wishing to increase their production capacity can be admitted to a preferential tariff framework. This entails the application of a global reduced rate of 5% for duties and taxes paid on imports of equipment (excluding materials, furniture, and spare parts) provided that these correspond to an investment schedule and their value is in excess of XAF 100 million.

New industrial companies can also benefit from this framework, if they are not subject to any of the other privileged frameworks outlined by current legislation.

The granting of this privileged tariff framework occurs on the basis of a decision by the Minister of Finances, following a proposal from the Director of Customs and Indirect Taxes.

### Capital investment incentive
New companies are exempt from the IMF, the minimum taxation of CIT, during the first two years of operations.

### Social housing incentive
The Financial Act of 2011 provides some exemptions of taxes applicable exclusively to authorised companies during the performance of a social housing investment project.

The concerned companies are those authorized for the planning of urban lands intended for social habitat and the building of housings of a socioeconomic nature and industrial units of manufacturing of materials and other inputs used for the performance of section relating to the building of social housings. The abovementioned tax exemptions relate to CIT, VAT, and business licence tax.

## *Withholding taxes*

### *10% WHT*

When they are paid by a debtor established in Gabon to individuals or companies subject to corporate income tax or personal income tax that do not have a permanent professional base in Gabon, the following amounts are subject to a 10% WHT:



- All amounts paid pursuant to the practice of an 'independent profession' in Gabon.
- Payments received by inventors, payments relating to copyrights, and all payments relating to intellectual and commercial property as well as assimilated rights.
- All amounts paid for services materially rendered or effectively used in Gabon.
- Interest, arrears, and all others fixed-income investment-products, pertaining to income declared as professional revenue of the beneficiary.

Net profits carried out by branches of foreign companies having their head offices abroad are also subject to a 10% WHT in Gabon before they are taken into account by the foreign companies.

### *Transferable securities income tax (IRCM) at rate 15%*

The IRCM is due on revenues from stocks and shares paid to legal entities. It is due by beneficiaries of these revenues and must be withheld by the distributing company.

## *Tax administration*

### *Returns*

Returns for the previous calendar year are to be filed before 30 April of each year. Companies are required by law to have a 31 December closing of any fiscal year.

### *Payment of tax*

Tax is payable to the General Tax Office in two instalments on 30 November and 30 January. The balance of the tax due tax must be paid by 30 April. The first instalment must equal one-quarter of the tax assessed in the previous year and the second instalment must equal one-third of this tax.

## *Other issues*

### *Legal reserve*

According to the provisions of the OHADA Uniform Act relating to commercial companies and economic interest groups, one tenth of the year's profits, reduced, if applicable, by any previous losses, must be put into a reserve account named 'Legal Reserve'.

The endowment of this reserve ceases to be obligatory when its value reaches one fifth (20%) of the company share capital.

# Georgia

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## Significant developments

To attract foreign investment, the Georgian government has reduced withholding tax (WHT) rates on passive income as follows:

- The WHT rate on dividends paid to non-residents is 5%. The rate will be reduced to 3% on 1 January 2013 and to 0% on 1 January 2014.
- The WHT rate on interest paid to non-residents is 5%. The rate will be reduced to 0% on 1 January 2014.

### Transfer pricing

The tax code introduces transfer pricing rules. The rules are broadly based on the Organisation for Economic Co-operation and Development (OECD) arm's-length principle, adopted in tax treaties and by most countries when they implement domestic transfer pricing rules *(see Transfer pricing in the Group taxation section for more information)*.

The Ministry of Finance of Georgia is in the process of preparation of guidance on the application of the transfer pricing rules.

### Thin capitalisation

With the introduction of the tax code, thin capitalisation rules became effective on 1 January 2011. Interest expense may be disallowed if a company's debt-to-equity ratio exceeds 3:1. The thin capitalisation rules will not apply to financial institutions, entities that have gross income of less than 200,000 Georgian lari (GEL), and entities with interest expense that is less than 20% of their taxable income before deducting such interest expense.

## Taxes on corporate income

Corporate income tax (CIT) in Georgia is applied to taxable profit at a rate of 15%. Taxable profit is defined as gross income minus deductible expenses.

Resident enterprises are subject to CIT on worldwide income.

Non-resident enterprises carrying out economic activities in Georgia through a permanent establishment (PE) are subject to CIT with respect to gross income earned from Georgian sources, which can be reduced by deductions attributable to such income.

Non-resident enterprises earning income from Georgian sources, other than through a PE, are subject to WHT *(see the Withholding taxes section for more information)*.

## Corporate residence

A resident enterprise is any legal entity that is established under the laws of Georgia or has its place of effective management in Georgia.

The domestic definition for a PE essentially adopts the definition for PE found in the OECD Model Tax Convention.

Local legislation provides the definition for economic activity to be any activity undertaken with the intent to gain profit, income, or compensation, regardless of the results of such activity, unless otherwise provided by the tax code.



## Other taxes

### Value-added tax (VAT)

The standard VAT rate is 18% and applies to the sale of all goods and services supplied in Georgia. Goods are considered to be supplied in Georgia if they are transferred in or their shipment originates in Georgia. Services generally are considered to be supplied in Georgia if they are performed in Georgia. However, special rules apply for services relating to immovable property and certain services provided to non-residents.

The export of goods is exempt from VAT with the right to credit input tax (formerly referred to as zero-rated). VAT-exempt supplies include financial services, goods and services required for oil and gas operations, and medical services.

Reverse-charge VAT applies to services provided to Georgian taxpayers by a non-resident entity.

A VAT payer is a person who is registered or required to be registered as a VAT payer. Any person whose annual taxable turnover exceeds GEL 100,000 in any continuous period up to 12 months or who produces or imports excisable goods must register as a VAT payer. In addition, an enterprise that expects to perform one-off taxable transaction of more than GEL 100,000 must also register as a VAT payer before effecting the transaction.

### Property tax

Property tax is payable at the rate of 1% on the annual average residual value of fixed assets (except for land) on the balance sheet as well as on leased out property of Georgian entities or foreign entities with taxable property in Georgia. For property acquired before 2005, the average residual value must be multiplied by a coefficient of between 1.5 and 3, depending on the acquisition date.

### Land tax

The annual land tax rate for agricultural land varies according to the administrative unit and the land quality.

The base tax rate per 1 hectare of agricultural land varies from GEL 1.50 to GEL 100. The tax is further adjusted by a territorial coefficient of up to 150%, depending on the location.

The base tax rate payable on non-agricultural land is GEL 0.24 per square metre, which is further adjusted by a territorial coefficient not exceeding 150%.

### Excise tax

Excise tax is levied on specified goods that are produced in Georgia or imported into Georgia. Excise tax generally is calculated with reference to the quantity of goods (e.g. volume, weight), or in the case of automobiles, on the basis of the engine's displacement and vehicle age. Excise tax rate varies from GEL 0.4 to 400 for one unit.

Excise tax applies to the following goods:

- Alcoholic drinks (i.e. GEL 5 per litre of whiskey).
- Condensed natural gas, except for pipeline.
- Oil distillates.
- Goods produced from crude oil.
- Tobacco products.
- Automobiles.
- Ferrous and non-ferrous metal scrap (i.e. GEL 160 per ton).

The export of excisable goods is taxed at a rate of 0%.

## Branch income

Branch income is taxed at the general rate of 15%. There is no tax on branch profit remittances.

## Income determination

Taxable profit is determined as the difference between the gross income of a taxpayer and the relevant deductions granted under the Georgian tax code.

### Inventory valuation

A taxpayer is required to record the value of goods produced or acquired as the outlays (except for depreciation charges) or the purchase price in tax accounting. Furthermore, the taxpayer shall include the storage and transportation expenses into the value of such goods.

A taxpayer is entitled to record the cost of inventory using the individual accounting method, the average weighted cost method, or first in first out (FIFO).

### Capital gains

The Georgian tax code does not define any separate tax for capital gains. Capital gains are taxable as normal business income at the general CIT rate.

### Dividend income

Dividends received by local legal entities (except for the sole enterprises and entrepreneur partnership) are not subject to taxation at the source and shall not be included in gross income.

Dividends received by non-resident enterprises from resident enterprises are subject to WHT at source *(see the Withholding taxes section for more information)*.

### Interest income

Resident legal entities and PEs of non-residents that received interest income that was taxed as source in Georgia are entitled to a credit tax paid to the State budget.

Interest income received from a licensed financial institution is not subject to WHT at source, and it should not be included in the gross income of a recipient unless the recipient is another licensed financial institution.

### *Partnership income*
In case of joint ownership (co-ownership) arrangement that involves ownership by more than one person but without establishment of a legal person, the taxable income shall be attributed to the owners pro rata shares and included in their gross income.

Regardless of whether the partnership distributes the profit by the end of the tax year or not, the shareholders are obliged to include the receivable income in gross income in the year when the partnership reported profit.



### *Rent/royalty income*
Rent and royalty income received by resident companies and/or PEs of non-resident enterprises should be included in the gross income of the enterprise and taxed at the CIT rate of 15%.

### *Foreign income*
Resident legal entities are subject to CIT on their worldwide income. Foreign income is subject to CIT at 15%.

## *Deductions*

Expenses connected with the receipt of income generally are deductible from income, provided sufficient primary documentation is available.

The following expenses are not deductible:

- Expenses not related to the generation of income (such as tax fines and penalties).
- Expenses related to the receipt of income exempted from CIT.

The deduction of certain expenses is subject to limitations, including:

- Representation expenses up to 1% of gross income.
- Charitable donations up to 10% of taxable profit.
- Repair expenses up to 5% of the book value of the relevant asset at the end of the year. Any excess must be capitalised and deducted through depreciation.

### *Interest paid on loans*
Interest paid on loans is deductible within the limits established by the Finance Minister. The annual deductible interest rate limitation established by the Minister of Finance of Georgia for the year 2011 is 24%.

### *Bad debts*
A taxpayer is entitled to deduct bad debts only if all of the following conditions are met:

- The bad debt is related to the taxpayer's goods or services sold.
- Income received from the sale of goods or services was previously included in taxable gross income.
- The bad debt has been written off and recorded as such in the taxpayer's accounting records.

### Depreciation
The declining balance method of depreciation applies to fixed assets for tax purposes. The maximum rate of depreciation is 20% for most fixed assets, though buildings and construction are subject to depreciation at the rate of 5% (please contact us for additional information regarding other groups and rates).

A taxpayer is entitled to fully deduct costs of fixed assets (excluding those contributed to capital) in the year when the fixed assets are put into operation (a form of capital allowance). In case the taxpayer employs the right of full deduction in this manner, this method may not be changed for five years.

### Net operation losses
Losses may be carried forward for five years but may not be carried back.

A taxpayer may elect to extend the carryforward period to ten years. However, this also results in the statute of limitations period being extended from six to 11 years.

International financial companies, free warehouse enterprises, and international enterprises are not entitled to carryforward losses.

An international financial company is a financial institution, which on behalf of the application of plenipotentiary representative, gets state registered, is granted as ‘international financial company’, and is given a status confirming certificate. These are resident companies that, after application, were granted the status of international financial company.

An international enterprise is an enterprise operating in the free industrial zone, which, for the purposes of tax exemption, is granted the status of international enterprise.

## Group taxation

Georgian law does not provide for taxation of groups.

### Transfer pricing
The transfer pricing rules introduced in the tax code are broadly based on the Organisation for Economic Co-operation and Development (OECD) arm’s-length principle, adopted in tax treaties and by most countries when they implement domestic transfer pricing rules.

The law recognises the five OECD transfer pricing methods for evaluating whether prices are arm’s length:

- Comparable uncontrolled price method.
- Resale price method.
- Cost plus method.
- Net profit margin method.
- Profit split method.

The tax code stipulates that in accordance with the Ministry of Finance instructions, the tax authority may recalculate the taxes if they can prove that the prices applied by related parties of transactions differ from the market prices.

The following general penalties, determined by tax legislation, apply for non-compliance with the arm's-length principle or failing to prepare or submit transfer pricing documentation:

- An understated tax liability (e.g. VAT, CIT) is subject to a penalty of 50% or 75% of the understated tax.
- Late payment of taxes is subject to interest at a rate of 0.07% per day.
- Failing to submit a required document is generally subject to a penalty of GEL 400 (approximately USD 220).

The Ministry of Finance of Georgia is in the process of preparation of guidance on the application of the transfer pricing rules.



### *Thin capitalisation*

With the introduction of the tax code, thin capitalisation rules became effective on 1 January 2011. Interest expense may be disallowed if a company's debt-to-equity ratio exceeds 3:1. The thin capitalisation rules will not apply to financial institutions, entities that have gross income of less than GEL 200,000, and entities with interest expense that is less than 20% of their taxable income before deducting such interest expense.

## *Tax credits and incentives*

The following are exempt from profit tax (the list is not exhaustive):

- Income of budgetary, international, and charitable organisations (including grants, membership fees, and donations), except for the profit from commercial activity.
- Profit received from financial services conducted by international financial companies.
- Gains on sales of securities issued by international financial companies.
- Income received from re-exporting goods from an independent warehouse via a free warehouse enterprise.

### *Free industrial zone (FIZ)*

The following rules apply for enterprises located in a FIZ:

- Income received by an international enterprise from its permitted activities conducted in a FIZ is exempt from income tax.
- The importation of foreign goods into a FIZ is free of customs duties and VAT-exempt.
- Operations carried out in FIZ are VAT-exempt.
- Property located in FIZ is exempt from property tax.
- The personal income tax of employees is paid by those individuals through self-reporting.

### *Foreign tax credit*

Income tax or profit tax paid on income earned from outside Georgia may be credited against CIT payable in Georgia. The amount of credited taxes may not exceed the Georgian tax payable on the foreign income.

## Withholding taxes

Non-resident enterprises earning income from Georgian sources, other than through a PE, are subject to WHT at the following rates:

| Income | WHT (%) |
|---|---|
| Dividends (reducing to 3% on 1 January 2013) | 5 |
| Royalties | 15 |
| Interest (reducing to 0% on 1 January 2014) | 5 |
| Oil & gas subcontractor income | 4 |
| International transportation/communication | 10 |
| Income from services rendered in Georgia | 15 |
| Other Georgian source income | 15 |
| Insurance and re-insurance | 0 |

## Tax administration

The tax departments under the Ministry of Finance are responsible for tax administrative matters in Georgia.

### Returns

The tax year is the calendar year in Georgia. A CIT return should be submitted and any taxes paid before 1 April of the year following the reporting period.

### Payments

CIT is paid in advance in four equal instalments on a quarterly basis before the 15th day of the month following the end of the previous quarter. The advance instalments are estimated according to the previous year's annual tax. A taxpayer with no prior-year CIT obligation is not required to make advance payments. Excess CIT payments may be offset against other tax liabilities.

# Germany

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## Significant developments



A new coalition government took office in the last quarter of 2009. It caused parliament to enact a number of specific measures for 2010, mainly in reaction to the worldwide financial crisis, but otherwise has announced that for the next four years priority is to be given to a return to financial and budgetary stability, rather than to any major reform of the tax system. In particular, there will be no tax cuts before 2013.

The main corporate tax measures enacted were:

- The suspension of the curtailment of loss relief provisions to enable corporate recovery of troubled businesses in 2008 and 2009 has been extended indefinitely. However, since then, the European Commission has decided that this suspension in favour of all troubled businesses is to be viewed as unauthorised state aid. Germany is contesting this view. The same loss curtailment provisions were repealed for reorganisations solely within groups and otherwise to the extent the loss carryforward is covered by hidden reserves in German assets other than shareholdings.
- The interest limitation threshold of EUR 3 million for 2008 and 2009 has been prolonged indefinitely. Unutilised taxable EBITDA (earnings before interest, tax, depreciation, and amortisation) above this threshold may now be carried forward.
- The deemed implicit interest charge in property rentals was reduced from 65% to 50% of the rent paid. The amount of rental disallowed for trade tax thus falls from 16.25% of the total to 12.5%.

The Accounting Modernisation Act, an accounting reform, was enacted in 2009, intended as a simpler alternative for unquoted companies to full International Financial Reporting Standards (IFRS) statements. From the tax point of view, the most radical change is the abolishment of the strict requirement for conformity between book and tax reporting. This has been replaced by a provision allowing a company to exercise all options permitted under the tax acts in its own tax interest without regard to the accounting treatment for the item in question. As a consequence, full deferred tax accounting is now mandatory. The Accounting Modernisation Act must be applied to accounting years ending in 2010. Application of this act was permitted but not required for 2009. IFRS statements remain mandatory for the published group accounts of quoted companies, whilst the Accounting Modernisation Act statements are the basis for the tax returns of all companies.

## Taxes on corporate income

Germany taxes its corporate residents on their worldwide income. However, most double tax treaties (DTTs) exempt income attributable to a foreign permanent establishment (PE). Non-residents with PE or property income are taxed by assessment on German-source income; those earning royalties and dividends are taxed by withholding at source. Interest paid abroad is, in most cases, free of German tax altogether.

German business profits are subject to two taxes, corporation tax and trade tax.

### *Corporation tax (Körperschaftsteuer)*
Corporation tax is levied at a uniform rate of 15% and is then subject to a surcharge of 5.5% (solidarity levy).

### *Trade tax (Gewerbesteuer)*
The effective rate of trade tax varies by location from a minimum of 7%, which is the legal minimum and applies in a few small villages in depressed areas, to the Munich rate of 17.1%. The local rates in most cities range between 14% and 16%, whilst those in small towns can be as low as 12%. The basis for this tax is the adjusted accounting profit: in particular, 25% of all financing costs over EUR 100,000, including the implicit financing costs in leasing, rental, and royalty payments, are added back to taxable income.

If the basis for the two taxes is identical (unlikely in practice), the overall burden on corporate profits earned in Munich would be 33%. In Frankfurt, the burden would be 31.9%. In Berlin, the burden would be 30.2%.

## *Corporate residence*

A corporation is resident in Germany for tax purposes if either its place of incorporation or its main place of management is in Germany. A corporation meeting neither of these criteria will be regarded as non-resident with tax obligations limited to its income from German sources. These include active business activities through a PE or the letting of property, as well as investment income, royalties, and equipment rental (leasing). Income of the first two categories is generally taxed by assessment on the actual net earnings. That of the last three is usually taxed at source by withholding from the gross amount payable. Interest paid abroad is generally tax-free. However, interest on convertible or profit-sharing bonds is taxed as a dividend; interest on a German property or ship mortgage is seen as property or shipping income respectively.

## *Other taxes*

### *Value-added tax (VAT)*
Proceeds of sales and services effected in Germany are subject to VAT under the common system of the EU at the standard rate of 19% (7% on certain items, such as food and books). The taxpayer generally is entitled to deduct the VAT charged on inputs from that payable on outputs.

VAT is administered by the tax office responsible for the corporation tax assessment of a company. It is based on returns filed monthly or quarterly by the tenth of the following month (monthly where the output tax in the previous year was more than 7,500 euros (EUR)) drawn up on the basis of the actual transactions during the filing period as shown in the books of account. A permanent filing extension of one month is available against an advance payment of one-eleventh of the total net tax due during the previous year. Otherwise, payment is due when the return is filed.

Legally, VAT is an annual tax. Each taxpayer must file an annual return for each calendar year, regardless of the actual accounting date for the business. The VAT return is filed together with the corporation and trade tax returns. If the annual return does not agree with the total of the monthly or quarterly returns, the tax office can be expected to ask for a detailed explanation and to penalise any irregularity.

### *Excise taxes*

Excise taxes on fuel, electric power, insurance, and some other products are not a compliance issue for businesses other than dealers in bonded goods and insurance companies, although they can be a significant additional cost factor for business users. These excise taxes also have an environmental element in as much as the rates are set to discourage excessive use of pollutants. However, an air passenger duty is the only tax on pollution as such. Energy producers (such as power stations) can claim a refund of the excise tax borne in the cost of the energy products used in the production process.



### *Social security contributions*

All employers are required to account for social security contributions on wages and salaries paid, up to set monthly limits. There are four separate types of insurance: for old-age pensions, unemployment benefits, health care, and invalidity care. Employees regularly earning more than EUR 4,125 per month can opt out of the health and invalidity insurances provided they take out appropriate coverage with a private insurance company. The pension and unemployment insurances are compulsory for all employees. The upper monthly salary limits are EUR 5,500 (EUR 4,800 in the eastern part of Germany) for the pension and unemployment insurances and EUR 3,712.50 for the health and invalidity insurances. The rates are as follows:

- Pension insurance: 19.9%, of which the employee's share is one half.
- Unemployment insurance: 3.0%, of which the employee's share is one half.
- Health insurance: 15.5%, of which the employee's share is 8.2%.
- Invalidity insurance: 1.95%, of which the employee's share is one half.

### *Stamp taxes*

The only significant German stamp tax is the real estate transfer tax of 3.5% of the consideration on all conveyances of German property.

This tax is also levied on indirect transfers from the acquisition of at least 95% of the shares in property owning companies. This applies to shares in the shareholder throughout the corporate chain. If the transfer is indirect, and therefore without its own specific consideration, the basis for the tax is 12.5 times the annual rentable value. This value is derived from rents actually achieved over the past three years or estimated from statistics maintained by the local authority.

The tax is not levied on direct or indirect transfers without consideration in the course of a corporate reorganisation under the laws of a member state of the European Economic Area (EEA), provided at least 95% of the ultimate interest in the property remains unchanged for five years before and after the transaction.

Real estate transfer tax is currently under attack before the Constitutional Court.

### *Property taxes*

There are no taxes on wealth or capital employed. There is a minor local authority tax on property, but the effect of this is largely offset by an additional trade tax deduction.

### *Customs duties*
Customs duties are levied under a common system on imports into the European Union. The rate is set at zero on most imports from EU candidate countries and on many imports from countries with which the European Union has an association agreement.

For manufactured products from other countries, the rates generally lie within the range of 0-10%. The basis is the import value of the goods and thus includes uplifts for royalty or other payments associated with their use but not apparent from the transit documents.

The European Commission also sets 'countervailing' duties from time to time on specific imports from specific countries in order to counter dumping attempts. The countervailing duty rate is set to fully absorb the dumping margin and is therefore usually much higher than 10%.

## *Branch income*

Both corporation tax and trade tax are imposed on the taxable income of a foreign company's German branch. The rates are the same for branches as for resident German companies, although the withholding tax (WHT) on dividend distributions by German companies is not deducted from profits transferred by a German branch to its foreign head office.

## *Income determination*

Strict conformity between book and tax reporting is no longer required. Rather, a company must draw up its financial statements according to the dictates of fair presentation, but may exercise all valuation and other options in the tax acts in its own best tax interest without regard to the accounting treatment for the item concerned. It must keep a register of all variances between the financial statements and the tax computation showing the basis on which each arose and its reversal. IFRS financial statements are not accepted as a basis for computing taxable income.

### *Inventory valuation*
Inventories normally are valued at the lower of actual cost, replacement cost, and net realisable value. However, any write-downs below actual cost must be for specific reasons. If specific identification of the inventories is not possible, valuation at either standard or average cost is acceptable. The last in first out (LIFO) method is accepted as an option. First in first out (FIFO) is not accepted unless its assumption accords with the facts, although this condition is often fulfilled in practice.

### *Long-term liabilities and accruals*
Non-interest bearing long-term liabilities, other than advance payments received, must be discounted at 5.5% per year. A similar provision applies to refurbishment (to restore an asset to its original condition) and other accruals which accumulate over time.

### *Capital gains*
Generally, capital gains realised by a corporate entity from a disposal of business assets are treated as ordinary income. It is possible to postpone the taxation of part or all of the gain on real estate by offsetting the gain against the cost of a replacement property.

Capital gains from the sale of investments in other companies are exempt from corporation and trade taxes. Corresponding losses are not deductible. However, 5% of the capital gains are added back to taxable income as non-deductible directly related expenses.

### *Dividend income*

Dividends received are exempt from corporation and trade taxes, regardless of the level of shareholding and the length of time it has been held. However, portfolio dividends are subject to trade tax. 5% of the tax-free gross dividend is added back to taxable income as non-deductible business expenses.

Note that banks do not enjoy this exemption on dividends from securities held for trading.



### *Stock dividends*

In principle, a declaration of stock dividends (by converting reserves to capital stock) by a company will not lead to taxable income for the shareholder or to other tax effects. Subsequent capital reductions, however, will be treated as cash dividends in most circumstances. There is no German tax reason for distributing a stock dividend as opposed to merely leaving accumulated profits on the books to be carried forward. The decision, therefore, depends upon the situation in the investor's home country.

### *Foreign income*

Foreign income, except dividends, received by a German corporation from foreign sources is included in taxable income for corporation tax unless a tax treaty provides for an exemption. Foreign PE income, in most cases, is exempt from corporation and trade taxes, while double taxation on most items of passive income (e.g. interest and royalties) is avoided by foreign tax credit or, at the taxpayer's option, by a deduction of the foreign taxes as an expense.

Irrespective of any tax treaty, income from a foreign branch or partnership is not charged to trade tax.

A Foreign Tax Act sets anti-avoidance (including Controlled Foreign Company [CFC]) rules with respect to subsidiaries in certain lines of business subject to a low-tax regime. A low-tax regime is one in which the rate applicable to the income in question is less than 25%. Most forms of passive income fall under the CFC rules, which essentially attribute the income to the German shareholder as though it had been earned directly. Active business income is not generally caught where the business operates from properly established facilities.

Investment income held in an EU/EEA subsidiary (except Liechtenstein) is also exempt from attribution, provided the subsidiary is commercially active in its country of operation and maintains at least a minimum establishment.

Other provisions give the tax office the right to insist on full disclosure of all the facts and circumstances surrounding a transaction as a condition for the deduction of a business expense incurred within an essentially tax-free environment for the supplier. This rule operates independently of ownership or shareholding considerations.

## Deductions

### Depreciation and amortisation

Depreciation on movable fixed assets is calculated on the straight-line method over the asset's anticipated useful life. The declining-balance method is not available for assets acquired in 2008, although it may be continued for assets acquired through 31 December 2007. The option was reintroduced for movable fixed assets capitalised in 2009 and 2010 at a maximum of two and a half times the straight-line rate, but in no case to exceed 25%. Depreciation takes the residual value of the asset into account, only if it is material, with any gains on a sale being treated as normal business income.

Buildings are depreciated on a variety of straight-line or reducing rate systems designed to reach a full write-down between 25 and 50 years, depending on the age of the building and on whether the taxpayer was its first owner.

In addition to normal depreciation, special depreciation is deductible for tax purposes in certain limited circumstances (e.g. small businesses, ancient monuments, buildings in designated renovated city zones).

Intangibles are amortised straight-line over their estimated useful lives with goodwill amortised over 15 years.

### Interest limitation

Annual net interest expense (the excess of interest paid over that received) is only deductible up to 30% of EBITDA (earnings before interest, tax, depreciation, and amortisation) for corporation and trade tax purposes. The 30% limitation applies to all interest, whether the debt is granted by a shareholder, related party, or a third party.

This limitation does not apply where the total net interest expense for the year is less than EUR 3 million or where the net amount paid to any one shareholder of more than 25% (or a related party) is no more than 10% of the total. If the company is part of a group, this latter concession is dependent on the demonstration that the equity to gross assets ratio of the company is no more than two percentage points below that of the group as a whole. Unused EBITDA potential may be carried forward for up to five years to cover future excess interest cost. This carryforward is otherwise subject to the same principles as the loss carryforward, including the curtailment of the carryforward on change of shareholder(s).

It is emphasised that the interest limitation is additional to, and not a substitute for, the transfer pricing requirement that related party finance be at arm's length.

### Taxes

All taxes borne are deductible except for corporation tax, trade tax, and VAT on non-deductible expenses. Late payment interest and similar charges are also not deductible.

### Net operating losses (NOLs)

NOLs are carried forward without time limit. For corporation tax (but not trade tax), there is an optional carryback to the previous year of up to EUR 511,500.

The loss relief brought forward claimable in any one year is limited to EUR 1 million plus 60% of current income exceeding that amount. The remaining 40% of income over EUR 1 million is charged to trade and corporation taxes at current rates. This is referred to as 'minimum taxation'.

The loss carryforward ceases if a single (immediate or ultimate) shareholder acquires more than 50% of the issued capital (voting rights) within a five year period. An acquisition of between 25% and 50% leads to a corresponding reduction in the loss carryforward.

Under the statute, these forfeiture rules do not apply to share acquisitions in connection with the recovery of a troubled business, where the change is part of a group internal reorganisation without effect on the single ultimate shareholder, or inasmuch as the loss carryforward is covered by hidden reserves in the company's assets that, on realisation, will lead to German taxation. This excludes the appreciation in value of shareholdings in other companies as well as business assets held in foreign PEs. However, the European Commission has recently decided to view the exemption from the forfeiture rules for share acquisitions within the context of a corporate recovery bid as unlawful state aid. Application of the provision has been suspended since April 2010; the government has announced that it intends to contest the Commission's finding.



### *Payments to foreign affiliates*
A German corporation can claim a deduction for royalties, management service fees, and, subject to the interest limitation, interest charges paid to foreign affiliates, provided the amounts are at arm's length. Detailed provisions covering both form and substance define this. In particular, all services must be covered by prior written agreement, and it is also necessary to conclude agreements for the purchase and sale of goods in writing where this would be usual between third parties (e.g. for quantity rebates on sales). The substance tests must be satisfied, both as to value for money and as to business relevance. Thus, the manager of a German subsidiary must be able to show both an adequate business benefit from a related party transaction and that the company could not have obtained a better deal on the open market. These and all other aspects of inter-company (related-party) trading fall under strict and extensive documentation requirements, breach of which can lead to serious penalties.

### *Special features for trade tax*
There are a number of differences between the income subject to trade tax and to corporation tax.

The most significant is the trade tax disallowance of one-quarter of the interest costs, including interest included implicitly in leasing, rental, and royalty charges. Banks have an exemption from this interest disallowance.

## *Group taxation*

If a German parent holds more than 50% of the voting rights in a domestic subsidiary, the two may conclude a formal, five-year, court registered profit pooling agreement. The ensuing relationship is then referred to as an Organschaft. Effectively, the annual results of an Organschaft are pooled in the accounts and tax returns of the parent. Profits and losses within a group can therefore be offset, but there is no provision for the elimination of intra-group profits from the total tax base.

### *Transfer pricing*
Extensive rules on transfer pricing in respect of all transactions with foreign related parties are in force. The basic principle is that all trading should be at arm's length, but the documentation requirements go far beyond the level of documentation normally found sufficient to demonstrate a conscientious approach to true third party business. Failure to meet these rules exposes the company to serious risk of penalties as well

as unfavourable estimates by the authorities with the right to exercise every possible leeway or margin to the taxpayer's disadvantage.

### Thin capitalisation

There are no thin capitalisation rules as such; their substitute is the 'interest limitation' to, basically, 30% of EBITDA discussed in the *Deductions section.*

### Controlled foreign company (CFC) regime

Germany operates a CFC regime aimed at passive income sheltered abroad and taxed at less than 25%. Essentially, the income is added to that taxable in Germany in the regular manner against a credit for the foreign tax actually paid and not recoverable by either the foreign entity or its shareholder. Active business income, except from tourism and the arms trade, is generally exempt from the CFC net, provided it is earned through a properly established facility of a scale appropriate to the activity concerned and treaty (or EU directive) rules exempting foreign income from German taxation are respected. However, taxpayers will have to demonstrate their treaty entitlement.

## Tax credits and incentives

Germany does not offer tax incentives except in very limited circumstances, not usually of direct business relevance (e.g. special depreciation for buildings under a conservation order). Partly, this is a question of the state budget, and partly, it reflects the constitutional requirement for equal treatment of all taxpayers.

### Other incentives

Investment grants of 7.5% or 15% are available on capital investment in new manufacturing facilities or hotels in the eastern part of Germany. The system is to be phased out by 2013.

Local authorities may offer facilities on favourable terms, such as the provision of cheap land on industrial estates.

### Foreign tax credit

If foreign source income is not exempt from German taxation, a credit will be given for the foreign tax actually paid and not otherwise recoverable. However, the credit is limited to the corporation tax (including the solidarity levy) on the net income after deducting the related expense. Unused credit is lost, as there are no provisions for carryforward or for offset against other taxes, such as trade tax. There are still a few cases of fictitious foreign tax credits under tax treaties with developing countries (to protect the treaty partner's investment incentives), but German treaty policy is to seek to abandon such provisions at the first opportunity.

## Withholding taxes

Resident corporations paying certain types of income are required to withhold tax as shown in the following tables. There is also a solidarity levy of 5.5% on the tax due.

### General

| Recipient of German-source income | Dividends (%) (1) | Interest (%) (1, 2, 3) | Royalties (%) | Movable asset rentals (%) (4) |
|---|---|---|---|---|
| Resident corporations and individuals | 25 | 25 | 0 | 0 |

| Recipient of German-source income | Dividends (%) (1) | Interest (%) (1, 2, 3) | Royalties (%) | Movable asset rentals (%) (4) |
|---|---|---|---|---|
| Non-resident corporations and individuals (1): | | | | |
| EU corporations (5, 6) | 0 | 0 | 0 | 0 |
| Non-treaty corporations | 25 | 25 | 15 | 15 |
| Non-treaty individuals | 25 | 25 | 15 | varies |

Notes

1. Corporate recipients of dividend and interest income (interest on convertible and profit-sharing bonds) can apply for refund of the tax withheld over the corporation tax rate of 15% regardless of any further relief available under a treaty.
2. Generally, only interest paid by banks to a resident is subject to a WHT. A 25% tax is also withheld from income on convertible or profit-sharing bonds.
3. Interest paid to non-residents other than on convertible or profit-sharing bonds is generally free of WHT. Tax on loans secured on German property is not imposed by withholding, but by assessment to corporation tax at 15% (plus solidarity levy) of the interest income net of attributable expenses. The tax authorities can order a WHT of 15.825% (including solidarity levy) if ultimate collection of the tax due is in doubt. Both forms of tax are reduced by treaty relief.
4. Movable asset rentals are taxed by assessment rather than by withholding. For corporations, the rate is the standard 15% corporation tax rate (plus solidarity levy) unless reduced by treaty.
5. Where the European Commission (EC) Parent/Subsidiary Directive applies, dividends paid by a German company to a qualifying parent company resident in another EU member state are exempted from German WHT. The minimum shareholding is 10%, to be held continuously for at least one year.
6. The EC Interest and Royalties Directive exempts payments from WHT if made to an associated company in another EU member state. The association must be through a common shareholding of at least 10%, to be held continuously for at least one year.

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## *Treaty rates*

| Recipient of German-source income | Dividends (%) (1) | Interest (%) (1, 2, 3) | Royalties (%) | Movable asset rentals (%) (4) |
|---|---|---|---|---|
| Albania (30) | 5/15 | 5 | 5 | 0 |
| Algeria | 5/15 | 10 | 10 | 0 |
| Argentina (5) | 15 | 10/15 | 15 | 15 |
| Armenia (5, 6) | 15 | 5 | 0 | 0 |
| Australia (5) | 15 | 25 | 10 | 10 |
| Austria (5) | 5/15 | 0 | 0 | 0 |
| Azerbaijan (7) | 5/15 | 0/10 | 5/10 | 0 |
| Bangladesh (5) | 15 | 25 | 10 | 10 |
| Belarus (7) | 5/15 | 0/5 | 3/5 | 5 |
| Belgium (5,8) | 15 | 0/25 | 0 | 0 |
| Bolivia (5) | 10 | 25 | 15 | 15 |
| Bosnia-Herzegovina (5, 9) | 15 | 25 | 10 | 10 |
| Bulgaria (5) | 5/15 | 5 | 5 | 5 |
| Canada (10) | 5/15 | 0/10 | 0/10 | 10 |
| China, P.R. (5) | 10 | 25 | 10 | 7 |
| Croatia (5) | 5/15 | 25 | 0 | 0 |
| Cyprus (11) | 10/15 | 10 | 0/5 | 0 |
| Czech Republic (12) | 5/15 | 0 | 5 | 5 |
| Denmark (5) | 5/15 | 25 | 0 | 0 |
| Ecuador | 15 | 10/15 | 15 | 15 |
| Egypt (5, 13) | 15 | 25 | 15 | 15 |
| Estonia (5) | 5/15 | 25 | 10 | 5 |

| Recipient of German-source income | Dividends (%) (1) | Interest (%) (1, 2, 3) | Royalties (%) | Movable asset rentals (%) (4) |
|---|---|---|---|---|
| Finland (14) | 10/15 | 0 | 0/5 | 5 |
| France | 5/15 | 0 | 0 | 0 |
| Georgia (5) | 0/5/10 | 25 | 0 | 0 |
| Ghana (5) | 5/15 | 25 | 8 | 0 |
| Greece | 25 | 10 | 0 | 0 |
| Hungary | 5/15 | 0 | 0 | 0 |
| Iceland | 5/15 | 0 | 0 | 0 |
| India (5) | 10 | 10 | 10 | 10 |
| Indonesia (5, 29) | 10/15 | 25 | 10/15 | 10 |
| Iran | 15/20 | 15 | 10 | 10 |
| Ireland, Rep. of | 10 | 0 | 0 | 0 |
| Israel (28) | 25 | 15 | 0/5 | 5 |
| Italy (5, 18) | 15 | 25 | 0/5 | 5 |
| Ivory Coast (5) | 15 | 25 | 10 | 10 |
| Jamaica (24) | 10/15 | 10/12.5 | 10 | 10 |
| Japan | 15 | 10 | 10 | 10 |
| Kazakhstan (5) | 5/15 | 25 | 10 | 10 |
| Kenya | 15 | 15 | 15 | 15 |
| Korea, Rep. of (5) | 5/15 | 25 | 10 | 2 |
| Kuwait (5) | 5/15 | 25 | 10 | 10 |
| Kyrgyzstan (5) | 5/15 | 25 | 10 | 0 |
| Latvia (5) | 5/15 | 25 | 10 | 5 |
| Liberia (15) | 10/15 | 10/ 20 | 10/15 | 10 |
| Lithuania (5) | 5/15 | 25 | 10 | 5 |
| Luxembourg | 10/15 | 0 | 5 | 5 |
| Macedonia (5) | 5/15 | 5 | 5 | 0 |
| Malaysia | 5/15 | 10 | 7 | 7 |
| Malta (5) | 5/15 | 25 | 0 | 0 |
| Mauritius (5, 17) | 5/15 | 0/25 | 15 | 15 |
| Mexico (5) | 5/15 | 25 | 10 | 10 |
| Moldova (5, 6) | 15 | 25 | 0 | 0 |
| Mongolia (5) | 5/10 | 25 | 10 | 10 |
| Morocco | 5 | 10 | 10 | 10 |
| Namibia (5) | 10/15 | 25 | 10 | 10 |
| Netherlands (19) | 10/15 | 0 | 0 | 0 |
| New Zealand (5) | 15 | 25 | 10 | 10 |
| Norway (5) | 0/15 | 25 | 0 | 0 |
| Pakistan (5) | 10/15 | 5 | 10 | 10 |
| Philippines (5, 20) | 10/15 | 25 | 10/15 | 10 |
| Poland (5) | 5/15 | 25 | 5 | 5 |
| Portugal (5) | 15 | 25 | 10 | 10 |
| Romania (5) | 5/15 | 25 | 3 | 0 |
| Russia (5) | 5/15 | 25 | 0 | 0 |
| Serbia (5, 9) | 15 | 25 | 10 | 10 |
| Singapore (5) | 5/15 | 25 | 8 | 8 |

| Recipient of German-source income | Dividends (%) (1) | Interest (%) (1, 2, 3) | Royalties (%) | Movable asset rentals (%) (4) |
|---|---|---|---|---|
| Slovakia (12) | 5/15 | 0 | 5 | 5 |
| Slovenia (5) | 5/15 | 25 | 5 | 0 |
| South Africa (21) | 7.5/15 | 10 | 0 | 0 |
| Spain | 10/15 | 10 | 5 | 5 |
| Sri Lanka (5) | 15 | 25 | 10 | 10 |
| Sweden (5) | 0/15 | 25 | 0 | 0 |
| Switzerland (5) | 0/15 | 25 | 0 | 0 |
| Syria | 5/10 | 10 | 12 | 0 |
| Tajikistan (5) | 5/15 | 25 | 5 | 0 |
| Thailand (22, 24) | 15/20 | 0/10/25 | 5/15 | 0 |
| Trinidad and Tobago (23, 24) | 10/20 | 10/15 | 0/10 | 10 |
| Tunisia (25) | 10/15 | 10 | 10/15 | 0 |
| Turkey (31) | ? | ? | ? | ? |
| Turkmenistan (5, 6) | 15 | 25 | 0 | 0 |
| Ukraine (5, 22) | 5/10 | 25 | 0/5 | 0 |
| USSR (5, 6) | 15 | 0 | 0 | 0 |
| United Arab Emirates (26) | 5/10 | 0 | 10 | 10 |
| United Kingdom (21) | 5/10/15 | 0 | 0 | 0 |
| United States (5, 27) | 0/5/15 | 25 | 0 | 0 |
| Uruguay (5, 30) | 5/15 | 10 | 10 | 0 |
| Uzbekistan (5, 22) | 5/15 | 25 | 3/5 | 0 |
| Venezuela (5) | 5/15 | 25 | 5 | 5 |
| Vietnam (5) | 5/10/15 | 25 | 10 | 10 |
| Yugoslavia (5, 9) | 15 | 25 | 10 | 10 |
| Zambia | 5/15 | 10 | 10 | 10 |
| Zimbabwe (5) | 10/20 | 25 | 7.5 | 7.5 |

Notes

1. Corporate recipients of dividend and interest income (interest on convertible and profit-sharing bonds) can apply for refund of the tax withheld over the corporation tax rate of 15% regardless of any further relief available under a treaty.
2. Generally, only interest paid by banks to a resident is subject to a WHT. A 25% tax is also withheld from income on convertible or profit-sharing bonds.
3. Interest paid to non-residents other than on convertible or profit-sharing bonds is generally free of WHT. Tax on loans secured on German property is not imposed by withholding, but by assessment to corporation tax at 15% (plus solidarity levy) of the interest income net of attributable expenses. The tax authorities can order a WHT of 15.825% (including solidarity levy) if ultimate collection of the tax due is in doubt. Both forms of tax are reduced by treaty relief.
4. Movable asset rentals are taxed by assessment rather than by withholding. For corporations, the rate is the standard 15% corporation tax rate (plus solidarity levy) unless reduced by treaty.
5. The treaty does not (effectively) limit the taxation of profit-based interest income; thus, the domestic rate (plus solidarity levy) applies.
6. The USSR treaty continues in force with Armenia, Moldova, and Turkmenistan.
7. The lower royalty rate applies to commercial and industrial royalties, as opposed to cultural royalties.
8. Mortgage interest to a Belgian business is exempt unless the recipient holds at least 25% of the voting rights in the payer.
9. The Yugoslav treaty continues in force with Bosnia-Herzegovina and Serbia. Croatia, Macedonia, and Slovenia have their own treaties. There is no treaty with Kosovo or Montenegro.
10. The higher royalty rate applies to film and TV royalties, licenses to use trademarks and names, and to franchises.
11. The 5% royalty rate applies to films and TV.
12. The Czechoslovak treaty continues to apply to the Czech Republic and to Slovakia. Interest on profit-sharing bonds is taxed as a dividend.
13. The tax on trademark royalties is also subject to the solidarity levy.

14. The higher royalty rate of 5% applies to commercial, industrial, and scientific royalties.
15. There is no treaty relief for copyright or trademark royalties, except for those on films and TV.
16. There is no treaty relief for copyright royalties, except for those on films and TV.
17. Interest to banks is exempt. Otherwise, tax is levied at the domestic rate (including solidarity levy) without treaty relief.
18. Cultural royalties are exempt.
19. Interest on convertible and profit-sharing bonds is taxed as a dividend; mortgage interest is exempt.
20. The 15% royalty rate applies to copyrights.
21. Treaty relief on interest, royalties, and rentals is conditional on taxation in country of receipt.
22. The 5% royalty rate applies to copyrights.
23. Royalties for copyrights, except for films and TV, are exempt.
24. The 10% interest rate applies in certain circumstances where the recipient is a bank.
25. The 15% royalty rate applies to patents, trademarks, films, and TV.
26. The treaty with the UAE has not yet been ratified, but is to have retroactive effect to 1 January 2009.
27. The dividend exemption applies to corporate shareholders with at least 80% throughout the previous 12 months.
28. The 5% royalty rate applies to industrial, commercial, film, and TV royalties.
29. The 10% royalty rate applies to access to industrial, commercial, or scientific experience.
30. The treaty with Uruguay is not yet in force. Effective from the 1 January following ratification.
31. The former treaty with Turkey expired on 31 December 2010. A new treaty has been initialled, but not yet signed or published. If ratified, it will enter into force with retroactive effect from 1 January 2011.

## Tax administration

### Returns

Returns are filed for each calendar year and reflect the financial statements for the business year ending in that calendar year. Assessments are issued once the tax office has reviewed the return.

In principle, returns are due by May 31 of the following year. However, there is a virtually automatic extension to December 31 for those filing with professional assistance. A further extension to February 28/29 is possible, if justified under the circumstances. Known late-filers and those with a record of other irregularities can be asked to submit their returns before these extension dates, though not before May 31.

### Electronic returns

Monthly or quarterly returns for WHT from employee salaries, dividends, interest, royalties, and other payments, and for VAT must be submitted electronically. Electronic filing of the annual returns for trade tax and VAT is encouraged, but is not yet required. For corporation tax, electronic filing is not yet available, though it will be required in 2012 for 2011 returns. This electronic filing requirement will also include the financial statements supporting the return.

### Payment of tax

Taxes are payable in quarterly instalments during the year, with a final settlement when the assessment is issued. The quarterly instalments are based on the estimated ultimate liability. Usually, this is the total tax due shown by the last assessment issued, as adjusted by any rate changes. The corporation tax instalments are due on the tenth day of March, June, September, and December. For trade tax, the due dates are the 15th day of February, May, August, and November. Failure to pay by the due date followed by a three day grace period leads to a penalty of 1% per month.

Corporation and trade tax assessments bear interest on the net amount payable after deduction of all credits and previous payments. The rate is 0.5% per month simple interest, and the period runs from 1 April of the second year following the year of assessment. The interest period is independent of the actual date of assessment. It thus runs in retrospect on assessments issued later, for example following a tax audit.

### *Rulings*
Tax offices are able to issue binding rulings in respect of planned transactions, provided the taxpayer can show a particular interest in the tax consequences of the intended action. The fee varies between EUR 121 and EUR 91,456, depending upon the amount of tax involved.

### *Advance pricing agreements (APA)*
A taxpayer can request the Central Tax Office to negotiate an APA on related-party transactions with a foreign tax authority on one’s behalf. The vehicle is the mutual agreement procedure under the treaty, and the fee is a lump sum EUR 20,000 for each new agreement.

# Ghana

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## Significant developments

The Government of Ghana in 2010 established the Ghana Revenue Authority (GRA) to replace the then Internal Revenue Service (IRS), the Customs Excise and Preventive Service (CEPS), and the Value Added Tax Service (VATS) for the administration of taxes in Ghana. The GRA is regulated by the Ghana Revenue Act 2009 (Act 791).

The introduction of the GRA Act has amended some sections (especially the tax administration sections) of the laws guiding the former revenue agencies (i.e. IRS, CEPS, and VATS). The GRA has the following divisions:

- Domestic Tax Revenue Division (formerly IRS, VATS).
- Customs Division (formerly CEPS).
- Support Services Divisions.
- Any other Division determined by Parliament.

Under the current GRA, there is only one Commissioner - General (C-G) responsible for the day to day administration of the Authority. The C-G would be assisted by the various Commissioners and staff of the Divisions of the GRA.

It is expected that having all three revenue agencies under the same body would reduce the administrative burden of taxpayers having to deal with the various revenue agencies at different locations/offices.

The principal legislation governing income taxes in Ghana is the Internal Revenue Act, 2000 (Act 592), with amendments in 2002, 2003, 2004, 2005, 2006, 2007, 2008, and 2010.

Other tax enactments are also contained in the Internal Revenue Regulations, 2001 (legislative instrument or L.I. 1675), 2002 (L.I. 1698), 2003 (L.I. 1727), 2004 (L.I. 1803), 2005 (L.I. 1811), 2006 (L.I. 1820), (L.I 1831) 2007, (L.I 1834) 2007, (L.I. 1959) 2009, (L.I. 1963) 2009, and (L.I. 1965) 2010.

Following the enactment of the GRA Act, the following laws/legislations were repealed:

- The Revenue Agencies (Governing) Board Act, 1998 (Act 558).
- The Internal Revenue Service Act, 1986 (PNDCL 143).
- The Revenue Agencies (Retention of Part of Revenue) Act 2002 (Act 628).

## Taxes on corporate income

National income tax is payable on the following:

- Income accruing in, derived from, brought into, or received in Ghana in respect of gains or profits from a trade, business, profession, or vocation.
- Dividends, interest, or discounts.
- Any charge or annuity.
- Royalties, premiums, and any other profits arising from property, including rents.
- Receipts, including royalties and deferred payments of any kind.

The corporate tax rate is 22% (this rate is applicable for three years for companies listed after 1 January 2004) for companies listed on the Ghana Stock Exchange (GSE), and 25% for companies that are not listed. The rate for companies engaged in non-traditional export and rural banking is 8% after ten years (due to a special exemption); bank lenders to the agricultural and leasing sectors pay 20% corporate tax; and companies in the hotel industry pay 25%.



## Corporate residence

Corporate residence is determined by the place where the trade, business, profession, or vocation is carried on. Hence, where a non-resident corporate body carries on any trade, business, profession, or vocation in Ghana (part of the operations of which may be carried on outside Ghana), the full gains or profits of the trade, business, profession, or vocation are deemed to be derived from Ghana.

If the corporate body's activities are carried on entirely outside Ghana, the mere supply of goods or services to Ghana does not constitute carrying on trade or business in Ghana.

## Other taxes

### Value-added tax (VAT)

Most economic sectors which formerly attracted a 15% service tax (e.g. service, entertainment; betting; hotel accommodation and food; food served in restaurants and snack bars; and advertisements), are now subject to VAT at a rate of 12.5% and a national health insurance levy (NHIL) of 2.5%. Most professional services are also subject to the same VAT and NHIL rates, including the following:

- Management services.
- Insurance brokerage and other services.
- Financial, tax, and economic consulting.
- Engineering and technical services.
- Accounting services.
- Courier services.
- Legal services.
- Provision of satellite television.
- Architectural services.
- Mobile cellular phone services.
- Services rendered by surveyors.

Exports of goods and services are zero-rated. Unless specifically exempt, supplies of all goods and services are subject to VAT.

There is a VAT Flat Rate Scheme (VFRS) under which businesses which meet the following thresholds are expected to pay 3% of their annual turnover as VAT without recourse to input VAT.

All businesses with an annual turnover between 10,000 Ghana cedi (GHS) and GHS 90,000 are now obliged to operate the VFRS charging a rate of 3%. All businesses whose annual turnover exceeds the GHS 90,000 threshold are obliged to charge and account for VAT at 15%. Businesses whose designation has changed due to the amendment are to convert to the appropriate system which they now qualify for.

Other amendments to the VAT system in Ghana are as follows:

- The following items which were previously zero-rated have now been classified as exempt goods:
  - Locally produced pharmaceuticals (list of essential drugs will be published).
  - Locally produced text and exercise books.
  - Locally manufactured agricultural machinery and other agricultural implements and tools.
- Transportation which was defined as an exempt supply has been narrowed to exclude haulage and vehicle hiring, making them liable to VAT.

### *Customs and excise duties*
Customs and excise duties are imposed on the importation of goods at the port of entry and certain manufactured goods produced or imported into Ghana. Some significant changes made to excise duties include a 2.5% reduction in *ad valorem* excise duty rates on all excisable goods, except spirits and cigarettes, and a revocation of the concessionary duty rate for the inputs of the tourism industry.

In addition to these, the government recently imposed a 20% environmental excise duty on polythene bags and other plastic packaging materials covered under the harmonized system and customs tariff schedules, effective as of 1 February 2011. The tax excludes the plastic packaging materials for water and mineral water.

### *National Fiscal Stabilisation Levy (NFSL)*
Originally set at a rate of 5% for two years from 2009 to 2010, the NFSL was recently extended until the end of 2011. NFSL is chargeable on the profit before tax of businesses and is applicable only to banks (excluding rural and community banks), non-bank financial institutions, insurance companies, communications companies, mining companies, and breweries.

### *Communications service tax (CST)*
CST is levied on charges payable by consumers for the use of Communication Services provided by Communications Class 1 licencees as defined in the National Communications Authority act. This essentially covered national fixed and mobile cellular network operators and Internet Service Providers (ISPs). Per recent amendments, CST has been extended to cover:

- Public/corporate data operators.
- Providers of radio (FM) broadcasting services.
- Providers of free-to-air and pay-per-view television service.

### Gift tax
A Gift tax is a tax payable by a person who receives a taxable gift. Gifts that are subject to tax have been defined in the Internal Revenue Act 2000 (Act 592) as amended. The gift tax rate was increased from 5% to 15% in the 2011 budget. However, the annual exemption for gifts valued up to GHS 50 remains unchanged.

### Airport taxes
Ghana also has Airport taxes which were revised to take retrospective effect from 1 January 2011 as follows:

| Description | Old rates | New rates |
|---|---|---|
| Domestic travel | GHS 1 | GHS 5 |
| International travel: within West Africa | USD 50 | USD 60 |
| International travel: outside West Africa (economy class) | USD 75 | USD 100 |
| International travel: outside West Africa (business class) | USD 75 | USD 150 |
| International travel: outside West Africa (first class) | USD 75 | USD 200 |

### Other taxes
Apart from these, there are property taxes and business rates, which are nominal amounts.



## Branch income

The rates on branch profits are the same as on corporate profits. However, the profits for the period deemed to arise in connection with the operations of the branch may, at the discretion of the tax authorities, be computed by reference to the total consolidated profits of the entire group, taking into account the proportion that the turnover of that branch bears to the total consolidated turnover of the group. When repatriating branch profits, the amount to be repatriated is subject to an additional tax of 10%.

## Income determination

### Inventory valuation
There is no statutory guidance on the principles of stock (inventory) valuation for income tax purposes. Any method of valuation of stock and work-in-progress based on sound accounting principles is acceptable, provided it is adopted and consistently applied from one period to another. In practice, inventory is normally valued for tax purposes at the lower of cost and net realisable value.

### Capital gains
A capital gains tax (CGT) is payable by every person, including a corporate body, on any capital gain accruing or derived from the realisation of any chargeable asset. These chargeable assets include buildings of a permanent or temporary nature; business and business assets, including goodwill; land other than agricultural land; and any assets declared as chargeable by legislative instrument made under the law.

Capital gains in excess of GHS 50 are subject to tax at 15%. However, gains resulting from a merger, amalgamation, reorganisation, reconstruction, and gains accruing to or derived from a venture capital financing company, are exempt from CGT. It is important to note that effective January 2011, gains from the sale of securities of companies listed on the Ghana Stock Exchange which were previously exempt from CGT are now subject to CGT. Details of further exemptions can be found in the income tax laws of Ghana.

### *Dividend income*
A dividend paid to a resident company by another resident company is exempt from tax where the company receiving the dividend controls, directly or indirectly, 25% or more of the voting power in the company paying the dividend.

### *Stock dividends*
The issue of stock dividends is permitted under Section 74 (1) of the Ghana Companies Code 1963, Act 179. It is, however, subject to income tax at the dividend tax rate of 8%.

### *Other significant items*
Specific exemptions from tax include the following:

- Income of a local authority.
- Income of a statutory or registered building society.
- Income of an ecclesiastical, charitable, or educational institution.
- Income of organisations formed for the purpose of promoting social or sporting amenities not-for-profit.
- Income accruing from a farming enterprise for a limited period.
- Income of a registered trade union.
- Income of rural banks for the first ten years of operations.
- Gain or profit from the business of operating ships or aircraft by non-resident corporate bodies.
- Investment income of a pension or provident society.
- Income or profit of any registered cooperative society.
- Income of a company engaged in the construction and sale or leasing of residential premises during the first five years following commencement of operations of the company.

### *Foreign income*
Resident corporations are taxed on their foreign income as and when it is brought into or received in Ghana. Foreign income is taxed together with other income derived in Ghana, and double taxation is avoided through treaties or foreign tax credits. No special rules exist for taxing undistributed income of foreign subsidiaries.

## *Deductions*

### *Depreciation and depletion*
Depreciation of capital assets in the accounts of a business is not an allowable deduction in computing taxable profits. It is replaced by capital allowances at statutorily prescribed rates. These allowances are available on capital expenditure for the following types of depreciating assets used in a trade:

- Plant and machinery.
- Trawlers and dredges.
- Furniture, fixtures, and fittings.
- Airplanes and helicopters.
- Industrial buildings.
- Mines and oil wells.
- Ships.
- Timber concessions.

Allowances are granted only on the following conditions:

- The taxpayer must own the asset.
- Capital expenditure must be incurred.
- The asset must be used in the trade.
- The asset must be in use up to the end of the basis period.

Capital allowances are granted for every year in which the asset is in use. In some cases, balancing allowances and charges are made where use continued until immediately before disposal of the asset.

For intangibles, such as patents, trademarks, and copyrights, the law allows deduction of fees and expenditure incurred in obtaining the grant and the cost of registration and renewals.



For capital expenditure for acquisition of Ghanaian mineral concessions and related interest in land, an annual write-down allowance is allowed of 80% of the cost base added to the pool during the basis period and 50% of the balance of the pool, if any. There is also an additional 5% allowance calculated on the previous year's additions.

### *Net operating losses*
Losses can be carried forward and deducted from assessable income for the five years immediately following the year in which the loss was incurred. This provision covers the following industries: farming and agro-processing, mining, manufacturing (for export only), tourism, and ICT (software development) industries.

Carryback of losses is permitted for persons deriving income relating to a long-term contract. A long-term contract of a business refers to a contract for manufacture, installation, or construction.

### *Payments to foreign affiliates*
No special restrictions are imposed on the deductibility of royalties, interest, and service fees paid to foreign affiliates, provided they are expenses incurred wholly, exclusively, and necessarily in the production of the income. However, the C-G may disallow certain transactions if of the opinion that they are artificial or fictitious.

### *Taxes*
No taxes are deductible in determining taxable income.

### *Other significant items*
No special deductions are allowed. Principal non-deductible items include the following:

- Domestic or private expenses, including cost of travel between residence and place of business or employment.
- Any disbursement or expense not being wholly and exclusively paid or expended for the purpose of acquiring income.
- Capital withdrawn or any sum employed or intended to be employed as capital.
- Capital employed in improvement.
- Any sum recoverable under an insurance contract of indemnity.
- Rent of or any expense in connection with premises or a part of premises not occupied or used for the purpose of producing business income.
- Any amount paid or payable in respect of any income tax, profits tax, or similar tax, whether due within or outside Ghana.

- Any payment to a provident, savings, or other society or fund, unless specifically allowed by the tax C-G.
- Any sum payable by way of mortgage or debenture interest by any person to a non-resident person, except where tax has been deducted and accounted for.
- Depreciation of any fixed assets of a permanent nature.

## *Group taxation*

No form of combined reporting of results of operations by a group or affiliates is permitted.

## *Tax credits and incentives*

### *Inward investment*

Under the Ghana Investments Promotion Centre Act 1994, various incentives are available to encourage investments in the country, particularly in the areas of agriculture; manufacturing industries engaged in export trade or using predominantly local raw materials or producing agricultural equipment, etc.; construction and building industries; mining; and tourism.

Incentives generally include exemption from customs import duties on plant and machinery; reduced corporate income tax rates; more favourable investment and capital allowances on plant and machinery; reduction in the actual corporate income tax payable where appropriate; retention of foreign exchange earnings where necessary; guaranteed free transfer of dividends or net profits, foreign capital, loan servicing, and fees and charges in respect of technology transfer; and guarantees against expropriation by the government.

### *Capital investments*

Venture capital tax incentives include the following:

- Relief from stamp duty in each year on subscriptions for new equity shares in venture capital funds.
- Full tax exemption from corporate income tax, dividend tax, and CGT for five years.
- Carryforward of losses from disposal of shares during the tax-exempt period to the post-exempt period up to five years.
- Chargeable income tax deduction equal to 100% of their investment for financial institutions which invest in venture capital subsidiaries.

### *Tax holidays*

Until January 2011, the income of a company from a business of construction for sale or letting of residential premises was exempt from tax for a period of five years. This was abolished in the 2011 national budget. The tax holiday is now limited to companies which partner with the Minister responsible for Works and Housing for construction for sale or letting of low cost affordable residential premises and are certified as such by the Minister responsible for Works and Housing.

## Withholding taxes

The threshold for WHT on goods and services has been increased from GHS 50 to GHS 500, hence only contracts for the supply of goods and services exceeding GHS 500 will attract a WHT. The rates, however, remain the same as follows:

| Income | Rate (%) |
|---|---|
| From employees' monthly salaries | * |
| **Resident persons** | |
| Interest (excluding individual and resident financial institutions) | 8 |
| Dividend | 8 |
| Rent (for individuals and as investment income) | 8 |
| Fees to part-time teachers, lecturers, examiners, and endorsement fees | 10 |
| Commissions to insurance agents, sales persons, and fees to directors, board members, etc. | 10 |
| On commissions of lottery agents | 5 |
| Supply of goods and services exceeding GHS 50 | 5 |
| **Non-resident persons** | |
| Dividend | 8 |
| Royalties, natural, resources payments, and rents | 10 |
| Management, consulting, and technical service fees, and endorsement fees | 15 |
| Interest income | 8 |
| Short-term insurance premium | 5 |

*Graduated tax rates as per regulations made under the Act.

## Tax administration

### Returns

The tax year runs from 1 January to 31 December. Corporations with financial periods other than the calendar year are taxed on their financial period ending during the calendar year. Separate provisions exist for commencement and cessation of business.

The tax administration system is an information return system, with subsequent assessment being issued by the tax authorities. Upon request to the Ghana Revenue Authority (GRA), a taxpayer is given Income Tax Form 22A for completion and submission to the IRS. This form provides the relevant information for determining taxable income and is filed by the taxpayer or an appropriate agent.

Companies are expected to submit a return four months after the end of the financial year. They may file an application for extension of filing time for not more than two months.

The following are to be furnished together with a return:

- Certified statement of turnover for the period covered by the return.
- Copy of certified accounts of the business for the period.
- An estimate of the tax due on the income declared and remittance of the tax so computed.

### *Assessments*
An assessment may be made on the company after the beginning of each year of assessment. If the return is considered incorrect and inadequate, additional assessments may be made as often as necessary. The tax authorities may make a provisional assessment before a return is filed, which can serve as a tax credit against the final assessment based on the return.

### *Payment of tax*
Where the assessment has been finalised, the tax is payable within 30 days after service of the notice. At the discretion of the Tax C-G, the time for payment may be extended. Without notice or demand from the C-G, a taxpayer is required to pay not less than the total of the tax paid or payable in respect of the preceding year of assessment. This may be paid by equal quarterly instalments at the end of March, June, September, and December in each year of assessment, but such payments are not deemed to be the actual tax payable.

Where tax is not paid by the due date, a penalty is assessed at 10% of the tax payable in addition to the tax unpaid up to three months after the due date; thereafter, the penalty is 20%.

# Gibraltar

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## Significant developments



On 16 June 2010, the Gibraltar Government published the text of the new, amended, and consolidated Income Tax Act under cover of a pre-legislative briefing paper. The new Act paved the way for the introduction of a low rate of corporate tax of 10%, with utility and energy providers and companies that abuse a dominant position paying an extra 10% surcharge. It has also lead to the end of the exempt tax regime.

The bill was formally published on 2 September 2010 and passed by Parliament in October 2010, with the legislation becoming effective as of 1 January 2011.

The main changes are summarised below. Please note that this information is current as of 1 June 2011. Typically, pending legislation is announced at the end of July in Gibraltar. Please visit the WWTS website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

### Increased investigative powers

The Commissioner has been granted increased powers for the purposes of investigating tax returns. Under the new Act, the Commissioner may also request information to satisfy any international exchange of information obligations.

### Change in the basis of taxation

Income tax is now assessed on an actual basis instead of a prior-year basis.

Companies still have the freedom to choose their financial year end. However, there is no longer any reference to a year of assessment.

### Exempt income

Under the new Act, tax on interest (except in the case where it is an integral part of the company's revenue stream, such as with banks, finance, or money lending companies), dividends, and royalties has been abolished.

### Introduction of self assessment and filing due dates

The new Act introduces the concept of self-assessment with new filing due dates as well as penalties and fines for non-compliance. *See the Tax administration section for more information*.

### Anti-avoidance

Like the existing Act, the new Act contains a generic anti-avoidance clause which allows the Commissioner to disregard an arrangement which he believes is fictitious or artificial. In addition, it introduces specific anti-avoidance measures including:

- Thin capitalisation rules.

- Transfer pricing legislation.
- Back to back loans.
- Dual employment contracts.
- Transfer of assets abroad.
- Head office charges.

*See the Group taxation section for further details.*

The new Act also requires that promoters of tax planning schemes notify the Commissioner within 30 days of any schemes which result in the payment of less tax. The Commissioner will decide whether the scheme is in the spirit of the Act and whether legislation is required to prevent it.

### *Transitional rules*

Complex transitional rules have been introduced in order to accommodate the change in the basis of taxation. Cessation rules will be applied as of 31 December 2010.

For companies in transitional years, the Act contains a table showing when and what the basis payments on account will be and when they will be due and payable.

With respect to capital allowances under the new Act, companies which were previously tax exempt will take the closing net book value of their assets at 31 December 2010 as the value of the opening pool available for allowances. For existing taxpayers, the amount will be the tax written down value at 1 January 2011, the date of entry of the new legislation.

## *Taxes on corporate income*

As of 1 January 2011, companies are subject to Gibraltar taxation on income accrued in, derived from, or received in Gibraltar on an actual basis.

Tax on interest (except in the case where it is an integral part of the company's revenue stream, such as with banks, finance, or money lending companies), dividends, and royalties has been abolished.

Prior to 1 January 2011, companies were subject to Gibraltar taxation on income accrued in, derived from, or received in Gibraltar on a prior-year basis. The main exemption to this was dividends, which were taxed on a worldwide basis, although tax could be mitigated provided certain criteria were met (*see the Income determination section*).

### *Corporate tax rates*

As of 1 January 2011, the 'low rate' of corporate income tax rate is 10%, with utility and energy providers and companies that abuse a dominant position paying a higher rate of 20%.

Prior to 1 January 2011, the standard rate of corporate income tax was 22%, but there was a 'small company' rate of 20% that applied where the profits of an accounting period were less than 35,000 British pounds sterling (GBP) per annum and a marginal rate that was charged on profits of between GBP 35,000 and GBP 43,333.

A 'small company' was one whose trading activities in any year had a minimum of 80% of its total trading receipts derived from sources other than the following: dividends, interest or discounts, rents, royalties, premiums, and any other profits arising from property.

### *Start-up relief*

Prior to 1 January 2011, a 'start-up' rate of 10% applied to any business established in Gibraltar after 1 July 2009.

As an anti-avoidance provision, the start-up relief did not apply in respect of any commercial activity carried out before 25 June 2009 and which was reorganised by the taxpayer in the name of a different entity for the purpose of benefiting from this scheme.

### *Exempt company*

On 31 December 2010, the tax exempt company legislation was repealed. As of 1 January 2011, all formerly tax exempt companies are subject to taxation at the rate of 10%, or 20% if they fall within the category of higher rate taxpayers.

Prior to 1 January 2011, an exempt company was not subject to taxes in Gibraltar. In order to qualify for such status, the exempt company must have demonstrated that it was not beneficially owned by Gibraltarians (or residents of Gibraltar) and did not trade with such persons.

The legality of this status was challenged by the European Union (EU) under the EU State Aid Rules in July 2001. In January 2005, the Government of Gibraltar reached an agreement with the EU Commission to permit existing tax-exempt companies to continue enjoying such status until 31 December 2010, provided that neither the beneficial ownership nor the activities of the company changed, in which case they became ordinarily resident entities taxable at the standard rate above.

Please note that no new exemptions were granted after 30 June 2006.

## *Corporate residence*

A company will be considered resident in Gibraltar if the management and control of its business is exercised from Gibraltar.

The location of central management and control will be established under legal principles laid down in the UK and is the place of the highest form of control and direction over a company's affairs, as opposed to decisions on the day-to-day running of the business.

## *Other taxes*

### *Value-added tax (VAT)*

There is no VAT in Gibraltar.

### *Customs and excise duties*

Goods imported into Gibraltar from outside are, with some exceptions, generally subject to import duty at the applicable rate, which is usually 12%. Different rates apply to food, alcohol, and tobacco (among others).

### Property tax
A general business property rate is levied on all businesses in Gibraltar. The amount varies depending on the property and is subject to an annual review.

### Stamp duty
Stamp duty is payable on the transfer or sale of any Gibraltar real estate or shares in a company owning Gibraltar real estate (on an amount based on the market value of said real estate) at the following rates:

- Less than GBP 200,000: 0%.
- Between GBP 200,000 and GBP 350,000: 2% on first GBP 250,000 and 5.5% on balance.
- Over GBP 350,000: 3% on first GBP 350,000 and 3.5% on balance.

### Gaming tax
Gaming tax is levied at 1% of the gaming income. The tax paid is subject to a minimum of GBP 85,000 and maximum of GBP 425,000.

### Capital duty
Capital duty of GBP 10 is payable on the initial authorisation of capital or any subsequent increase thereto.

### Social insurance
Employers are obliged to pay a proportion of social insurance on behalf of their employees.

Employers' social insurance contribution for employees paid weekly is calculated as 20% of gross earnings, subject to a minimum of GBP 15.00 and a maximum of GBP 32.97 per week.

Employers' social insurance contribution for employees paid monthly is calculated as 20% of gross earnings, subject to a minimum of GBP 65.00 and a maximum of GBP 142.87 per month.

## Branch income

The basis for taxation of branches of foreign enterprises is the same as for corporations.

## Income determination

Generally, companies are subject to Gibraltar taxation on income accrued in, derived from, or received in Gibraltar.

Prior to 1 January 2011, the main exception to this was dividends, which were taxed on a worldwide basis, although tax on this could be mitigated (*see Dividends section below*). As of 1 January 2011, please note that dividends are no longer taxed.

Where a taxpayer seeks to reduce their liability to tax by creating an artificial split between activities in Gibraltar and outside of Gibraltar, the Commissioner shall use anti-avoidance provisions to defeat such an attempt.

### *Inventory valuation*
Inventory is valued at the lower of historical cost or net realisable value. The last in first out (LIFO) method is not permitted. Generally there are no material differences between accounts prepared on a normal accounting basis and those prepared on a tax basis.

### *Capital gains*
Capital gains are not subject to tax in Gibraltar.

### *Dividends*
As of 1 January 2011, there is no charge to tax on the receipt by a Gibraltar company of dividends from any of its subsidiaries, regardless of where incorporated.

There is no withholding tax on dividends.



Prior to 1 January 2011, only dividend income received from companies listed on a recognised stock exchange (except in the case where the income formed part of the company's trading receipts) was not taxable in Gibraltar.

Also prior to 1 January 2011, dividends received from participating interests or from any subsidiaries in the participating interest group were not liable to taxation in Gibraltar. A participating interest existed where there was a direct or indirect shareholding of at least 10% in a company registered in the EU (or a company which was registered in a country which has a bilateral agreement with the EU).

There was no tax on dividends paid by one Gibraltar company to another, and there was no liability to tax on dividends paid by a Gibraltar company to a person who was not resident in Gibraltar.

### *Interest*
As of 1 January 2011, interest, except where it is an integral part of the company's revenue stream (e.g. banks, finance, or money lending companies), is not taxable in Gibraltar.

For companies where interest is considered 'a trading receipt', no tax shall be charged on the net interest receivable from deposits received from related parties to the extent that these funds do not themselves generate interest income from money lending activities to third parties.

Prior to 1 January 2011, interest received from financial institutions, except in the case where the income formed part of the company's trading receipts, was not taxable in Gibraltar.

With respect to non-bank loans, where the situs of a loan was outside Gibraltar, there was no source of income which would give rise to a liability to tax in Gibraltar in respect of the interest received on that loan.

The situs of a loan depended upon:

- the place of residence of the debtor
- the source from which the interest was paid
- the place where the interest was paid, and
- the nature and location of the security for the debt.

Where loans were primarily secured on assets situated in Gibraltar, unless there were compelling reasons to the contrary, they were likely to have their situs in Gibraltar.

## *Deductions*

For the purpose of ascertaining the assessable income there shall be deducted all expenses wholly and exclusively incurred in the production of the income. No deduction shall be allowed in respect of the following:

- Domestic or private expenses.
- Expenses not incurred wholly and exclusively in the generation of income.
- Any expenses of a capital nature.
- Any sum recoverable under an insurance contract or contract of indemnity.
- Property expenses not incurred for the purposes of producing income.
- Any tax charges under the Income Tax Act.
- Depreciation of assets (although capital allowances are available, *see below*).
- Employee remuneration not accompanied by a certified statement of name, addresses, and amount of remuneration.
- Certain business entertainment expenditure falling within guidelines published by the Commissioner.
- Interest paid to a non-Gibraltar resident at more than a reasonable commercial rate.

### *Capital allowances*

As of 1 January 2011, the concept of 'pooling' of allowances was introduced.

The first GBP 30,000 of qualifying expenditure on plant and machinery (including fixtures and fittings) and the first GBP 50,000 of qualifying expenditure on computer equipment is fully deductible in the first year.

Annual capital, or wear and tear, allowances are available for plant and machinery (including fixtures and fittings), computer equipment, and motor vehicles at the rate of 15% (20% for companies that are obliged to pay the higher rate of corporate tax - *see the Taxes on corporate income section*) and are calculated on a reducing balance basis. Capital allowances for industrial buildings are deductible at the rate of 4% per annum on a straight-line basis.

Prior to 1 January 2011, the first GBP 30,000 of qualifying expenditure on plant and machinery (including fixtures and fittings) acquired in a year of assessment was fully deductible, with the balance deductible at the rate of 25% per annum on a straight-line basis.

The first GBP 50,000 of qualifying expenditure on computer equipment was fully deductible, with the balance deductible at the rate of 25% per annum on a straight-line basis.

An expenditure on motor vehicles which did not qualify as plant and machinery was deductible at the rate of 25% per annum on a straight-line basis.

An expenditure on industrial buildings was deductible at the rate of 4% per annum on a straight-line basis.

Both prior to and after 1 January 2011, capital payments for leases which are for periods of less than 12 years qualify for capital allowances on a straight-line basis over the remaining period of the lease.

### *Operating losses*

A trading loss incurred in an accounting period may be offset against trading income arising in the same period or subsequent period, provided that within a period of three years there has not been both a change in the ownership of the company and a major change in the nature or conduct of the trade.

There is no provision for the carrying back of losses.



## *Group taxation*

### *Trading losses*

Companies are assessed on an individual basis, and trading losses of group members may not be offset against profits of other members of the group.

### *Anti-avoidance*

Like the existing Act, the new Act contains a generic anti-avoidance clause which allows the Commissioner to disregard an arrangement which he believes is fictitious or artificial. In addition, it has introduced specific anti-avoidance measures including:

#### Thin capitalisation

Interest paid on a loan to related parties (or loans where security is provided by related parties) where the ratio of the value of the loan capital to the equity of the company exceeds five to one will be considered as dividend payments and thus not a deductible expense for tax purposes. This provision is not applicable to Gibraltar banks and money lenders.

#### Transfer pricing

More stringent transfer pricing rules have come into effect. The amount of interest payments to connected persons which is in excess of that payable at 'arms length' will be deemed to be a dividend. Where the amount charged for goods and services by connected persons is not at 'arms length', the excess will be disallowed as a taxable expense. Any expenses allowed will be subject to the lesser of (i) the expense, (ii) 5% of the gross turnover of the company, and (iii) 75% of the pre-expense profit of the company.

Prior to 1 January 2011, the transfer pricing regime consisted of just the Commissioner's ability to disregard a transaction under anti-avoidance provisions and specific rules governing non-resident individual control over a resident individual.

#### Back to back loans

Since interest income is not taxable, nor is the interest expense deductible.

#### Dual employment

Income from dual employment contracts will be taxed in Gibraltar where the two employers are connected persons.

#### Transfer of assets abroad

Where assets are transferred abroad with the propose of avoiding tax and the taxpayer has the power to enjoy these assets either now or in the future, then any income or benefits received from these assets will be deemed to be income chargeable to income tax.

**Head office charges**
Allowable head office charges or expenses incurred by a Gibraltar branch for the common purpose of the company and its branches, or for the purpose of the head office or another branch exclusively, have been limited to 5% of turnover of the Gibraltar branch.

## *Tax credits and incentives*

### *Development aid*
In order to encourage private development in Gibraltar, promoters and developers of approved projects are offered certain incentives such as tax relief, import duty relief, and rates relief.

In order to qualify for the above relief, the project needs to be a new project, which is for the economic benefit of Gibraltar and the aim of which is:

- to create a tangible immovable asset in Gibraltar that will remain in existence after the applicant has ceased to derive the benefits under the license
- to provide more than two additional units of housing accommodation in Gibraltar
- to contribute materially to the development of the tourist industry in Gibraltar
- to afford any new employment opportunities or career prospects in Gibraltar, or
- to improve materially the economic or financial infrastructure of Gibraltar.

The project needs to be completed within a specified time (dependent on the type of project) following the issue of the licence, and the applicant must not expend less than the prescribed amount for the project.

Application for development aid must be made to the Minister for Trade.

### *Deduction of approved expenditure on premises*
For taxpayers with an interest in a building situated in Gibraltar, an allowance is available for approved expenditure on the painting, decorating, repair, or enhancement of the frontage of that building.

The approved amount will be available as a deduction against the taxpayer's income. This deduction is in addition to any deduction, relief, or allowance given in accordance with any other provision of the Income Tax Act in respect of the same expenditure.

The claim for the deduction must be made within two years after the end of the year of assessment with respect of which the deduction is claimed.

## *Withholding taxes*

There are no withholding taxes (WHT) in Gibraltar except in the following cases:

- Payments to subcontractors in the construction industry. Unless the subcontractor is in possession of an exemption certificate, tax is withheld at the rate of 25% of the amount which relates to the labour and profit element of the contract.

- Payments to employees under the Pay As You Earn (PAYE) system. Under the PAYE regulations, employers are obliged to deduct an amount of tax in accordance with the employee's tax code.

Prior to 1 January 2011, interest payments on Gibraltar situs loans payable to non-financial institutions were subject to WHT at the corporate tax rate.

## *Tax administration*

### *Tax returns*
As of 1 January 2011, companies are required to file returns and calculate their tax liability for the year. The return, together with the estimated liability, needs to be accompanied by payment of the tax due six months after the date of the company's financial year end.



Companies with turnover of GBP 500,000 or more are also obliged to file audited accounts within nine months of the company's financial year end.

Companies with turnover of less than GBP 500,000 will be obliged to file unaudited accounts accompanied by an Independent Accountant's Report within nine months of the company's financial year end.

Prior to 1 January 2011, tax returns were due by 30 September in the year of assessment.

### *Payment of tax*
As of 1 January 2011, companies are required to make payments on account of future liabilities on 28 February and 31 August in each calendar year. Each payment should be equal to 50% of the tax based on the previous year's assessable income.

The balance of tax due (i.e. the actual liability less payments on account) is due on the date of filing of the return.

Prior to 1 January 2011, tax for any year of assessment was due on the later of 28 February in the year of assessment or 60 days after the issue of the assessment.

### *Appeals*
As of 1 January 2011, a taxpayer may appeal against a disputed assessment by notice in writing addressed to the Commissioner within 28 days of the date of service of the notice of the assessment.

Prior to 1 January 2011, the appeal notice period was 21 days.

### *Fines and penalties*
As of 1 January 2011, the following penalties and fines are applicable:

For the late payment of tax, there is a penalty of 10% of the amount of tax due on the day immediately after such payment was due. If unpaid for 90 days, a further amount of 20% of the tax due is charged; and if still unpaid after this period, then a 10% per annum surcharge will be added which is compounded on a daily basis until the amount of the tax and penalties are fully paid.

Failure to file a return by the due date will result in a penalty of GBP 50 with a further penalty of GBP 300 if the return is not submitted within three months after the due date.

Failure to respond to a notice or request to submit information or documentation will result in a fine of GBP 200 on the day the failure occurs and a penalty of up to GBP 500 per day thereafter. Failure to comply beyond a three month period, if convicted, can result in imprisonment.

For fraudulently, recklessly, or negligently delivering to the Commissioner an incorrect return, accounts, or information there is a fine of up to 150% of the difference between the actual tax due and the tax due as per the original declaration. The amount of the penalty will depend on:

- the amount of the tax lost and / or delayed
- the gravity of the offence (i.e. if deliberate or an honest mistake), and
- the level of cooperation in the investigation.

Failure to pay to the Commissioner PAYE or social insurance which has been withheld or should have been withheld will become a criminal offence leading to imprisonment and / or a fine.

If an amount of PAYE and / or social insurance exceeding GBP 5,000 is outstanding for over three months, the Commissioner will, after giving 14 days notice, publish in the Gibraltar Gazette the name of the person whom he has reason to believe has failed to comply with the PAYE Regulations.

Failure to notify the Commissioner of an arrangement the main benefit of which is to avoid the payment of tax will result in a fine of GBP 100 on the day the failure occurs and a penalty of GBP 200 per day thereafter.

Fines and penalties introduced under the new Act will not apply until after 30 June 2012; however, interest on unpaid tax will apply as from the introduction of the Act.

Prior to 1 January 2011, penalties were imposed if tax was not paid by the due date. The amount of the penalty was equal to 10% of the tax due. If tax remained unpaid for five months after the due date, the Commissioner at his discretion could levy additional penalties of 10% of the tax due for each of the additional five months that passed until the tax was repaid.

If a person made an incorrect return by omitting or understating any income without a reasonable excuse, they were liable on conviction to a fine and double the amount of tax which had been undercharged as a consequence of the incorrect return. Default of payment could result in imprisonment.

A person who wilfully and with intent to evade or to assist any other person to evade tax by purposely omitting income from a return, maintained false accounts, or provided a false answer or statement was, if convicted, liable to a fine being treble the amount of tax not paid as a result of the offence and imprisonment.

# Greece

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## Significant developments

The new tax law 3943/2011 adopted by the Greek Parliament amended the Greek tax regime by introducing new provisions affecting all fields of taxation. The most significant amendments in the field of corporate taxation are the following:

- The two corporate income tax (CIT) rates for non-distributed and distributed profits of legal entities that were introduced by L.3842/2010 are abolished.
- The CIT rate of legal entities is set at 24% for income of financial year 2011 and at 20% for income of financial years 2012 onwards. Financial year 2012 in Greece would normally cover any financial year ending after, but not including, 31 July 2011.
- A 25% withholding tax (WHT) is imposed on profits distributed by Greek Societe Anonymes to individuals or legal entities, Greek or foreign, independent of whether the payment is made in cash or in kind (shares). Specifically for profits distributed within 2011, the WHT rate is 21%.
- Similar taxation is imposed on profits distributed by Greek Limited Liability Companies (and also some associations) to individuals or legal entities, Greek or foreign.
- WHT shall not be imposed on dividends paid to a legal entity established in another member state of the European Union (EU), subject to the conditions of L.2578/1998 (Parent-Subsidiary Directive).
- A participation exemption is introduced on dividends received by Greek Societe Anonymes and Limited Liability Companies from subsidiaries that have their registered seat in another EU member state, in which they participate, in the meaning of article 11 of L.2578/1998 (Parent – Subsidiary Directive), on the condition that these profits are booked in a untaxed reserve account.
- Capital gains derived by legal entities maintaining double entry accounting books from the sale of shares listed on the Athens Stock Exchange, which are acquired from 1 January 2012 onwards, will be taxed based on the general income tax provisions.
- Amendment to the rules on special restrictions on transactions with non-cooperative states and states with preferential tax treatment. Expenses concerning transactions realized between Greek companies and entities established in non-cooperative states or preferential tax regimes may be deductible for Greek companies, on the condition, however, that satisfactory evidence is provided that transactions are real and usual and do not have as a result the transfer of profits or income or capital with the purpose of tax evasion or tax avoidance.

## Taxes on corporate income

The CIT rate of legal entities is set at 24% for income of financial year 2011 and at 20% for income of financial years 2012 onwards. Financial year 2012 in Greece would normally cover any financial year ending after, but not including, 31 July 2011.

Resident corporations are taxed on their worldwide income. Non-resident corporations are taxed in Greece for any Greek-source income they derive. Such tax may take the form of a WHT, depending on the nature of the income, or of PE taxation, if the criteria for establishment of a PE in Greece are met.

### Local/state/provincial tax rates

No local taxes on income are paid at a local level. However, it should be noted that the aforementioned rates are reduced by 40% for profits of companies derived from activities carried out on islands with less than 3,100 inhabitants (Article (Art.) 118 par.2 Income Tax Code (ITC)).

### Special one-off contribution on profits

A one-off special lump sum contribution aimed to address the current fiscal deficits was imposed on the total net income of legal entities for financial year 2009. It is possible that such contribution will also apply for 2010 and 2011, depending on progress of the Greek economy, but no relevant legislation has been adopted as of April 2011.

The special one-off contribution is imposed on the total net income declared by legal entities, provided that it exceeds 100,000 euros (EUR) or the total net income of legal entities publishing financial statements under International Financial Reporting Standards (IFRS), whichever is higher.

The abovementioned lump sum is calculated based on a progressive scale of rates and, more specifically, at 4%, 6%, 8%, and 10% for income from EUR 1 up to EUR 300,000, from EUR 300,001 up to EUR 1,000,000, from EUR 1,000,001 up to EUR 5,000,000, and exceeding EUR 5,000,001, respectively. The amount of the lump sum is reduced so that the remaining total net income does not fall under EUR 100,000.

L.3943/2011 introduced a provision, in order to avoid the imposition of the special contribution on income of legal entities derived from participations, for which the special contribution has already been paid by the subsidiary company, not only based on the provision of L.3842/2010, but also based on the provisions of L.3808/2009 (special contribution that had been imposed on income of fiscal year 2008).

## Corporate residence

Corporate residence is determined primarily by place of incorporation. However, based on the effective management criterion under the corporate law rules, the place of legal seat could be relevant.

### Permanent establishment (PE)

Subject to related tax treaty provisions, foreign corporations are subject to Greek taxation if they maintain a PE in the country. Such PE may arise in cases of foreign companies maintaining inventories from which orders are filled; maintaining offices, warehouses, factories, etc.; carrying out any other operations for the purposes of exploiting natural resources; processing raw materials or agricultural products in their own factories or through third parties; or providing services of a technical or scientific nature (surveys, designs, or research) (Art. 100 ITC).

Note that the local definition of a PE is generally broader than the standard Organisation for Economic Co-operation and Development (OECD) definition; however, where a double tax treaty (DTT) applies, its provision will override the domestic definition.

## Other taxes

### Value-added tax (VAT)

As of 1 July 2010, the standard VAT rate is 23%. As of 1 January 2011, the reduced rate on basic necessities is 13%. A super reduced rate of 6.5% for accommodation in hotels or similar establishments (including holiday accommodation and letting of places in camping or caravan sites), medicines of CN3003 and 3004, and vaccines of CN3002 intended for human consumption is applicable. The aforementioned rate is also applicable for children's books, coloring, and drawing books.



Supplies of goods and services to individuals and legal entities subject to VAT and established in EU countries (intra-Community supplies) are exempt from VAT (zero-rated). Exports of goods and certain services to non-EU countries are also exempt (zero-rated).

With the following exceptions, real estate leases are generally exempt from VAT. As of 1 January 2007, shopping centres lease contracts may be subject to VAT, on condition that the taxable person opts for the submission to taxation of the leasing right. The newly introduced L.3943/2011 further extended the aforementioned option to logistics centres.

### Custom duties

Many goods imported into Greece from outside the European Union are subject to customs duties. The rates of duty are provided by the EU's Common Customs Tariff.

### Stamp taxes

Rentals of non-residential properties are subject to 3.6% stamp duty (with the exception of shopping centres and logistics centres subject to VAT).

In general, loans and interest may be subject to a 2.4% stamp duty. However, there are a number of exemptions, the main one covering bank loans and bond issues.

Other stamp duties may apply, in certain limited cases.

### Excise taxes

Excise taxes are imposed on energy and electricity products (e.g. petrol, natural gas, electricity), manufactured tobacco, and alcoholic products. The tax rates vary depending on the category of products.

### Real estate tax

An annual real estate tax is imposed effective from 2010 onwards on real estate located in Greece, which is owned on 1 January of the tax year by individuals or legal entities, regardless of nationality or residence.

The applicable tax rate for legal entities amounts to 0.6%, 0.3%, or 0.1% depending on their profit or non-profit making character and the use of the properties. The tax rate remains reduced at 0.33% for real estate owned by hotel enterprises and used for their business activities.

An exemption from real estate tax is provided for buildings built within three years from the issuance of the initial building permit, unless these have been leased or in any other way used, from the year 2011 onwards.

### *Special real estate tax*
The special real estate tax of 3% effective as of 1 January 2003, on legal entities owning real estate property in Greece on the objective value of such property, was increased to 15% as of 1 January 2010. This tax is mainly directed against property held, directly or indirectly, by offshore companies for the purpose of tax avoidance of transfer and inheritance taxes by the real owners. In this context, exemptions apply to listed companies, companies with registered shares up to the individual shareholder (provided such shareholder holds a tax registration number in Greece), companies for which the income derived from the real estate property does not exceed the income from other activities, EU banks, insurance companies, investment funds, etc, on the condition, however, that these are not established in non-cooperatives states *(see the Deductions section for more information on non-cooperative states)*.

### *Real estate transfer tax*
Each transfer of real estate, which is not subject to VAT, is subject to real estate transfer tax. The tax rates of the real estate transfer tax amount to 8% for the value up to EUR 20,000 and 10% for the exceeding value of the real estate.

Exemptions from real estate transfer tax for the acquisition of primary residences are determined according to the value of the property.

### *Contribution tax on capital accumulation*
A 1% tax contribution is imposed on capital accumulation by:

- business companies and joint ventures
- associations of all degrees and any other form of company, legal entity, or union of persons or society aiming to make profits, and
- branches of foreign companies (unless of EU origin).

For Societe Anonyme (SA) companies, an additional 0.1% duty is payable on capital to the competition committee.

## *Branch income*

For profits arising in financial year 2011, profits of branches of foreign companies are subject to CIT at a rate of 24%, and at 20% for income of financial years 2012 onwards. Financial year 2012 in Greece would normally cover any financial year ending after, but not including, 31 July 2011.

Note that the equivalent of a dividend WHT is also imposed on profit repatriations from the branch to its head office or other foreign branches of the legal entity.

## Income determination

### Inventory valuation

Inventories are stated at the lower of cost or market (replacement value). The Greek tax system recognises various valuation methods such as first in first out (FIFO), last in first out (LIFO), weighted average, etc.

### Capital gains

In general, capital gains are included in the taxable profits of Greek companies. Certain special rules apply in the case of sales of shares in listed or non-listed entities.

### Capital gains tax on sale of listed shares

The sale of listed shares that were acquired up to 31 December 2011, and irrespective of the time of sale of those shares, is subject to a transaction duty at a rate of 0.2%. The capital gains derived from the sale of such listed shares shall be exempt from income tax, on the condition that the capital gain is booked in a special tax-free reserve.



Capital gains derived by legal entities maintaining double entry accounting books from the sale of listed shares, which are acquired from 1st January 2012 onwards, will be taxed based on the general income tax provisions. Any loss, arising within the same year and for the same reason, shall be offset with capital gains. Moreover, if losses arise following the offset, reference is made to the provision on the carrying forward of losses. The law includes details in relation to the specification of profits. Similar provisions are introduced with regard to profits realized by individuals or legal entities keeping income-expenses accounting books. The transaction duty of 0.2% is abolished for such shares.

### Transfer tax on sale of non-listed shares

The sale of Greek shares non-listed on the Stock Exchange triggers a 5% tax calculated on the transfer value as either agreed by the parties or determined on the basis of a 'minimum-value' formula set forth by law, whichever is the higher. The aforementioned 5% tax is also due in the case of transfer of foreign non-listed shares by a Greek tax resident, calculated on the consideration agreed. In the case where the seller is a Greek corporation, the payment of the 5% tax does not exhaust the transferor's tax liability. Any capital gains arising thereof, are further subject to tax at the standard CIT rate (i.e. they are included in the taxable profits of the company). It should be noted that the 5% tax paid at the time of the transfer may, under certain conditions, be provided as a credit against the company's annual corporate liability.

Moreover, gains arising from the sale of parts of limited liability companies (LLC) are subject to a 20% tax rate. In cases where the seller is a Greek entity, the tax liability is not exhausted and the respective capital gain is taxed according to the general tax provisions with the 20% tax being credited against the final income tax liability.

### Dividend income

Profits distributed from Greek companies are not included in the taxable profits of their shareholders.

A participation exemption is applicable also on dividends received by Greek Societe Anonymes and Limited Liability Companies from subsidiaries that have their registered seat in another EU member state, in which they participate, in the meaning of article 11 of L.2578/1998 (Parent – Subsidiary Directive), on the condition that these profits are booked in a untaxed reserve account.

Other foreign dividends are included in taxable profits, but a foreign tax credit may be obtained under certain conditions.

### *Stock dividends*
Stock dividends are treated as cash dividends for income tax purposes.

### *Interest income*
Interest income is generally taxable. There are certain special rules that govern the receipt of interest income from bonds by banks and insurance companies.

### *Partnership income*
Both general partnerships (Omorrythmi Etairia or OE) and limited partnerships (Eterrorythmi Etairia or EE) are not tax transparent. They are generally taxed at a rate of 25%, but there are special rules on income determination or cases where partners are individuals.

### *Rents/royalties income*
Income derived from rents and royalties is taxed as ordinary income.

### *Foreign income*
Resident corporations are taxed on their worldwide income. Foreign income received by a domestic corporation is taxed together with other income. If related income tax is paid or withheld abroad, a tax credit is generally available up to the amount of the applicable Greek income tax. Losses incurred abroad can only be offset against foreign profits.

There are no special anti-deferral regimes or controlled foreign company (CFC) rules in Greece.

## *Deductions*

In general, expenses are deductible subject to certain conditions. The following is a list of certain key conditions or restrictions on expense deductibility:

- Accrued interest from loans or credits of a company is generally deductible, with the exception of interest on arrears due to the debt of taxes, duties, contributions, and fees to the state and other legal entities governed by public law; interest on loans for the purchase of shares in any type of company, to the extent that this participation is transferred within a two-year period; interest on loans used for the purchase of shares in a legal entity established in non-cooperating states or states with preferential tax regime; and interest paid to companies established in such states.
- The deductibility of hotel expenses, expenses for corporate gifts, education of personnel, special clothing of personnel, and mobile telephone expenses are subject to specific conditions set out in Art. 31 of the ITC.
- Payroll expenses are not deductible when they are not paid through professional bank accounts or cheques paid through the same accounts.
- The value of raw and ancillary materials and other goods (plus processing thereon), which is paid to a legal entity whose role consists exclusively of the invoicing of the transactions, while the delivery of goods or provision of services is conducted by a third party, is not deducted from the gross profits of companies.
- Car expenses are generally deductible up to 70% for motor vehicles up to 1,600 cc and 35% for motor vehicles exceeding 1,600 cc.

- Expenses concerning transactions realised between Greek companies and entities established in preferential tax regimes may be deductible for Greek companies, on the condition that satisfactory evidence is provided that the transactions are real, usual, and do not result in the transfer of profits, income, or capital for the purpose of tax evasion or tax avoidance.

### *Accrued expenses*
Accrued expenses are, in principle, non-deductible until they become final and settled, supported by respective invoices.

### *Bad debt*
Tax-deductible bad debt provisions are calculated at 0.5% on the stated value of invoices for sale of goods or provision of services, after a reduction for discounts, sales to the State or other entities governed by public law and the special consumption tax imposed in certain cases. Special restrictions and rules apply to certain transactions, while there is a recapture system for provisions which are not realised.



### *Charitable contributions*
Donations and sponsorships paid to charitable institutions, non-profit making foundations, churches and monasteries, and various other welfare institutions may be deductible up to 10% of the total net profits or income arising from the balance sheet of the legal entity.

### *Depreciation of fixed assets*
Depreciation of tangible assets is compulsory for financial years ending after 30 December 1997 (not compulsory for financial years ended within the period from 1 January 1992 through 30 December 1997). Fixed assets with acquisition value of up to EUR 1,200 each may be written off to profit and loss in the year acquired or when used in operations. Depreciation is computed on the basis of the straight-line method or, in some cases, the declining-balance method on the acquisition value, increased by any additions and improvements. The straight-line method or the declining-balance method must be used consistently. However, new companies, for the three consecutive financial years that follow the financial year in which their productive operation commenced, are permitted to depreciate all their fixed assets either at 0% or at a rate equal to 50% of the applicable rate, provided that the selected rate will not change from year to year. If the declining-balance method is used, the straight-line method rates increase three times.

For each category of assets, maximum and minimum annual depreciation rates are determined by a presidential decree. Companies may select any rate within this range, provided that this is consistently applied.

### *Goodwill*
There are some court cases which support the deductibility of goodwill as a start-up expense, but the specifics of each case must be carefully considered.

### *Taxes*
Taxes, other than income tax and real estate tax, are recognised as deductible expenses if supported by related tax returns and payment receipts and borne by the company.

### *Fines and penalties*
Fees received from activities constituting a criminal offence, from penal clauses, fines, and penalties are not recognised as deductible expenses.

### Special restrictions on transactions with non-cooperative states and states with preferential tax treatment
Greek tax law has established rules in relation to non-cooperating states and states with preferential tax treatment in Art. 51A and B of the ITC.

Non-cooperating states are defined as states that on 1 January 2010 are not EU member states and which, up to the aforementioned date, have not concluded agreements of administrative assistance in the tax sector with Greece or with, at least, 12 other states. Non-cooperative states will be enumerated in an annual Ministerial Decision to be issued annually.

An individual or legal entity, irrespective of its legal form, is considered located in a preferential tax regime, even if its residence of registered office is located in an EU member state, in cases where it is not subject to taxation in this state or is de facto not subject to taxation, or is subject to tax on income or capital at an amount which is lower than 60% of the tax that would have been due, in accordance with Greek tax legislation, if such entity were resident or were maintaining a PE in Greece.

Expenses concerning transactions realized between Greek companies and entities established in non-cooperative states or preferential tax regimes may be deductible for Greek companies, on the condition, however, that satisfactory evidence is provided that transactions are real and usual and do not have as a result the transfer of profits or income or capital with the purpose of tax evasion or tax avoidance.

### Net operating and capital losses
Losses can be carried forward five years. Carrybacks are not permitted.

### Organisational and start-up expenses
The amount of start-up expenses (including costs for acquisition of real estate) is amortised, either as a lump sum during the year of its realization or in equivalent instalments within a five year period. Specifically, expenses realised by financial leasing companies in relation to the acquisition of real estate, which will constitute the object of an agreement of the same law, may be depreciated in equivalent amounts, in analogy to the years of duration of the agreement.

### Payments to foreign affiliates
Royalties, interest, and service fees paid to foreign affiliates are deductible expenses under certain requirements and conditions.

### Pension expenses
Group life insurance premiums, which include pension plans, may be deducted at up to EUR 1,500 per employee.

### Payment for directors
Fees of board members are taxed at source at a rate of 35%. Such amounts are tax-deductible.

Bonuses (benefits in cash, on top of regular remunerations and overtime payments) paid to executives of credit institutions up to financial year 2013 are subject to special increased taxation. Taxation is based on the general progressive tax scale applicable to individuals provided the total annual income of the executive does not exceed EUR 60,000 and the amount of the bonus does not exceed 10% of the total annual regular remuneration. For amounts exceeding the outlined limitations, taxation at source based on a progressive tax scale is provided as follows:

- Up to EUR 20,000: 50%.
- EUR 20,001 to EUR 40,000: 60%.
- EUR 40,001 to EUR 60,000: 70%.
- EUR 60,001 to EUR 80,000: 80%.
- EUR 80,001 and above: 90%.

## *Group taxation*

Group taxation is not permitted in Greece.

### *Transfer pricing*

Article 26 of L.3728/2008 on 'Monitoring the Markets and other provisions' of the Ministry of Development introduced, for the first time in Greece, rules on the documentation of prices of inter-group transactions with the intention of "detecting possible overpricing of inter-group transactions, expanding artificially the cost of sold products and services, having as a consequence the reduction of the gross profit of enterprises in Greece, picturing the increase of sale prices to the final consumers as necessary and justified".



In accordance with the relevant transfer pricing rules, companies operating in any form in Greece are obliged to apply to their transactions with companies that are connected to them, terms in accordance with the arm's-length principle (ALP).

For this purpose, companies must document the prices for all their inter-group transactions with a complete and standardised study of documentation of prices. The study consists of the 'basic documentation file', concerning groups in which the parent company is Greek and the 'Greek documentation file', with regard to Greek subsidiaries of foreign groups and foreign companies operating in any form in Greece.

These files must be made available when requested by the competent authorities of the Ministry of Development within 30 days from the notification of the relevant request. Moreover, companies that have inter-company transactions must submit annually, within four months and 15 days from the end of the accounting period, to the Ministry of Development a catalogue in which the data of their inter-group transactions, and specifically the number and their value, are documented. In case of non-compliance with these obligations, an independent fine is imposed, equal to 10% of the value of the transactions for which the relative documentation was not submitted or the foreseen catalogue was not submitted timely.

If an infringement of the ALP is established, the competent tax authorities are immediately informed in order for the provisions of tax legislation and the imposition of the relevant tax penalties to apply.

In parallel to the aforementioned regimes, transfer pricing is also regulated by the ITC.

The aforementioned provisions of Art. 39 and 39A ITC were amended by Article 11, par.13 of L.3842/2010. Specifically, the provisions expanded the frame of application of the provision to leases of movable or immovable property, while the condition of (direct or indirect) tax avoidance taxes for the application of the provision was abolished. Moreover, the new provisions provide for a 20% fine on the surplus net profits arising on behalf of enterprises in case of infringement of the ALP, as well as a fine equal to 20% on the value of the transaction in case of non-compliance, faulty compliance, or overdue filing of the required documentation. With reference to the obligation of documentation, the deadline within which enterprises are obliged to present the file is 30 days and the minimum amount of transactions for which documentation is required is EUR 100,000 annually.

### *Thin capitalisation*
Article 3 of L.3775/2009 established, for the first time, rules on thin capitalisation of enterprises in Greece.

According to the relevant thin capitalisation rules, accrued interest on loans paid to affiliated companies are deductible on the condition that the debt to equity ratio is 3:1.

The aforementioned provisions of Article 3 of L.3775/2009 were amended by Article 11, par.7, of L.3842/2010. Specifically, the new provisions extended the exceptions from the application of the thin capitalisation rules to banks, factoring companies, as well as special vehicle companies of L.3156/2003, and L.3601/2007 (an exception was already in force for leasing companies). It was, moreover, provided that loans assumed by third companies and for which any kind of guarantee has been issued by the aforementioned connected companies are added to the total amount of loans undertaken by the connected companies. Finally, the relevant provisions abolished the clause of non-application of thin capitalisation rules for loans that had been concluded until the publication of L.3775/2009 (namely until 21 July 2009) (grandfathering clause), thus as of 2010 the debt equity ratio covers also older loans.

Pursuant to the provisions of the newly introduced L.3943/2011, the exemption from thin capitalization provisions is extended to Investment Service Companies of L.3606/2007.

### *Controlled foreign company (CFC) regime*
There are no CFC rules in Greece.

## *Tax credits and incentives*

### *Foreign tax credit*
Tax paid abroad for income taxable in Greece is credited but is limited to the amount of Greek tax due.

### *Incentives for the maintenance of workplaces*
Legal entities, which suffer a reduction of turnover for two consecutive accounting periods without reducing their workforce, can enjoy a reduction of the tax rate by three percentage units. However, a revocation of the granted benefit and imposition of further tax in case of reduction of personnel or increase of the turnover within the three-year period is provided.

### *Other tax incentives*
Apart from the aforementioned tax incentives, L. 3908/2011 on 'Bolstering of Private Investments for Economic Growth, Entrepreneurship and Regional Sustainability' (the new Investment Incentive Law) includes the following tax incentives:

- Any investment plan in any sector of the economy may receive benefits under the law. Only certain cases explicitly specified in the law are exempt (e.g. power generation from photovoltaic arrays).
- The types of subsidized expenditures for tangible and intangible assets are indicatively mentioned, whereas the expenses that may not be subsidized are

exhaustively enumerated. Especially the subsidy percentage for the expenditure of intangible assets may not exceed 50% of the total eligible expenditure of the investment plan.

- The term of 'new' enterprises is specifically defined for the new law's purposes. An enterprise is considered as 'new', if the establishment procedures have not been completed before the enterprise applies for aid according to the new law or if it has been established within the past 24 months prior to filing the application.
- There are three types of aid: (a) tax exemption, (b) subsidy, and (c) leasing subsidy.
- The new law lists three categories of General Investment Plans and specifies the type of aid for each of them: (a) General Entrepreneurship which only the tax exemption may be granted for, whereas for the (b) Technological Development and the (c) Regional Sustainability investment plan, the subsidy and/or the leasing subsidy may be granted in principle, with different percentages for the existing and the new enterprises. The remaining percentage may be covered by tax exemption.
- The law also lists four categories of Special Investment Plans: (a) Youth Entrepreneurship, (b) Major Investment Plans, (c) Integrated Long-Term Investment Plans, and (d) Synergy and Networking. The aids granted are further specified by type, volume, and/or percentage for each of them.
- The percentages of aid available are specified in conjunction with the division of the country into three zones (A, B, and C) and are the following:



| Zones | Large enterprises | Medium-sized enterprises | Small & micro enterprises |
|---|---|---|---|
| ZONE A' (Prefecture of Attica, Prefecture of Viotia) | 15% | 20% | 25% |
| ZONE B' (Prefectures with GDP per capita > 75% of the average GDP of the country) | 30% | 35% | 40% |
| ZONE C' (Prefectures with GDP per capita < 75% of the average GDP of the country) | 40% | 45% | 50% |

In any case, the above percentages should comply with the ceiling set by the Regional State Aid Map (RSAM) approved by the European Commission.

- An additional 5% aid percentage, up to the ceiling set by the RSAM, is granted for investment plans in Industrial Entrepreneurship Zones and Innovation Zones. Benefits are also granted up to the ceiling set by the RSAM, by enterprise size and up to 50% of the eligible expenditure, for investment plans on islands and regional units of islands that belong administratively to the regions of the mainland.
- The new law sets a ceiling for each aid (EUR 10 million to 15 million in principle, but graduated according to various criteria).
- The period for filing the application (April and October, with the exception of large investment projects) and the conditions for approval are further specified.
- The law specifies the conditions and evaluation criteria for each investment project and determines, in general, the procedure for evaluation, approval, and monitoring of implementation of investment projects (further specification by ministerial decisions).
- The mode of payment of each type of aid is further determined. Especially for the aid of tax exemption, the law stipulates that the amount of tax exemption aid is annually formed with the following restrictions:
  - The enterprise is entitled to the use benefit of the incentive from the fiscal year in which the decision on the completion and beginning of the productive

  - operation of the investment has been published. In this fiscal year, the ceiling of tax exemption to be used is set at 1/3 of the approved amount of the tax exemption aid.
  - In the following fiscal year, the ceiling of tax exemption to be used, including the aid for the first fiscal year, is set at 2/3 of the approved amount of the tax exemption aid.
  - The remaining amount of the approved tax exemption aid may be covered within ten fiscal years for new enterprises and within eight fiscal years for existing enterprises following the fiscal year in which the decision on the completion and beginning of the productive operation of the investment has been published.
- The amount of the tax exemption aid shall be shown as a tax-free reserve in a special account in the enterprise's accounting books and shall consist of the income tax on the net profits reported in the initial timely income tax return which shall not be paid based on the tax exemption granted.
- Where the equipment is acquired through leasing, the tax exemption to which the enterprise is entitled in each fiscal year is calculated on the part of the purchase price of the equipment which is included in the rents already paid by the end of this fiscal year.
- The law stipulates that the amounts of subsidies and leasing subsidies as well as of tax exemption shall be shown as tax-free reserves in special accounts. Said reserves may not be distributed or capitalized and shall be returned in case of dissolution of the enterprise. In case of distribution or capitalization, certain penalties shall be imposed.
- The law stipulates that any aid to be paid is exempt from any tax, stamp duty, right, and any other charge in favor of the State or any third party.
- Finally, the new law specifies the obligations of the beneficiary enterprises and penalties in case of non-compliance.

The above rules are very detailed, and analytical and careful advices needs to be sought before making any decision in respect thereof.

## *Withholding taxes*

Profits distributed by Greek Societe Anonymes or Limited Liability Companies (and also some associations) in the form of dividends, Board and Directors fees, profits distributed to personnel, as well as interim dividend payments made to individuals or legal entities, Greek or foreign, and independent of whether the payments are made in cash or in kind (shares), are subject to 25% WHT.

Specifically for profits distributed within 2011, the WHT rate is 21%.

Tax is withheld by Greek Societe Anonymes, Limited Liability Companies, and associations with exhaustion of tax liability of the beneficiaries. An exception is provided with regard to individuals that are taxed on their total income at a tax rate lower than the WHT rate, in which case income derived from dividends or the aforementioned participations shall be taxed based on the general provisions with a credit on the tax withheld.

WHT shall not be imposed on dividends paid to a legal entity established in another member state of the European Union, subject to the conditions of L.2578/1998 (Parent-Subsidiary Directive).

25% WHT shall also be applicable on the distribution of profits remitted or credited by a PE of a foreign legal entity in Greece to its registered seat or to another permanent establishment located abroad.

The dividend WHT is equally applicable for distributed or capitalized profits of previous fiscal years.

The following table provides a summary of the WHT applicable under the respective DTT entered into by Greece:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident individuals and companies | 21/25 (1) | 10/20 (2) | 0 |
| | | | |
| Non-resident individuals and companies: | | | |
| Non-treaty | 21/25 (1) | 40 (2) | 25 (3) |
| | | | |
| Treaty: | | | |
| Albania | 5 | 5 | 5 |
| Armenia | 10 | 10 | 5 |
| Austria (4) | 5/15 (5) | 8 | 7 |
| Azerbaijan (13) | 8 | 8 | 8 |
| Belgium | 5/15 (9) | 5/10 (8) | 5 |
| Bulgaria | 10 | 10 | 10 |
| Canada (13) | 5/15 (9) | 10 | 0/10 (16) |
| China | 5/10 (6) | 10 | 10 |
| Croatia | 5/10 (6) | 10 | 10 |
| Cyprus | 25 | 10 | 0/5 (7) |
| Czech Republic | Domestic | 10 | 10 |
| Denmark | 38 | 8 | 5 |
| Egypt | 10 | 15 | 15 |
| Estonia | 5/15 (6) | 10 | 5/10 (14) |
| Finland | 47 | 10 | 0/10 (11) |
| France | Domestic | 10 | 5 |
| Georgia | 8 | 8 | 5 |
| Germany | 25 | 10 | 0 |
| Hungary | 45 | 10 | 10 |
| Iceland | 5/15 (6) | 8 | 10 |
| India | Domestic | Domestic | Domestic |
| Ireland | 5/15 (9) | 5 | 5 |
| Israel | Domestic | 10 | 10 |
| Italy | 15 | 10 | 0/5 (11) |
| Korea, Rep. of | 5/15 (6) | 8 | 10 |
| Kuwait | 5 | 5 | 15 |
| Latvia | 5/10 (6) | 10 | 5/10 (14) |
| Lithuania | 5/15 (6) | 10 | 5/10 (14) |
| Luxembourg | 38 | 8 | 5/7 (10) |
| Malta | 5/10 (6) | 8 | 8 |
| Mexico | 10 | 10 | 10 |

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# Greece

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Moldova | 5/15 (6) | 10 | 8 |
| Morocco (13) | 5/10 (6) | 10 | 10 |
| Netherlands | 35 | 10, 8 (15) | 5/7 (10) |
| Norway | 40 | 10 | 10 |
| Poland | Domestic | 10 | 10 |
| Portugal | 15 | 15 | 10 |
| Qatar (13) | 5 | 5 | 5 |
| Romania | 45 | 10 | 5/7 (10) |
| Russia | 5/10 (6) | 7 | 7 |
| Saudi Arabia (13) | 5 | 5 | 10 |
| Serbia (13) | 5/15 (6) | 10 | 10 |
| Slovakia | Domestic | 10 | 10 |
| Slovenia | 10 | 10 | 10 |
| South Africa | 5/15 (6) | 8 | 5/7 (10) |
| Spain | 5/10 (6) | 8 | 6 |
| Sweden | Domestic | 10 | 5 |
| Switzerland | 35 | 10 | 5 |
| Tunisia (13) | 35 | 15 | 12 |
| Turkey | 15 | 12 | 10 |
| Ukraine | 5/10 (6) | 10 | 10 |
| United Kingdom | Domestic | o | 0 |
| United States | Domestic | 0/Domestic (12) | 0 |
| Uzbekistan | 8 | 10 | 8 |

Notes

1. The 21%/25% WHT applies to distribution of dividends by Greek Societes Anonymes and Greek EPEs (i.e. Limited Liability Company). The rate is 21% for distributions within 2011 and 25% from 2012 onwards.
2. Interest earned on deposits with banks operating in Greece, as well as on any kind of bonds, is subject to WHT at the rate of 10% withheld at source. WHT on interest payable to non-Greek residents is 40%.
3. Payments of royalties and service fees to foreign residents are subject to a WHT at the rate of 25%.
4. The new DTT concluded between Greece and Austria will apply to income earned as of 1 January 2011. For payments realised up to 31 December 2010 the former DTT applies, which provides for a WHT of 8% for interest payments and 7% for royalty payments.
5. The rate of 5% will apply if the beneficial owner is a company which holds directly at least 25% of the voting power of the company paying the dividends.
6. The rate of 5% applies in case the beneficiary is a company (excluding a partnership) and directly holds at least 25% of the capital of the paying company.
7. The rate of 5% is applicable only for the right to use cinematograph films.
8. Rate of 5% applies to loans not incorporated into negotiable instruments and granted by banks.
9. A rate of 5% is applicable to shareholders of 25% and above.
10. The rate is 5% applies if the royalties consist of payments of any kind received as a consideration for the use of or the right to use any copyright of literary, artistic, or scientific work, including cinematograph films.
11. Exemption ('0' rate) applies to payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work including cinematograph films and films or tapes for television or radio broadcasting.
12. Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) received from sources within Greece by a resident or corporation of the United States (US) not engaged in trade or business in Greece through a PE therein, shall be exempt from Greek tax but only to the extent that such interest does not exceed 9% per annum; but such exemption shall not apply to such interest paid by a Greek corporation to a US corporation controlling, directly or indirectly, more than 50% of the entire voting power in the paying corporation.
13. The DTT applies to income earned as of 1 January 2011.

14. The 5% rate is applicable if the royalties consist of payments of any kind received as a consideration for the use of industrial, commercial, or scientific equipment, and the 10% rate is applicable for all the other cases.
15. The 8% rate is applicable when the beneficiary of the interests is a bank or a financial institution, 10% rate is applicable for all the other cases.
16. Exemption ('0' rate) applies to copyright royalties and other like payments in respect of the production or reproduction of any cultural or artistic work (but not including royalties in respect of motion picture films nor royalties in respect of works on films or videotapes or other means of reproduction for use in connection with television broadcasting).

In general, it should be noted that certain DTTs may include specific clauses on specific cases that are not all captured in the table; therefore, a careful review of each DTT is highly advisable.

## *Tax administration*



### *Returns*

Income tax returns of Greek SAs, EPEs, and branches of foreign companies are filed on a special form within four months and ten days from the end of their financial year, which can be on either 30 June or 31 December. By a decision of the Minister of Finance, the filing date for SAs may be extended a few days, depending on the last digit (figure) of their tax registration number (known in Greece as the arithmos phorologikou metroou or AFM). Branches and subsidiaries (at least 50% participation) of foreign companies may follow the financial year of the parent company. A Greek company that is at least 50% held by another Greek company that is in turn a subsidiary of a foreign company that has participation with the same or higher percentage may also follow the financial year of the foreign parent company. The income tax return constitutes the basis for assessment.

Tax returns are required to be submitted electronically from 2011 onwards.

### *Payment of tax*

Income tax and tax prepayment (80% [100% for banks operating in Greece] of the current year's income tax less tax withheld at source) based on the tax return are paid in eight equal monthly instalments, the first of which should be paid upon filing. For newly established companies, the pre-payment is reduced to 50% for the first three years of their operating. A deduction of 1.5% in case of a lump sum payment of income tax liability applies to tax returns filed from 2010 onwards.

### *Audit cycle*

#### Tax audit procedures

The tax audit commences with the issuance of an audit order for tax open years, usually not more than five. The order concerns the audit of all tax issues (income tax, VAT, WHT, capital gain tax, etc.). The duration of the audit may vary from a few weeks to a few months, in certain cases.

A regular or temporary audit may also be conducted from the office of the audit authority. Such audit from the office is based on the data of the file, the sheets of information, the audit reports of the Financial Crime Prosecution Unit and other authorities of the Ministry of Finance, the books and records that the taxpayer may be required to submit, the data and information of the entities stipulated in article 17 of L. 3842/2010, and the data accruing from the electronic data processing at the General Secretariat for Information-Security Systems. The possibility of issuing from the office an act of partial tax determination for one, or more, fiscal years, without auditing all the books and records and without requiring the audit of other taxes, also applies, in case where it is derived from other data at the disposal of the audit authority (i.e. information sheets, reports of the Financial Crime Prosecution Unit, electronically processed data of the General Secretariat for Information-Security Systems) that the liable entity omitted to declare, or inaccurately declared taxable income, or even miscalculated the percentages, or deductions.

However, the ability of conducting an audit at the registered seat of the legal entity, specifically with regard to cases that are explicitly stipulated in the law, is in parallel applicable.

Following the audit and the notification of tax audit findings, the company may in turn:

- Negotiate with the tax authorities with a view to reducing the tax burden and achieve an 'out of court settlement'. The out-of court settlement offers the possibility to reduce additional taxes (not the principal amount of tax) at the rates provided now under the provisions of L.2238/94 (reduction of the additional tax to 3/5). The conclusion of such a settlement presupposes that the company accepts the findings of the audit (e.g. of expenses) for the audited years and is likely to face the same issues in the following years as well.
- Take the case to court (filing of a recourse), which necessitates an advance payment (50% of the taxes and penalties assessed). The first decision normally takes two to three years and another six to eight years until a decision by the Court of Appeal and Supreme Court is issued.
- There is also a possibility to take the case to a Fiscal Arbitration Body, competent to arbitrate over dispute resolution arising from tax assessments exceeding EUR 150,000, by filing an application and subject to the consent by the Minister of Finance. The commencement of operation of the Fiscal Arbitration Body is to be determined by a Presidential Decree to be issued following the suggestion of the Ministers of Finance and Justice – to date (April 2011) such Presidential Decree has not been issued.

Criminal sanctions are also imposed on the company's representative under certain conditions, which are waived in the case of settlement on the amount of taxes assessed.

**Tax auditors' practice**

The complexity of the Greek tax legislation and the vagueness of its requirements enable the tax auditors to dispute either the company's results reflected in its accounting records or to disallow expenses. This is true in all tax audits and in spite of companies' endeavours to comply with the tax requirements, tax audits always result in assessment of additional taxes and penalties.

The amount of additional taxes depends mainly on the following:

- Company's vulnerability because of nature of business and transactions.
- Taxes already paid on the basis of the company's income tax returns.
- Profits declared by competitors.
- Weaknesses and shortcomings which the tax auditors might reveal, if a full audit is carried out.

The amount of additional taxes is capped and cannot exceed:

- 60% for the submission of a delayed tax return and
- 120% for the submission of an inaccurate submission or non-submission of a tax return.

In respect of deductible expenses, the legislation prescribes, among other requirements, that such expenses must be of a 'business' nature, without defining what a business expense is. Consequently, the tax auditors dispute the deductibility of various items arguing that, in their opinion, they are not contributing to the company's business.

In a worst-case scenario, if serious violations are detected that make the audit verifications impossible, then the validity of the accounting books may be contested, resulting in the deemed (out-of-books) profit calculation and the imposition of heavy penalties and additional taxes.

Specifically, the validity of the books may be contested on the basis of the kind and gravity of infringements, which are divided in two categories:

- Infringements determining the books as 'inadequate'.
- Infringements determining the books as 'inaccurate'.



In the extreme cases, where the accounting books are treated as 'inadequate' or 'inaccurate', the taxable income and the tax due by the company will not be calculated according to book figures; but instead, the out of books determination method is applied, according to which the company's gross income of each financial year will be multiplied by the net profit rates defined by the Greek Ministry of Finance. These rates have been defined on the basis of the business activities of each company. In cases where the books are deemed to be 'inaccurate', these rates would be surcharged by 40% to 80%, depending on the kind of infringement from which the inaccuracy of the books has resulted.

The practice could change as the tax audit force is undergoing a serious reshuffling. In this direction, it is expected that Greek companies will be required to obtain a 'tax certificate' from their certified auditors, confirming compliance with Greek tax legislation.

### *Statute of limitations*

The right of the Greek State to seek to collect unpaid taxes is normally five years starting from the end of the year in which the relevant tax return should be filed. For example for taxes due in 2009, the clearance VAT return should be filed in 2010 and the statute of limitation expires on 31 December 2015. However, in the case where a return is not filed, then the statute of limitation is extended to ten years. Furthermore, it should be noted that the statutes of limitation may be extended by law. This has happened many times in the past. Thus, the statutes of limitation for tax audit cases regarding accounting years 2000, 2001, 2002, and 2003 and fictitious or forged invoices' cases were extended until 31 December 2010.

## *Other issues*

### *Choice of business entity*

The main differences between a subsidiary (i.e. SA, EPE, or LLC) and a branch of a company from the law/establishment perspective are as follows:

- A subsidiary is a separate legal entity from its parent company, whereas a branch does not form a separate legal entity, does not have its own shareholders, and consequently the funds needed for its operation are transferred from the overseas parent company.

- The parent company of a branch must be either the equivalent of a Greek SA or a LLC, whereas there is no such restriction for subsidiaries.
- The day-to-day management of a branch is exercised by the legal representative, a person appointed by the parent company, whereas an SA is represented by its board of directors (BoD) and a LLC is administered and directed by the administrator(s).
- No minimum capital is required for the establishment of a branch, nevertheless the share capital of the parent company should be at least EUR 60,000 if it is an SA and EUR 4,500 if it is a LLC.
- An SA appears to be a more prestigious type of company than a branch and a LLC. This has a mainly psychological effect. Certain investors still tend to opt for the establishment of an SA company, particularly if they would like to participate in public tenders, etc.

The main legal differences between a SA and a LLC in Greece from a company law/ establishment perspective are as follows:

- An SA is managed by a BoD consisting of at least three members, whereas a LLC can be managed by only one individual, the administrator (legal entities are permitted to be appointed as BoD members or administrators). Both BoD members and administrators have to acquire a Greek tax registration number and a Greek residence permit before the establishment of the companies. Obtaining a residence permit for non-EU citizens is a time consuming procedure.
- The shareholders of an SA are not required to be registered with the Greek tax authorities, whereas the partners of an LLC have to be registered with the Greek tax authorities and this may prove to be a time consuming procedure.
- An SA is established by virtue of registration or approval (in case the company's share capital is higher than EUR 3 million as well as in special cases) of the notarial deed which embodies the company's Articles of Association (AoA). The announcement of the Ministry of Development, containing a summary of the AoA, must be published in the 'Bulletin of Societes Anonymes and Limited Liability Companies' of the Government Gazette. Generally, the registration of a SA requires approximately one to two working days after submission of relevant documentation. However, the time period may be extended to ten working days, in the case that a special approval by the Ministry of Development is required. Whereas a LLC is established by a notarial deed, which incorporates the company's AoA, filed with the relevant authority (Registry with the Court of First Instance). A summary of the AoA must be published in the 'Bulletin of Societes Anonymes and Limited Liability Companies' of the Government Gazette. Such registration usually takes three to five working days after the signature of the notarial deed.
- An SA company is supervised by the Greek Ministry of Development (Prefecture), which necessitates certain filings to be performed (e.g. minutes of BoD, general announcements, financial statements). Whereas, at least at this stage, no supervising authority exists for an LLC and thus its filing requirements are less restrictive.

# Guatemala

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## Significant developments

As of 2010, all optional income tax regime taxpayers and drawback industry taxpayers are required by law to file audited financial statements along with their annual income tax returns.

## Taxes on corporate income

The tax system of Guatemala is a unitary system, whereby income of all kinds, other than capital gains, is lumped together and subject to a single tax. The components of gross income subject to tax are usually business income, interest, dividends, rent, salaries, and services. Companies are subject to income tax only on their Guatemala-source income. Dividends and other income payable abroad are taxed separately by way of withholding taxes (WHT).

There are two income tax regimes in Guatemala: general and optional.

### General income tax regime

A rate of 5% is applicable to a company's gross income from Guatemalan sources (less exempt income).

A rate of 5% is applicable on gross revenue of juridical entities and individuals performing mercantile and non-mercantile activities, resident in Guatemala.

The tax is payable under flat tax withholdings (the tax is to be retained by either the customer or the recipient of services) or by direct remittances to the tax office made monthly within the first ten working days of the month following the invoice date.

### Optional income tax regime

A rate of 31% is applicable to a company's taxable income from Guatemalan sources.

A rate of 31% is applicable on net income of juridical entities and individuals resident in Guatemala.

Under this system, the tax is determined and paid at the end of each quarter, without prejudicing the end-of-period final tax liquidation.

# Guatemala

## *Corporate residence*

The place of incorporation determines corporate residence. Entities incorporated under Guatemalan laws are required to have their fiscal and corporate residence in Guatemalan territory.

There are no specific provisions that determine corporate residence or permanent establishment (PE).

## *Other taxes*

### *Value-added tax (VAT)*

A 12% VAT is levied on the sale or transfer of merchandise and on non-personal services rendered or effected in Guatemala. The tax is payable to the government by way of the invoice method, whereby the tax charged to the customers is offset by the VAT paid over purchases, and the government collects the net resulting amount. The issuance and circulation of credit titles is VAT-exempt.

#### Sale of goods

The taxable amount on the sale of goods includes the sales price, less any discounts provided under sound commercial practices, plus other charges shown on the invoice.

#### Services

The taxable amount of services includes the price of the service, less any discounts provided under sound commercial practices, plus financial charges and products used to render the services.

#### Imports and leases

The tax base for imports is the value declared for import duties computation purposes.

The tax base for leases of movable or immovable property is the value of the lease.

#### Exempted sales and services

The following items are exempt from VAT:

- Importations made by:
  - cooperatives legally constituted as registered on imported machinery, equipment, and other goods relating to the activity or service of the cooperative
  - individuals and juridical entities under temporary importation regulations, and
  - diplomatic and consular missions accredited before the Guatemalan government.
- Banking institution services and their agents.
- The issuance, circulation, and transfer of credit bonds, value bonds, and stocks of any kind.
- Interest accrued by credit bonds and other obligations issued by mercantile partnerships, negotiated through an authorised stock exchange.
- Exports of goods and services.
- Contributions and donations to educational, cultural, assistance, or security service partnerships, constituted as not-for-profit entities.

#### VAT tax return

The amount payable to the Superintendencia de Administración Tributaria (SAT), Guatemala’s tax authority, is the difference between the debits and credits accrued during the tax period (one month) and is paid monthly by filing a tax return in the following calendar month at the end of each tax period.

**Refunds of VAT**
Any tax credits at the end of the tax period may be carried forward the next month to offset any tax debits that month. No cash refunds are allowed other than to exporters.

### *Stamp taxes*
Other than sales invoices, contracts, and documents subject to VAT, and other minor exemptions, a stamp tax must be paid on all documents covering commercial and legal transactions (e.g. collection of dividends), either by preparing the document on papel sellado, which is special stamped paper, or by affixing stamps on the documents. This tax is also assessed on documents issued abroad, other than drafts or promissory notes and commercial invoices from foreign suppliers. Letters of credit and acceptances involving international transfers of funds are generally exempt from stamp taxes.



The normal tax rate is 3% and is calculated on the face value of the documents or on the gross value of the related transaction.

### *Real estate tax*
Real estate taxes are assessed annually at 2 Guatemalan quetzales (GTQ) per thousand on declared property values of from GTQ 2,000 to GTQ 20,000, at GTQ 6 per thousand on values from GTQ 20,000 to GTQ 70,000, and at GTQ 9 per thousand on values in excess of GTQ 70,000 (e.g. property valued at GTQ 1,000,000 will pay real estate taxes of GTQ 9,000).

### *Solidarity tax (Impuesto de Solidaridad or ISO)*
The ISO tax rate of 1% is assessed on the net assets of a corporation, or on the gross income of a corporation, whichever is higher, and there is no limit on the amount to be paid. Tax paid may be credited against the corporation's income tax. If the annual business tax exceeds the income tax, no reimbursement is possible.

The tax is to be paid quarterly on the basis of the corporation's opening balance sheet for each fiscal period.

### *Social security contribution*
Corporations contribute 12.67% of their monthly payroll and employees contribute 4.83% of their monthly salary to social security.

## *Branch income*

In Guatemala, branches are taxed as any other legal entity. There are no specific taxes for branches.

## *Income determination*

### *Inventory valuation*
There are no provisions regarding inventory valuation in Guatemala.

### Capital gains
Capital gains are taxed at 10% in the general income tax regime and at 31% in the optional income tax regime. Capital losses can be netted only against capital gains.

### Dividend income
Dividends from domestic subsidiaries and other domestic corporations are not subject to income tax withholdings if Guatemalan income tax has been paid.

### Interest income
Interest income earned by resident persons other than banks is subject to a flat WHT rate of 10%. The interest taxed must be included by taxpayers in their income tax returns as non-taxable income.

### Foreign income
Foreign-source income received by a domestic corporation is generally exempt from Guatemalan income tax.

## Deductions

Deductions apply only under the optional income tax regime.

### Depreciation
Depreciation is generally computed on a straight-line basis. Upon request by the taxpayer, the tax authorities may authorise other depreciation methods. The maximum annual rates allowed as deductible expenses are the following:

| Asset | Rate (%) |
|---|---|
| Building and improvements | 5 |
| Machinery and equipment | 20 |
| Furniture and fixtures | 20 |
| Vehicles | 20 |
| Tools | 25 |
| Tree and vegetable species | 15 |
| Computer equipment and software | 33.33 |
| Any other depreciable asset | 10 |

Tax depreciation must conform to book depreciation.

### Interest expense
The deduction of interest expense is limited to the maximum interest rate used by the National Bank annually (to date approximately 12-13%) in excess of the authorised rate for commercial banks.

### Employee pension/retirement funds
The deduction of provisions to establish or increase employee pension and retirement funds or reserves is allowed, provided the government approves the related plans.

### Severance compensation payments
Severance compensation payments are allowed as deductible expenses as well as limited allocations (not to exceed 8.33% of total annual salaries and wages) to a reserve for severance compensation. Provisions pertaining to actual liability for severance

compensation per year are also allowed, provided the related plans, based on collective bargaining agreements, are approved by the employer and employees.

### *Charitable contributions*

Duly proven donations made to the government, the municipalities, and their agencies, as well as to duly authorised not-for-profit welfare, social service, and scientific associations and foundations, universities, political parties, and guild entities are deductible. The maximum deductible amount for income tax purposes of each period shall not exceed 5% of the donor's net income up to a maximum of GTQ 500,000 per year.

### *Taxes*

All taxes other than income tax and VAT are deductible.



### *Net operating losses*

Operating losses may not be carried forward for deduction from otherwise taxable profits. Guatemalan laws also do not permit carryback of losses.

### *Payments to foreign affiliates*

Deduction for royalties will be allowed, up to 5% of gross income. Charges for technical service fees are deductible, up to 1% of gross income or 15% of total salaries paid to Guatemalans, whichever is larger.

Expenses incurred abroad by non-residents in connection with income earned from Guatemalan sources cannot be deducted for income tax purposes by merely having the supporting receipts, as the regulations to the law do not permit such a deduction for these purposes, unless these expenses are related with the Guatemalan company operations and these expenses are needed for generating taxable income.

## *Group taxation*

No consolidation for tax purposes is permitted as each group entity is treated as an independent taxpayer, which shall file its own tax return.

### *Transfer pricing*

There is no specific transfer pricing legislation; however, the tax authorities have the power to hire professionals in law, economics, finance, or other scientific or technical specialties where it is necessary for the best performance of their auditing and collection functions.

### *Thin capitalisation*

There is no specific legislation regarding thin capitalisation in Guatemala.

## *Tax credits and incentives*

### *Drawback industries (Maquila)*

The Law of Promotion and Development of Exports Activities and Drawback Industries is known in Guatemala as maquila. This law seeks to promote, encourage, and develop the manufacture of products within areas controlled by the Customs Authority for export to countries outside the Central American region, as well as to regulate exporting and drawback activities.

The exporter may apply for authorisation to operate under any of the following three systems provided by the law:

- Export under a temporary admission system.
- Export under the reimbursement of duties system.
- Export under the total added national component system.

Tax incentives and benefits of the law include the following:

- Exemption of taxes, import duties, and other charges on imports of machinery and equipment, including VAT.
- Discontinuance of VAT payments on temporary raw material imports.
- Exemption of income tax for ten years on profits obtained under this law.

### *Free Trade Zones Law*

The Free Trade Zones Law seeks to encourage and regulate the establishment of free trade zones that promote domestic development by activities carried out within certain zones, particularly those that tend to strengthen export activities, generate employment, and transfer technology.

Tax incentives and benefits of the law include the following:

- Import duties exemption.
- Income tax exemption as follows:
  - Ten-year period for the administrative agency.
  - Ten-year period for industrial & service permit holders.
  - Five-year period for commercial permit holders.
- Exemption of real estate taxes for a five-year period.
- Exemption of tax stamps on the conveyance of title over properties.
- Dividends or profits distributed by the administrative agency and permit holders shall also be considered tax-exempted income.
- Exemption of custom duties and any other charges on import and consumption of fuel oil, bunker, butane, and propane gas used exclusively in the free trade zone.
- Foreigners working in the free trade zone are subject to the provisions of the immigration law and the Labour Code.

## *Withholding taxes*

The following WHT rates apply on payments to non-resident corporations or individuals:

| Payment | WHT (%) |
|---|---|
| Dividends, profit participations, earnings, and other benefits (1) | 10 |
| Commissions, salaries | 10 |
| Interest (2) | 10 |
| Professional fees, royalties, technical service fees | 31 |

Notes

1. For taxpayers that already paid corporate income tax, there is no WHT regarding dividends.
2. Interests will not be taxed (i.e. no withholding applies) when:
   - These interests are paid to a legal bank or financial institution.
   - The interests are in connection with a loan registered in the Guatemalan banking system.
   - The loan was used in taxable activities.

### Tax treaties
Guatemala has no tax treaties in force.

## Tax administration

### Returns
#### General income tax regime
Under the general income tax regime, there is no tax return to be filed.

#### Optional income tax regime
Under the optional income tax regime, the annual final tax liquidation period begins on 1 January and ends on 31 December of each year. Returns are due after the end of the fiscal period (31 December) but no later than 31 March of each year.



The income tax return shall be accompanied by the documents required by the regulations, which might include a:

- balance sheet
- statement of results of operations
- statement of cash flows, and
- statement of cost of production.

Documents must be duly certified by a professional or an independent accounting firm. The financial statements that accompany the return shall agree with both those recorded in the financial statements ledger and those destined for publication.

Both the income tax return and exhibits thereto shall be signed by the taxpayers, their agent, or their legal representative or by any other responsible persons so determined by this law and the tax code.

### Payment of tax
#### General income tax regime
Under the general income tax regime, tax is payable via flat tax withholdings (the tax is to be retained by either the customer or the recipient of services) or by direct remittances to the tax office made monthly within the first ten working days of the month following the invoice date.

Taxes on income are governed by the income tax law, Ley del Impuesto sobre la Renta, and its related regulations. Administration of the law is vested with the SAT.

#### Optional income tax regime
Under the optional income tax regime, taxpayers are required to prepay their estimated annual income tax liability in quarterly instalments. The balance is due upon filing the return.

Taxpayers may choose one of the following procedures for computing estimated quarterly tax liability:

- Tax on income shown by partial closure of accounts or computation of presumed liquidation of operations at the end of each quarter.
- Tax on 5% of overall gross income earned during the corresponding quarter of the preceding year (5% of the 30% income tax rate = 1.5%).
- Tax equivalent to one-fourth of the tax paid for the immediately preceding tax year.

## *Other issues*

Accurate and current information regarding taxation in Guatemala is often difficult to obtain as the country lacks reporting services such as those available in other countries. It is also difficult to determine how the tax laws will be applied in practice in complex situations. The laws and regulations are limited and ordinarily cover only the most common situations. The system of legal precedent resulting from court decisions is narrowly used, and each issue is resolved by reference to the respective codes. Guatemala has shown little interest in tax planning, but it is possible to have informal consultations with the tax authorities and to obtain authoritative rulings in many cases. Discrepancies between government and management criteria are commonly brought to judgment by the Constitutional Court, whose binding sentences generally abrogate the laws in dispute.

# Guernsey, Channel Islands

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## Significant developments

The tax regime underwent radical changes with effect from 1 January 2008 with the introduction of the zero/ten tax legislation. Under this regime, the standard rate of company income tax moved to 0%, with a 10% rate applied to income derived from banking businesses and a 20% rate applied to publicly regulated utility companies and income derived from property located in Guernsey.

The new regime also saw the abolition of the 'international company' designation and two categories of exempt company status with effect from 1 January 2008. As a result, a company may no longer be able to negotiate a specific rate of tax with the Income Tax Office. The only companies that may potentially qualify for the exempt company status are certain categories of collective investment schemes and unit trusts.

The new zero/ten regime is currently under review and may therefore change in the future.

## Taxes on corporate income

Companies pay income tax at the standard rate of 0% on taxable income.

Income derived from a banking business is taxable at 10%. 'Banking business' is broadly defined as income that arises as a result of the provision of credit facilities by any type of company and the utilisation of customer deposits. Relief is available for eligible expenses that are allocated against different streams of income.

Any income derived from the exploitation of property located in Guernsey or received by a publicly regulated utility company is subject to tax at the higher rate of 20%.

### Exempt companies

Some collective investment schemes and unit trusts may qualify for exempt status, which would place them completely outside the Guernsey tax regime. For each year for which exempt status is sought, a charge of 600 pounds sterling (GBP) is levied.

One of the following conditions, among others, must be met for the company to be considered exempt:

- The company is beneficially owned outside of Guernsey.
- No Guernsey resident individual or company has a beneficial interest in the company (with the exception of shareholders, loan creditors, or nominees/trustees).

### Loans to participators
If a company makes loans with preferential terms to an individual or entity connected with the company, this will be deemed to be income in the hands of the debtor, and the creditor company will be required to account for, withhold, and pay the tax. Certain exemptions apply.

## Corporate residence

All Guernsey-registered companies are regarded as residents in the island unless granted exempt company status. In addition, a company will be treated as a resident in Guernsey (regardless of where it is incorporated) if shareholder control is exercised by persons resident in the island.

## Other taxes

### Dwellings profit tax
The dwellings profit tax has been abolished with effect from 28 January 2009.

## Branch income

Branch income is taxed in the same manner as companies, at the appropriate rate according to the activity being undertaken.

No further tax is withheld on the transfer of profits abroad to group companies, provided no Guernsey resident individual has an interest in the company.

## Income determination

### Inventory valuation
Inventory is valued at the lower of historical cost or net realisable value. Use of last in first out (LIFO) is not permitted. Generally, there are no material differences between accounts prepared on a normal accounting basis and those prepared on a tax basis.

### Capital gains
Capital gains are not subject to tax in Guernsey.

### Inter-company dividends
All dividends paid by a standard tax-paying company (0%) are deemed to have been paid from income arising after 31 December 2007, (i.e. after the introduction of the new zero/10 tax regime) unless the company elects to have them treated otherwise.

### Stock dividends
Stock dividends may be treated as income.

### Foreign income
Resident corporations are liable to tax on their worldwide income. Income tax is levied on foreign branch income when earned, and on investment income from foreign dividends, interest, rents, and royalties. Double taxation is mitigated either through unilateral relief (by giving credit for foreign taxation of up to three-quarters of the effective Guernsey rate) or by treaty relief.

## Deductions

### Capital allowances

Depending on the life of an asset, annual allowances (depreciation for tax purposes) are available on machinery and equipment, including vehicles, on diminishing-balance or on straight-line basis at varying standard rates. Obsolescence allowance is given when, on disposal, proceeds of a sale are less than the unclaimed annual allowances on machinery and equipment being replaced. Any surplus of realisation value of an asset over its tax written-down value is liable to tax, up to the total amount of allowances claimed.

Limited allowances are applicable to buildings but not to the depletion of natural resources.



### Taxes

Local income tax paid is not deductible in computing taxable income.

### Other significant items

Normally, business deductions are allowed if they are incurred wholly and exclusively for the purpose of the trade.

### Net operating losses

Losses from one class of income may be used to offset the profits from another class of income if both classes are subject to tax at the same rate. Unrelieved trading losses may be carried forward to offset future trading income.

Upon cessation of trade, operating losses arising from balancing allowances may be carried back to the previous two years of charge to be relieved against past trading profits.

### Payments to foreign affiliates

Guernsey-source royalties and long-term interest are subject to taxation at source. Relief is obtained by the retention of the tax deducted. Short-term interest, unless owed to an authorised bank, is not deductible, unless the advance in respect of which it is paid is used wholly and exclusively for the purposes of the trade. Other fees must be paid on an arm's-length basis.

## Group taxation

Group loss relief may be claimed when both companies are members of the same group and the companies are either carrying on business in Guernsey through a permanent establishment (PE) or incorporated in Guernsey. Loss relief is available only against income taxed at the same rate.

A claim for group loss relief must be made by the claimant company within two years after the end of the calendar year in which the relevant accounting period ended, and the claim must be accompanied by a declaration by the surrendering company that it consents to the surrender.

## Tax credits and incentives

In view of the low rate of tax, no special incentives are available to local businesses.

## Withholding taxes

### Deemed distributions

A company will be required to withhold tax on any distributions made to or in reference to any Guernsey resident individual shareholders.

Furthermore, following certain trigger events, such as the sale of shares, death of the beneficial member, etc., the company is deemed to have distributed all of the Guernsey resident shareholder's share of the company's undistributed profits accumulated since 1 January 2008. All investment income is deemed to be distributed as it arises.

Although the liability to tax is the shareholder's, the company is obligated to account for, withhold, and pay tax to the Income Tax Office and may then claim this back from the shareholder.

### Agency

A company also is required to withhold tax when it is acting as an agent and making payments to a non-resident liable to Guernsey tax.

## Tax administration

### Returns

An income tax return is required to be filed one year and 15 days after the end of the calendar year in which the accounting period ends. Should a company meet the conditions below, a simplified return may be filed without either a computation or financial statements.

In order to qualify for a simplified return, a company must have none of the following:

- Guernsey employees (other than directors).
- Guernsey resident individual beneficial owners.
- Income from utilities (e.g. Guernsey water or electricity companies).
- Income from Guernsey properties.
- Income from a banking business.
- Loans to Guernsey participators.
- Distributions made to Guernsey resident individuals.

Should a company have Guernsey resident individual beneficial members and/or make loans to participators, it will be required to submit quarterly returns accounting for distributions and deemed distributions and loans advanced.

### Payment of tax

In Guernsey, tax is payable in two instalments, on 30 June and 31 December in the year of charge (calendar year). If liabilities have not been determined, this may necessitate initially raising estimated assessments based on prior year figures and raising a final assessment when the figures are agreed.

# Honduras

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## Significant developments



The following tax reforms became effective on 12 May 2010:

- A 10% withholding tax (WHT) on the distribution of profits or dividends to non-resident companies was initiated.
- Distribution or payment of dividends or any other form of distribution of retained earnings or reserves to resident or domiciled individuals is taxed via WHT at 10%.
- The Temporary Solidarity Contribution tax rate was increased to 10% for 2010 and 2011, 6% for 2012, 5% for 2013, 4% for 2014, and 0% for 2015.
- Taxpayers with annual income over 15 million Honduran lempiras (HML) are required to withhold 1% from payment to their suppliers on purchase of goods, machinery, and services if they do not use the payment on account regime. This WHT is credited against the annual income tax.

Effective 1 June 2011:

- Corporate and individual taxpayers will be subject to a 1% income tax on gross income if the income tax calculation for the fiscal year is lower than 1% of gross income.

Please note this information is current as of 1 June 2011. Typically, pending legislation is announced in June or July. Please visit the Worldwide Tax Summaries website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

## Taxes on corporate income

Honduran resident companies are taxed on their worldwide income. Non-resident companies are subject to income tax only on income derived from Honduran sources.

The corporate tax rate for a resident company is 25% of its net taxable income.

### Temporary Solidarity Contribution

The Temporary Solidarity Contribution is a non-deductible surcharge levied on all companies with taxable income in excess of HNL 1 million. The Temporary Solidarity Contribution tax rate is 10% for 2010 and 2011, 6% for 2012, 5% for 2013, 4% for 2014, and 0% for 2015.

# Honduras

## Corporate residence

The place of incorporation is regarded by Honduran authorities as the corporate residence. Non-resident companies are companies incorporated/registered outside of Honduras.

### Permanent establishment (PE)

PE is not regulated in Honduras; nonetheless, a law reform on this matter is expected for 2011.

## Other taxes

### Sales tax

Sales tax is charged on all sale and purchase transactions of goods and services made in Honduran territory.

The general tax rate is 12%. It applies to most goods and services, with the exception of machinery and equipment, basic grains, pharmaceutical products, raw materials for the production of non-taxable goods, petroleum products, school supplies, and insecticides, among others.

The import and sale of beer, other alcoholic beverages, cigarettes, and other tobacco products are subject to 15% sales tax.

There is a 15% sales tax applicable to some PCS, cellular, internet broad band, cable TV, and energy services, depending on the amount of consumption billed by the supplier.

There is an 18% sales tax levied on first class and business class air tickets.

### Net assets tax

The net assets tax is an annual 1% tax on the net asset value of the company. It applies to the gross value of assets less reserve for accounts payable and any accumulated depreciation allowed under the income tax law and other deductions allowed by law. The law also allows a special deduction of HNL 3,000,000.

The net assets tax is in lieu of the corporate income tax when the corporate income tax is less than the amount due for net asset tax. Resident companies during their preoperative period (i.e. the period in which the company started operations but has not issued its first invoice) and companies operating in Free Zones, among others, are exempt from the net assets tax.

Non-resident companies are not liable for the net assets tax.

### Capital gains tax

In general, a 10% tax is applied on capital gains, regardless of the person's residence status. Under the Zolitur law territory, a special regime, the tax rate is a 4% flat tax on capital gains.

### Customs duties

The duty assessed by the Honduran government at the time of Customs clearance ranges between 0% and 15% for most items.

Honduras is a member of the Central American Common Market (CACM), which also includes Guatemala, El Salvador, Nicaragua, and Costa Rica. Honduras' rates on most goods from outside CACM are currently within the 0% to 15% range. Under the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) with the United States (US), about 80% of US industrial and commercial goods can now enter the region duty-free, with the remaining tariffs to be phased out over ten years. Nearly all textile and apparel goods that meet the Agreement's rules of origin are now duty-free and quota-free, promoting new opportunities for US and regional fiber, yarn, fabric, and apparel manufacturing. (The Agreement's tariff treatment for textile and apparel goods was made retroactive to 1 January 2004.)

It is necessary to first obtain the appropriate Harmonized System (HS) classification number for determining when a particular product can enter the CAFTA-DR region duty-free. With this number, it is then possible to check the country and product-specific tariff elimination schedule.



*Ad valorem* import taxes can be as high as 20%. In addition, imports are subject to the sales tax of 12% or 15% that applies to the sum of the cost, insurance, and freight (CIF) value; the *ad valorem* duty; and the customs fees.

### Payroll taxes and contributions

Payroll taxes and contributions are paid by employers at the following rates:

- Social security: 7.2% with a ceiling of HNL 4,800.
- Instituto Nacional de Formación Profesional (INFOP): 1%.
- Housing fund ('Régimen de Aportaciones Privadas' or RAP/ ' Fondo Social para la Vivienda' or FOSOVI): 1.5%.

### Municipal taxes

Companies doing business in Honduras are also subject to the rules and regulations of the respective municipalities. Taxes and obligations are ruled by the 'Plan de Arbitrios'. Some of these tax obligations include the following:

- Industry, commerce, and service tax, which is based on sales volume per year.
- Public services tax, which is paid for services such as waste management.
- Real estate tax, which is a tax on assets and asset gains.
- Sign tax, which is a tax on public advertising.

## Branch income

Branch income is subject to income tax at the rates applicable for corporate income.

## Income determination

Income is computed in accordance with generally accepted accounting and commercial principles, subject to certain adjustments required by the tax law.

### Inventory valuation

Inventories are generally valued using the first in first out (FIFO), last in first out (LIFO), and weighted-average cost methods.

### Dividend income
The income from dividends is considered 'other income', thus non-taxable under the general income tax rates. Stock dividends are also not taxable.

### Interest income
Honduran Bank interests are subject to a 10% WHT at the moment the interest is given, when the sum is over HNL 50,000. Interests from abroad are considered as normal income.

### Royalty income
Royalties are taxed in the same manner as general income if the recipient is a local company or branch.

### Foreign income
Deferral and anti-deferral of foreign income are not regulated in Honduras.

## Deductions

The net taxable income of an enterprise is determined by deducting all the ordinary and necessary expenses incurred in the generation of income, including amortisation and depreciation; municipal taxes; donations made in favour of the State, the Central District, the Municipalities, and legally recognised educational institutions, charities, and sporting facilities; mandatory employer-employee contributions to the social security system; and 'reasonable' charges for royalties and management services.

In general, all expenses incurred in the generation of taxable income are considered as deductible for income tax purposes. However, there are some 'non-deductible' expenses, even if incurred in the generation of income (e.g. interest paid to owners or shareholders, capital losses).

### Contingent liabilities
Provisions for contingent liabilities, such as severance pay, are not deductible for tax purposes; actual payments during the fiscal period, for those liabilities, are considered to be deductible expenses.

### Depreciation
Depreciation may be computed using the straight-line method. Companies may also obtain authorisation from the tax authorities to use other depreciation methods. However, after a company selects a depreciation method, it must apply the method consistently thereafter. The following are the applicable straight-line method rates for some common assets.

| Asset | Rate (%) |
|---|---|
| Buildings | 2.5 to 10 |
| Plant and machinery | 10 |
| Vehicles | 10 to 33 |
| Furniture and office equipment | 10 |
| Tools | 25 |

### Taxes
With the exception of the Temporary Solidarity Contribution, net asset taxes, income tax, and sales tax (i.e. if sales tax paid is used as a credit to net the sales tax payable to the government), taxes and contributions paid to district or municipalities are deductible expenses when determining taxable income.

### Capital losses
Capital losses are not deductible to determine the net taxable income. Capital losses can only be netted against capital gains, which are subject to a tax rate of 10%.

### Net operating losses
Companies engaged in agriculture, manufacturing, mining, and tourism may carryforward losses for three years. However, certain restrictions apply. Losses may not be carried back.



## Group taxation

No provisions exist for group taxation in Honduras.

### Transfer pricing
Transfer pricing is not regulated in Honduras; nonetheless, a law reform is expected on this matter in 2011.

## Tax credits and incentives

Companies operating under a special tax regime are exempted from income tax, sales tax, customs duties, and some municipal taxes. These special tax regimes are the following:

- Free zone.
- Industrial processing zone ('Zona Industrial de Procesamiento' or ZIP).
- Temporary import regime ('Régimen de Importación Temporal' or RIT).
- Tourism incentive law.
- Law of the Tourism Free Zone of the Bay Islands ('Ley de la Zona Libre Turística de las Islas de la Bahia').
- Law promoting the generation of electric energy with renewable resources ('Ley de Promoción a la Generación de Energía Eléctrica con Recursos Renovables'), which provides tax exemptions for projects generating 50MW and over.

Companies must comply with some governmental requirements to operate under one of the abovementioned special regimes.

### Drawback industries
Special benefits exist for industries that import semi-manufactured materials for assembly in Honduras and export finished products. Benefits consist of duty-free imports of raw materials for subsequent export as manufactured products. Machinery for these industries may also be imported duty-free.

## Withholding taxes

### WHT for residents

Distribution or payment of dividends or any other form of distribution of retained earnings or reserves to resident or domiciled individuals is taxed via WHT at 10%.

### WHT for non-residents

For non-residents in Honduras, any income derived from Honduran sources is taxable under the following table of the Income Tax Law:

| Income source | WHT (%) |
|---|---|
| Real estate and movable property rent, except dividends and interest | 10 |
| Royalties from mining operations and other natural resources | 10 |
| Salaries paid for services and other remuneration for rendering of services within national territory or abroad | 10 |
| Profit transfers from branch office to head office | 10 |
| Dividends | 10 |
| Royalties | 10 |
| Interest paid on commercial operations, bonds, securities or negotiable instruments, and other types of obligations | 10 |
| Income from operation of airplanes, ships, and vehicles | 10 |
| Income from operation of telecommunication companies | 10 |
| Insurance premiums | 10 |
| Income obtained from public shows | 10 |
| Films and video tapes for cinemas, TV, video clubs, and cable TV | 10 |
| Any other income not mentioned previously | 10 |

### Tax treaties

Honduras has not signed any tax treaties with foreign jurisdictions.

## Tax administration

The 'Dirección Ejecutiva de Ingresos' (DEI) is the tax authority in Honduras. It is responsible for the administration of the tax and customs system. Taxpayers may request approval from the DEI regarding direct or indirect taxes (e.g. accelerated depreciation methods on new assets, acquired by corporations with monetary activities requiring constant technological update, higher installed production capacity and productive re-conversion processes, in order to maintain and strengthen their competitive advantage).

### Returns

The statutory tax year runs from 1 January through to 31 December. However, taxpayers may apply to use a special tax year by requesting an authorisation from the DEI. Companies must file an income tax return on 30 April every year.

### Payment of tax

Mandatory advance tax payments are payable each quarter, based on the income tax paid for the preceding tax year. Final tax is due with the income tax return on 30 April every year.

# Hong Kong

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## Significant developments

### Developments in tax treaty network

Hong Kong's treaty network expanded at an unprecedented pace during the 13-month period from April 2010 to April 2011, in which 15 comprehensive double tax agreements (CDTAs) were signed by Hong Kong with various Asian and European countries. All these CDTAs adopt the more liberal 2004 Organisation for Economic Co-operation and Development (OECD) version of the Exchange of Information (EoI) article. In addition, the EoI articles of the CDTAs previously signed with Mainland China and Luxembourg were updated to the 2004 OECD version by means of a protocol signed in May and November 2010 respectively. Accordingly, Hong Kong has concluded 17 CDTAs that adopt the latest international standard of EoI as of April 2011.

Of the 15 newly signed CDTAs, the ones concluded with Austria, Brunei, Hungary, Ireland, and the United Kingdom were ratified and entered into force in late 2010/early 2011. The CDTAs with Brunei and the United Kingdom became effective as of 1 April 2011 in Hong Kong whereas the remaining three will become effective as of 1 April 2012 in Hong Kong.

*For more information about Hong Kong's existing treaty network, please see the Withholding taxes section.*

### Newly enacted tax legislation

The following are the two Hong Kong profits tax measures that became effective in the past 12 months:

- The legislation that provides for an accelerated 100% tax deduction for capital expenditure on environment-friendly vehicles was enacted in June 2010. Prior to the enactment of the legislation, the purchase costs of all vehicles (including environment-friendly vehicles) used for producing assessable profits were eligible for a 60% initial tax depreciation allowance in the year of purchase and an annual tax depreciation allowance of 30%. With the enactment of the legislation, the purchase costs of environment-friendly vehicles can now be fully deducted in the year of purchase, with a few exceptions.
- In March 2011, another piece of tax legislation was enacted to expand the scope of concessionary profits tax treatment for qualifying debt instruments (QDIs). Prior to the change in the tax law, interest and trading profits derived from medium-term QDIs were entitled to a concessionary profits tax rate (i.e. 50% 0f the normal rate) whereas those derived from long-term QDIs were tax exempt. With the enactment of the legislation, interest and trading profits derived from the short-term QDIs (i.e. with a maturity period of less than 3 years) are also entitled to the 50% concessionary profits tax rate. In addition, the requirement for these QDIs to be issued to the public in Hong Kong has been replaced with a less restrictive

requirement. Under the new law, such QDIs only need to be issued in Hong Kong, at issuance, to (i) ten or more persons or (ii) less than ten persons if none of whom is an associate of the issuer of the instrument.

However, the new legislation also introduces a specific anti-avoidance measure that denies the concessionary tax rate/tax exemption for interest and trading profits derived from QDIs by a person who is an associate of the issuer of the QDIs. The anti-avoidance provision applies to QDIs issued on or after 25 March 2011.

## *Taxes on corporate income*

Hong Kong adopts a territorial basis of taxation. Profits tax is payable by every person (defined to include corporation, partnership, and sole proprietorship) carrying on a trade, profession, or business in Hong Kong on profits arising in or derived from Hong Kong from that trade, profession, or business. However, capital gains and receipts that are capital in nature are not subject to tax. Dividends are also not subject to tax in Hong Kong. The tax residence of a person is generally irrelevant for profits tax purposes. The tax treatments of public and private companies are the same.

Certain income that would not otherwise be subject to Hong Kong profits tax is deemed to arise in or be derived from Hong Kong from a trade, profession, or business carried on in Hong Kong and thus becomes taxable in Hong Kong. This includes royalties received by a non-resident for the use of or right to use in Hong Kong a patent, design, trademark, copyright material, secret process or formula, or other property of a similar nature.

The tax rates are 16.5% for corporations and 15% for unincorporated businesses for year of assessment 2011/12.

There are special rules for determining the tax liabilities of certain industries such as shipping, air services, and financial services.

Incomes from certain qualifying debt instruments (QDIs) are either tax exempt or subject to a concessionary tax rate (i.e. 50% of the regular profits tax rate). A specific anti-avoidance provision was recently introduced whereby the concessionary tax rate/tax exemption does not apply to incomes derived from QDIs by a person who is an associate of the issuer of the QDIs.

Offshore funds having Hong Kong fund managers and investment advisors with full discretionary powers are exempt from Hong Kong profits tax on profits derived in Hong Kong from six types of 'specified transactions' which are carried out or arranged by 'specified persons'. However, there are also specific anti-avoidance provisions in the Inland Revenue Ordinance (IRO) deeming certain resident persons to be subject to profits tax on their share of the non-resident person's tax exempt profits.

## *Corporate residence*

In general, for Hong Kong profits tax purposes, corporate residency is not important in determining taxability of an entity. The decisive factors for taxability are (i) whether a corporation is carrying on a trade, profession, or business in Hong Kong, and (ii) whether the profits are arising in or derived from Hong Kong.

However, where it is necessary to determine the corporate residence, such as for the purpose of a comprehensive double tax agreement (CDTA), companies incorporated in Hong Kong and companies that are normally managed or controlled/centrally managed and controlled (depending on the provisions of the relevant CDTA) in Hong Kong are generally considered as a Hong Kong tax resident.

For Hong Kong profits tax purposes, whether a foreign corporation is carrying on a trade, profession, or business in Hong Kong and the source of profits, rather than whether there is a permanent establishment (PE) in Hong Kong, are the decisive factors in determining taxability.

## *Other taxes*

### *Value-added tax (VAT)*
Hong Kong does not have a VAT, goods and services tax, or sales tax.



### *Property tax*
Property tax is charged annually to the owner of any land or buildings (except government and consular properties) in Hong Kong at the standard rate of 15% on the net assessable value of such land or buildings. Net assessable value of a property is the consideration payable to the owner for the right to use the land or buildings less rates paid by the owner and a 20% notional allowance.

Rental income derived by a company from a Hong Kong property is subject to profits tax. The company that is subject to profits tax may apply for an exemption from property tax in respect of the property. If no exemption is applied, the property tax paid can be used to offset against the profits tax payable by the company.

### *Customs duties*
There is no tariff on general imports in Hong Kong.

### *Excise tax*
Duties are levied on limited categories of dutiable commodities (i.e. tobacco, liquor, methyl alcohol, and hydrocarbons), regardless of whether they are imported or locally manufactured.

### *Stamp duty*
Stamp duty is charged on transfer of Hong Kong stock by way of sale and purchase at 0.2% per transaction. Hong Kong stock is defined as stock the transfer of which must be registered in Hong Kong.

For conveyance on sale of immovable property, the stamp duty payable depends on the property consideration and ranges from a flat rate of 100 Hong Kong dollars (HKD) (for property consideration of up to HKD 2 million) to the highest rate of 4.25% of the consideration of the property (for property consideration exceeding HKD 20 million), with marginal relief upon entry into each higher rate band. For lease of immovable property, stamp duty is calculated at a specified rate of the annual rental that varies with the term of the lease. Currently, the applicable rate ranges from 0.25% (for lease period of not more than one year) to 1% (for lease period of more than three years).

Exemption is available to certain transactions, such as transfer of shares between associated corporate bodies and certain stock borrowing and lending transactions, provided that the specified conditions for exemption are satisfied.

### *Special stamp duty (not yet implemented)*
In November 2010, a Special Stamp Duty (SSD) on resale of residential property within 24 months from the date of acquisition was proposed by the Hong Kong SAR Government in order to further discourage speculation on residential properties. The SSD will be imposed on top of the normal stamp duty currently payable on conveyance on sale of immovable property, with a few exemptions available. The seller and buyer are jointly and severally liable for paying the SSD. The SSD payable will be calculated based on the stated consideration or the market value (whichever is higher) of the resold property at the following regressive rates, with higher rates for shorter holding periods.

- 15% for residential properties held for six months or less.
- 10% for residential properties held for more than six months but for 12 months or less.
- 5% for residential properties held for more than 12 months but for 24 months or less.

The proposed effective date for the SSD is 20 November 2010, that is, the SSD will be applied retrospectively from 20 November 2010 upon enactment of the relevant legislation. However, the related amendments to the Stamp Duty Ordinance have not yet been approved and implemented as of May 2011.

### *Business registration fees*
Every person who carries on a business in Hong Kong is required to apply for business registration with a fee within one month from the date of commencement of the business. The business registration certificate has to be renewed either on an annual basis or every three years with a payment of a business registration (renewal) fee. Special registration and licence fees are applicable to banks and deposit-taking companies.

### *Capital duty*
A fee of HKD 1 for all or part of HKD 1,000 of the nominal share capital, or increase in nominal share capital, is payable as capital duty. The fee is capped at HKD 30,000 per case, counted on a company (rather than group) basis.

### *Government rates and rent*
Rates are an indirect tax levied on properties in Hong Kong. Rates are charged at 5% of the rateable value, which is the estimated annual rental value of a property at the designated valuation reference date of 1 October.

Privately owned land in Hong Kong is normally held by way of a government lease under which rent is payable to the Hong Kong SAR Government in return for the right to hold and occupy the land for the term (i.e. duration) specified in the lease document. Currently, government rent is calculated at 3% of the rateable value of the property and is adjusted in step with any subsequent changes in the rateable value.

### *Transfer tax*
Hong Kong does not have a transfer tax.

### *Turnover tax*
Hong Kong does not have a turnover tax.

## Branch income

The tax rate for branch is the same as that for corporations. The Hong Kong profit of a foreign corporation with a branch in Hong Kong is determined according to the accounts maintained for the Hong Kong operation (or business). If the Hong Kong accounts do not disclose the true profits arising in or derived from Hong Kong attributable to the Hong Kong operation, the Hong Kong profit will be computed according to the ratio of turnover in Hong Kong to total turnover (or the proportion of Hong Kong assets over total assets) on the worldwide profits. Alternatively, the Hong Kong Inland Revenue Department (HKIRD) tax assessor may estimate the profits of the Hong Kong branch. In certain situations, the profits of the Hong Kong branch could be estimated based on a fair percentage of the turnover in Hong Kong.

## Income determination



### Inventory valuation

Inventory may be stated at the lower of cost or market value. Last in first out (LIFO) may not be used for tax purposes. First in first out (FIFO) must be consistently applied.

The prevailing accounting standards require financial assets and liabilities held for trading purpose (e.g. shares and securities held as trading stock) to be carried at market value, with fluctuations in values of such assets and liabilities taken to the profit and loss accounts, irrespective of whether the profits or losses are realised. The HKIRD requires that this accounting treatment be followed in computing the assessable profits for tax purposes.

There are special tax provisions for valuation upon cessation of a business under which inventory is valued at market value, unless it is sold to a person carrying on business in Hong Kong, who may deduct a corresponding amount as the cost of the inventory in computing the assessable profits.

### Capital gains

Gains from realisation of capital assets or receipts that are capital in nature are not taxed.

### Dividend income

Dividends from sources either inside or outside Hong Kong are not subject to Hong Kong profits tax. Hong Kong corporations may declare bonus issues (i.e. stock dividends), which are not taxable in the hands of the recipients.

### Interest income

Interest income received by or accrued to a corporation carrying on a trade or business in Hong Kong is subject to profits tax. Exemption is provided to interest income derived from any deposit placed in Hong Kong with a financial institution, unless the deposit secures a borrowing the interest expense of which is deductible. This exemption, however, does not apply to interest accruing to a financial institution.

Interest accruing to a bank or financial institution will be deemed to be sourced and taxable in Hong Kong if the interest arises through or from the carrying on of business in Hong Kong by the bank or financial institution.

### *Royalties*
Royalties paid or accrued to a non-resident for the use of or right to use in Hong Kong or outside Hong Kong (if the royalties are deductible in ascertaining the assessable profits of a person for Hong Kong profits tax purposes) a trademark, patent, design, copyright material, secret process, or other property of a similar nature, or for the use in Hong Kong of cinema or television tape or any sound recording, are deemed to be taxable in Hong Kong.

A total of 30% of the sum receivable is deemed to constitute profits subject to tax in normal situations. Where such royalties are received by or accrued to an associated corporation, however, 100% of the sum is deemed to constitute profits under certain circumstances.

### *Partnership income*
Partnership business is taxed as a single entity though an individual partner can use its share of losses incurred by a partnership to offset against the assessable profits of its other business. In general, there is no special registration requirement other than business registration for a partnership. The assessable profits of a partnership are basically determined in the same way as those of a corporation, with certain special rules (e.g. salaries or other remunerations paid to a partner or a partner's spouse are not deductible).

### *Unrealised exchange gains/losses*
In general, unrealised gains/losses are taxable/deductible if they are recognised in the profit and loss accounts in accordance with the generally accepted accounting principles (GAAP), provided that they are revenue in nature and with a Hong Kong source. The nature and source of exchange gains/losses are determined by the nature and source of the underlying transactions. Exchange gains/losses arising from ordinary business transactions (e.g. trade receivables or payables) are taxable/deductible whereas exchange gains/losses arising from capital transactions (e.g. sale of capital assets) are non-taxable/non-deductible.

### *Foreign income*
Hong Kong resident corporations are not taxed on their worldwide income. Foreign-sourced income, whether or not remitted to Hong Kong, is not taxed. As such, there is no specific tax provision dealing with deferral or non-remittance of foreign earnings. Nor does Hong Kong have any controlled foreign company (CFC) legislation.

## *Deductions*

Expenses that are incurred for producing profits chargeable to tax and that are not capital in nature are generally tax deductible. In addition, special tax relief is available for certain capital expenditure. There are special rules for deduction of certain expenses (e.g. interest expenses).

Accounting treatments are usually followed in determining the assessable profits except when there is an explicit rule in the IRO. Accrued expenses recognised in the profit and loss accounts in accordance with the GAAP are usually deductible if they are incurred for producing profits chargeable/subject to tax and are not capital in nature.

Expense items of which a tax adjustment is necessary in determining the amount of taxable profits from the accounting profits include: tax depreciation allowance vs.

accounting depreciation, expenses that are capital in nature, general provisions that are non-deductible, and non-deductible interest expenses on borrowings used to finance non-income producing assets.

Set out below are the Hong Kong profits tax treatments of some common expense items.

### *Tax depreciation of fixed assets*

Tax depreciation allowances/deductions are available for capital expenditure incurred on the construction of buildings or structures and in the provision of machinery and plant for trade or business purposes, as follows:

- Industrial buildings and structures: An initial allowance of 20%, in addition to an annual allowance of 4%, of the cost of construction or cost of purchase from a developer is granted for an industrial building or structure occupied for the purpose of a qualifying trade. Provision is made for balancing allowance or charge in the year of assessment in which the building is disposed of to adjust the written-down value of the building to the disposal price. Balancing charges are restricted to the total of initial and annual allowances previously given.
- Commercial buildings and structures: An annual allowance of 4% of the capital expenditure incurred on the construction is applicable. A balancing allowance or charge applies upon disposal. Balancing charges are restricted to the total annual allowances previously given.
- Plant and machinery: An initial allowance of 60% of the capital expenditure on plant and machinery is given for the year of assessment during the basis period in which the expenditure is incurred. An annual allowance is also given for depreciation at three prescribed rates on the reducing value of each of the three depreciation rate 'pools'. The three prescribed rates are 10%, 20%, and 30%, and the reducing value of each of the three depreciation rate pools is original cost less initial and annual allowances and sales proceeds. Provision is made for balancing charges when plant and machinery within one of the three depreciation rate pools is sold or disposed of and the reducing value of that pool is less than the sale price, which is capped at the original amount incurred in the pool. In addition, balancing allowances or charges may be applicable upon cessation of business. Otherwise, sales proceeds are deducted in calculating the reducing value on which the annual allowance is calculated.

Book depreciation is adjusted for tax purposes in accordance with the above depreciation allowances granted under the IRO.

### *Goodwill*

Cost of acquisition of goodwill/amortisation of goodwill is not deductible as they are capital in nature.

### *Organisational and start-up expenses*

In general, company formation/start-up expenses that are incurred before the commencement of a trade, profession, or business and that are for the establishment of the overall income producing structure are capital in nature and not tax deductible.

### *Research & development (R&D)*

There is a specific provision allowing the deduction of expenditure incurred on R&D (including payments made to an approved research institute and in-house expenditure), provided that certain specified conditions are met.

### *Interest expenses*
There is no thin capitalisation rule in Hong Kong. However deduction of interest expense is subject to stringent and complicated rules which are designed to guard against loan arrangements with an intention to avoid Hong Kong profits taxes.

### *Bad debts*
A bad or doubtful debt incurred in any trade, business, or profession, proved to the satisfaction of the HKIRD to have become bad during the basis period for a year of assessment, is deductible. The deduction is limited to debts which were included as a trading receipt in ascertaining the taxpayer's assessable profits or debts in respect of money lent in the ordinary course of a money-lending business in Hong Kong.

If any bad or doubtful debt which has previously been allowed as a deduction is ultimately recovered, it will be treated as taxable profits of the basis period in which it is recovered.

### *Charitable contributions*
A deduction is allowed for cash donations to approved charities made in the basis period for a year of assessment if the aggregate of such donations is not less than HKD100. The deduction is limited to 35% of the assessable profits of the year of assessment.

### *Pension expenses*
A deduction is allowed for regular/ordinary contributions to a mandatory provident fund scheme or recognised occupational retirement scheme made by an employer in respect of an employee to the extent that the contributions do not exceed 15% of the employee's total emoluments for the period to which the contributions relate.

Special payments other than the ordinary contributions to a mandatory provident fund scheme or recognised occupational retirement scheme are capital in nature but can be deducted evenly over a five-year period under a specific provision of the IRO.

There are also specific rules for deduction of provisions for contributions to a mandatory provident fund scheme or recognised occupational retirement scheme.

### *Payments for directors*
Director fees or other remunerations paid by a corporation to its directors are generally deductible under the normal deduction rule. Nevertheless, no deduction is allowed on salaries or other remunerations paid to a sole proprietor or any partners or partners' spouses of a partnership business.

### *Contingent liabilities*
Generally speaking, general provisions for expenses are not deductible whereas specific provisions are deductible if the HKIRD is satisfied that the amount has been incurred (i.e. the taxpayer has a legal/contractual obligation to pay such amount in future) and that the provision represents a reasonably accurate estimate of the future liability.

### *Special deductions*
There are special deduction rules for expenditures incurred (i) for refurbishment of a building or structure, other than a domestic building or structure; (ii) on environmental protection instalation and machinery; (iii) on environment-friendly vehicles; (iv) on machinery or plant used specifically and directly for any manufacturing process, computer hardware (other than that which is an integral part of machinery or plant), computer software, and computer systems (collectively known as prescribed fixed

assets); (v) for registering trademarks, designs, or patents used in the production of taxable profits; and (vi) on the purchase of patent rights or rights to any industrial information or techniques likely to assist in the manufacture or processing of goods or materials, for use in Hong Kong.

It has also been proposed in the 2010/11 Budget that a deduction (i.e. over a five-year period, starting from the year of purchase) be provided for capital expenditures incurred on the purchase of registered trademarks, copyrights, and registered designs. However, the legislation giving effect to that proposal has not been enacted as of May 2011.

### *Fines and penalties*
Fines and penalties are generally not deductible as the HKIRD does not consider them to be expenses incurred for producing profits chargeable/subject to tax.

### *Taxes paid*
Taxes paid on corporate profits are generally not deductible for the purpose of calculating the assessable profits. However, the HKIRD generally accepts that a foreign tax that is an expense that must be borne regardless of whether or not a profit is derived (e.g. a foreign withholding tax levied on the gross amount of interest or royalties received), as opposed to a charge on the profits themselves, is deductible under the general deduction provision. Where interest income or gains from the sale of a certificate of deposit or bill of exchange are deemed to be subject to profits tax, a deduction is allowed for foreign taxes of substantially the same nature of Hong Kong profits tax paid in respect of the same income, provided that the taxpayer is not eligible for double taxation relief under a CDTA.



### *Net operating and capital losses*
Net operating losses incurred in an accounting year can be carried forward indefinitely to offset future profits of the business. A corporation carrying on more than one business may have losses in one business offset profits of the others, with any balance being carried forward. Net operating losses cannot be carried backward.

Capital losses are not tax deductible.

### *Payments to foreign affiliates*
Royalties and service fees paid/payable by a Hong Kong corporation to foreign affiliates are deductible provided they are incurred for the production of profits chargeable/ subject to tax. There is no special restriction on the deductibility of these payments. Interest payable to a foreign affiliate is not deductible if the recipient is not chargeable/ subject to Hong Kong profits tax on the interest income received.

## *Group taxation*

Hong Kong does not have a consolidated or group taxation regime.

### *Transfer pricing regime*
Strictly speaking, there is no comprehensive transfer pricing legislation in Hong Kong. While a few existing provisions in the IRO may be employed by the tax authority to tackle non-arm's-length transactions, such provisions are primarily aimed at transactions with closely connected non-residents or tax avoidance transactions rather than specific legislation on transfer pricing.

In 2009, the HKIRD issued two Departmental Interpretation and Practice Notes (DIPNs) to address the transfer pricing issues in Hong Kong. DIPN 45 focuses on the administrative/procedural issues involved in providing double tax relief in a treaty context such as when such relief is available and what are the procedures for claiming such relief. DIPN 46 outlines the HKIRD's view on the legislative framework for transfer pricing in Hong Kong (including the statutory provisions in the IRO and the articles in a CDTA that are relevant to transfer pricing) and provides guidance on numerous transfer pricing related issues such as the application of the arm's-length principle, the acceptable transfer pricing methodologies, which are largely in line with the OECD transfer pricing guidelines. The DIPN also spells out the documentation that taxpayers should consider retaining to support their transfer pricing arrangements and explains the interaction between the transfer pricing and sourcing rules in Hong Kong.

In general, the HKIRD adopts the arm's-length principle and would seek to apply the OECD transfer pricing guidelines except where they are incompatible with the express provisions in the IRO.

### *Thin capitalisation rules*
Hong Kong does not have thin capitalisation rules.

### *Controlled foreign company (CFC) regime*
Hong Kong does not have a CFC regime.

## *Tax credits and incentives*

### *Foreign tax credits*
Foreign tax credits are available if foreign taxes are payable/paid on income derived from a jurisdiction which has entered into a CDTA with Hong Kong and the same income is subject to tax in Hong Kong. *See the Withholding taxes section for a list of jurisdictions that have entered into a CDTA with Hong Kong.*

### *Tax holidays*
Hong Kong does not have a tax holiday program.

### *Foreign investment incentives*
Hong Kong does not have any specific incentives for foreign investment except that offshore funds may be exempt from profits tax under certain circumstances.

## *Withholding taxes*

There is no withholding tax (WHT) on dividends, interest, or royalties. However, the 4.95%/16.5% (for corporations) or 4.5%/15% (for unincorporated businesses) tax on royalties received by non-residents *(see Royalties in the Income determination section)* is in effect similar to a WHT.

Resident consignees are required to furnish quarterly returns to the HKIRD showing the gross proceeds from sales on behalf of their non-resident consignors and to pay to the HKIRD Commissioner a sum equal to 0.5% of such proceeds. The HKIRD normally accepts this as satisfying the Hong Kong tax obligations of the non-resident.

# Hong Kong

Hong Kong has so far entered into a CDTA with Austria, Belgium, Brunei, France, Hungary, Indonesia, Ireland, Japan, Kuwait, Liechtenstein, Luxembourg, the Netherlands, New Zealand, the People's Republic of China (PRC), Portugal, Spain, Switzerland, Thailand, the United Kingdom, and Vietnam. The agreements with France, Indonesia, Japan, Kuwait, Liechtenstein, the Netherlands, New Zealand, Portugal, Spain, and Switzerland have not yet entered into force, pending the completion of the ratification procedures of the governments concerned.

The following table shows the applicable WHT rates for payments made from Hong Kong payers to non-treaty and treaty country corporate recipients. The rates shown in the table are the lower of the domestic and treaty rates. For WHT rates on payments received by Hong Kong recipients from treaty country payers, please refer to the summaries of the respective treaty countries.

| Recipient | Dividends (%) (1) | Interest (%) (1) | Royalties (%) |
|---|---|---|---|
| Non-treaty | 0 | 0 | 4.95 (2) |
| Treaty: | | | |
| Austria | 0 | 0 | 3 |
| Brunei | 0 | 0 | 4.95 (3) |
| Belgium | 0 | 0 | 4.95 (3) |
| China, the People's Republic of (PRC) | 0 | 0 | 4.95 (3) |
| France | 0 | 0 | 4.95 (3) |
| Hungary | 0 | 0 | 4.95 (3) |
| Indonesia | 0 | 0 | 4.95 (3) |
| Ireland | 0 | 0 | 3 |
| Japan | 0 | 0 | 4.95 (3) |
| Kuwait | 0 | 0 | 4.95 (3) |
| Liechtenstein | 0 | 0 | 3 |
| Luxembourg | 0 | 0 | 3 |
| The Netherlands | 0 | 0 | 3 |
| New Zealand | 0 | 0 | 4.95 (3) |
| Portugal | 0 | 0 | 4.95 (3) |
| Spain | 0 | 0 | 4.95 (3) |
| Switzerland | 0 | 0 | 3 |
| Thailand | 0 | 0 | 4.95 (3) |
| United Kingdom | 0 | 0 | 3 |
| Vietnam | 0 | 0 | 4.95 (3) |

Notes

1. Hong Kong IRO does not impose WHT on dividends and interest currently. However, the treaties provide for a maximum WHT rate on dividends and interest should Hong Kong IRO impose such WHT in the future. Some of the treaties also provide for a reduced WHT rate on dividends and interest if conditions specified in the treaties are met.
2. Generally, royalties paid to non-resident corporations that are not otherwise chargeable to Hong Kong profits tax are subject to WHT at 4.95%. The 16.5% rate applies if the royalties are received by or accrued to a non-resident from an associate, unless the Commissioner is satisfied that no person carrying on business in Hong Kong has at any time wholly or partly owned the property in respect of which the royalties are paid.
3. Since a higher rate is specified in the treaty, the lower domestic/non-treaty rate of 4.95% will apply.

## Tax administration

### Returns

A year of assessment (or tax year) begins on 1 April of a year and ends on 31 March of the following year.

Tax returns are issued on the first working day of April each year. The filing deadline is usually within a month from the date of issue. However, corporations whose financial year ended after November 30 and are represented by a tax representative are normally granted with an extension for filing their returns. The exact filing due date depends on the accounting year end date of the taxpayer.

The basis of assessment is the accounting profits of the financial year ending within the year of assessment, with appropriate adjustments for tax purposes. A tax return is usually filed together with a tax computation showing the tax adjustments to the accounting profits in arriving at the taxable profits or allowable tax losses for a given year of assessment.

Corporate taxpayers are also required to attach their audited accounts as supporting documents when filing a profits tax return, unless they qualify as a small corporation as defined by the HKIRD (i.e. mainly those with gross income for a basis period of not exceeding HKD 2 million plus a few other conditions). Small corporations are not required to attach supporting documents with their profits tax returns but are still required to keep those documents and submit them upon request. A branch of a foreign corporation doing business in Hong Kong is required to file a profits tax return annually, and the HKIRD may require audited accounts of the foreign corporation to support the Hong Kong branch's profits tax return.

Notice of assessment will be issued after the tax return has been examined by the HKIRD. Taxpayers may be subject to post-assessment investigation or field audit under the computerised random selection procedures of the HKIRD at a later date.

### Payment of tax

The dates of payment of tax are determined by the HKIRD Commissioner and specified in the assessment notice. A system of provisional tax payments applies whereby estimated tax payments are made during the current year. The provisional profits tax payable is normally estimated based on the previous year's profits tax liability. The provisional profits tax already paid is credited against the final profits tax assessed for a year of assessment, which is determined after filing of the return.

### Statute of limitation

An additional assessment may be made by a HKIRD tax assessor if a taxpayer chargeable to tax has not been assessed to tax or has been assessed at less than the proper amount. The assessment must be made within the relevant year of assessment or within six years after the end of that year of assessment. The time limit for making additional assessments is extended when a taxpayer either has not been assessed, or is under-assessed, due to fraud or wilful evasion. In that case, an additional assessment may be made up to ten years after the end of the relevant assessment year.

A statement of loss is not an assessment, and the above six-year time limit does not apply to issue or revision of a statement of loss. A tax loss year remains technically open until the sixth year after the first year in which the taxpayer has an assessable profit after utilising all the tax losses brought forward.

### Tax audit cycle
There is no specific tax audit cycle in Hong Kong. Tax audit targets are selected with reference to certain criteria determined by the HKIRD.

### Topics of focus for tax authorities
Issues that are often subject to close scrutiny of the tax authority include offshore claim of profits, capital claims of income, transactions with related parties and closely connected non-residents, and deductibility of expenses (e.g. interest expenses, share-based payments, and intra-group management/service fees).

### General anti-avoidance rules (GAAR)
The IRO includes a GAAR (i.e. section 61A) allowing the HKIRD to disregard a transaction or counteract the tax benefit conferred by a transaction if the sole or dominant purpose of entering into such a transaction is to obtain a tax benefit. Whether the sole or dominant purpose of entering into a transaction is for obtaining a tax benefit will be assessed according to a set of factors stipulated in section 61A. Another GAAR in the IRO is section 61, which empowers the HKIRD to disregard a transaction that reduces or would reduce the amount of tax payable by any person if that transaction is considered artificial or fictitious. Although both GAARs could be used, in practice, section 61A is more often invoked by the HKIRD in tackling tax avoidance schemes.



### Specific anti-avoidance provision for related party transactions
In addition to the general anti-avoidance provisions described above, there is a specific anti-avoidance provision dealing with transactions with closely connected non-residents. Under the specific provision, if a resident person carries on a business with a closely connected non-resident person such that no profits or less than the ordinary profits are derived by the resident person in the course of such business, the non-resident person can be assessable and chargeable to tax in respect of his profits derived from such business in the name of the resident person.

## Other issues

### Foreign investment restrictions
In general, Hong Kong does not impose restriction to foreign investors to make investments in Hong Kong; and wholly foreign owned companies are allowed. The only exception is the restriction on foreign ownership of Hong Kong's licensed television/sound broadcasters, of which the collective foreign ownership ceiling is 49% of the voting power. In addition, an approval from the Broadcasting Authority must be obtained for holding, acquisition, or exercise of voting control by a foreign investor of more than 2% of a licensee.

### Exchange controls
Hong Kong does not have any foreign exchange control. There is no restriction on entry or repatriation of capital or remittance of profits from investments. Funds can be freely remitted to persons outside Hong Kong by various means such as dividends, interest, royalties, service fees, and branch profits, etc.

### Choice of business entity
The principal forms through which a business can be conducted in Hong Kong are as follows:

- Company incorporated in Hong Kong (either private or public via listing on the Stock Exchange of Hong Kong).

- Branch of a foreign company.
- Representative or liaison office of a foreign company.
- Joint venture (can be set up either as a company or partnership).
- Partnership.
- Sole proprietorship.

Of the above, privately incorporated companies and branches of a foreign companies are most commonly used by foreign investors, as limited liability is usually desirable.

### *Intellectual property regulations*

The Intellectual Property Department is responsible for monitoring the intellectual property regime and ensuring the protection and enforcement of intellectual property rights in Hong Kong. The Department is also responsible for investigating complaints against infringements and has extensive powers of search and seizure. Registration and protection of patents, copyrights, trade marks, and registered designs are each governed by a separate ordinance.

### *Merger & acquisition (M&A) activities*

There are no specific restrictions on M&A activities in Hong Kong. The following tax considerations are relevant in the M&A context:

- Hong Kong does not impose any tax on dividends or other forms of distribution of profits (e.g. distribution of branch profits to the head office).
- Capital gains arising from an M&A transaction is not taxable in the hands of the transferor, whereas amortisation of the goodwill in the transferee's accounts is not tax deductible due to its capital nature.
- For a share deal, stamp duty is payable on the transfer of Hong Kong shares at 0.2% unless an exemption applies; for an asset deal, stamp duty is payable on conveyance of immovable property at progressive rate of up to 4.25%.
- Gains derived from transfer of revenue items (e.g. trade receivables) in an asset deal would be subject to profits tax.
- There is no special tax concession/incentive relating to M&A transactions.
- Tax losses in the acquired company can generally be carried forward indefinitely to set off against future assessable profits. However, there are specific anti-avoidance provisions in the IRO that prevent the transfer of shares of a company with accumulated tax losses to owners of a profitable company for the sole or dominant purpose of utilising the tax losses i.e. offsetting the tax losses against the profits generated from other trade, profession, or business of the transferee.

# Hungary

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## Significant developments

As of 1 January 2011, the following significant changes were introduced to the Hungarian tax system.

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### Corporate income tax (CIT)

- The CIT rate is now 10% on the first 500 million Hungarian forint (HUF) of a positive CIT base. The tax base above this limit is subject to 19% CIT. As of 2013, a 10% general CIT rate will be applicable to the entire positive CIT base.
- Withholding tax (WHT) is no longer levied on interest, royalty, or service fees paid to foreign organisations in low tax countries.
- The EU Community legal framework for a European Research Infrastructure Consortium (ERIC) entered into force on 28 August 2009. This new legal form is designed to facilitate the joint establishment and operation of research facilities of European interest.
- New controlled foreign company (CFC) legislation reduced the effective tax rate ceiling for CFC qualification from 12.66% to 10%.
- The Tax Authority and the Customs Authority have been merged to become the National Tax and Customs Authority.

### Value-added tax (VAT)

- Cost-sharing groups were introduced as a new VAT category. The service provided by a cost-sharing group to its members qualifies as tax-exempt for a member that does not order the service as a taxpayer or receives the service for certain specified tax-exempt activities. In addition, the consideration received by the group may not exceed the certified expenses of the provision of the service, and members will have to provide the consideration to the group in the form of members' contributions.
- Hungary is obliged to implement the general place-of-supply VAT rules for cultural, artistic, scientific, educational, entertainment, and sports services. One exception to the general rule is facilitating entry to such events; in such cases, the place of supply will be where the service is physically carried out.
- In the course of 2010, a definition of what qualifies as a public donation was introduced. Public donations are no longer treated as supplies of goods or services for consideration and are not subject to VAT. Under the new regulations, and according to the Tax Authority's practice based on these regulations, the right to deduct VAT on purchases made for business purposes will not be restricted unless the purchase in question is made for the purpose of donation.
- As there have been technical difficulties with the implementation of the New VAT refund procedure for foreign taxpayers in the EU member states, the deadline for filing 2009 refund applications was extended to 31 March 2011, as proposed by the European Commission.

### Excise duty
Excise duty rates of tobacco products increased as of 1 January 2011. The duty rates from 1 January 2011 are as follows:

- Cigarettes: HUF 9,750 (approximately EUR 35) per thousand cigarettes plus 28.4% of the retail sale price, but a minimum of HUF 18,080 (approximately EUR 65) per thousand cigarettes. The tax base per cigarette also depends on the length of the cigarette (without filter). It is double if the length of the cigarette is 8cm to 11 cm, triple if the length is 11cm to 14 cm, and so on.
- Cigars and cigarillos: 28.5% of the retail price.
- Fine-cut tobacco: 52% of the retail price, but a minimum of HUF 7,860 (approximately EUR 30) per kilogram.
- Other tobacco: 32.5% of the retail price, but a minimum of HUF 7,860 (approximately EUR 30) per kilogram.

A new duty rate was introduced for flavoured beers that contain less than 2.8% alcohol, depending on the alcohol content (compared to other beers, which are taxed on the basis of Balling (Plato) Degree). The duty rate for such flavoured beers is HUF 1,400 (approximately EUR 5) per alcohol degree and per hectolitre.

## Taxes on corporate income

Resident taxpayers are subject to all-inclusive or unlimited CIT liability. Non-residents are subject to CIT on their income from their Hungarian branch's business activities.

As of 1 January 2011, the CIT rate is 10% on the first HUF 500 million of a positive CIT base without any further preconditions. The tax base above this limit is subject to 19% CIT. As of 2013, a 10% general CIT rate will be applicable to the entire positive CIT base.

Prior to 1 January 2011, the CIT rate was 10% on just the first HUF 50 million of a positive CIT base.

As of 1 January 2011, foreign organisations are no longer subject to 30% WHT on interest, royalties, and service fees received from Hungarian resident companies.

### Minimum tax base
If a company's CIT base or the pre-tax profit, whichever is higher, is less than 2% of its total revenues reduced by the cost of goods sold, the value of mediated services, and the income of the foreign permanent establishments (PE) (i.e. the 'minimum tax base'), the company can choose to file a declaration and pay CIT either according to the general provisions or on its minimum tax base.

### Special income tax
Companies with the following activities are liable to pay a special 'austerity' tax:

- Retail sales in stores.
- Telecommunications activity.
- Business activity of energy suppliers.

The special 'austerity' tax base is the net sales revenue and not the pre-tax profit. The tax rates are progressive and depend on the company's business activity, as follows:

### Retail sales in stores
Tax base is the net sales plus revenue on services provided to retail supplier and revenue from discount.

| Tax base (HUF) | Rate (%) |
|---|---|
| 0 to 500 million | 0 |
| 500 million to 30 billion | 0.1 |
| 30 billion to 100 billion | 0.4 |
| above 100 billion | 2.5 |

### Telecommunications activity
Tax base is the net sales revenue of the activity of telecommunication.

| Tax base (HUF) | Rate (%) |
|---|---|
| 0 to 500 million | 0 |
| 500 million to 5 billion | 4.5 |
| above 5 billion | 6.5 |

### Business activity of energy suppliers
Tax base is the net sales revenue of the activity of supplying energy.

| Tax base (HUF) | Rate (%) |
|---|---|
| 0 to 5 billion | 0.3 |
| 500 million to 5 billion | 1.05 |

Financial organisations that closed their financial statements before 1 July 2010 are subject to a special tax at the rate of 5.6%.

## *Local taxes/local business tax*
All municipalities are entitled to levy local taxes and, as of 29 June 2010, their administration has been delegated back to them from the Hungarian State Tax Authority. Local taxes are deductible for Hungarian CIT purposes and are not normally treated as 'income tax' in the application of the tax treaties.

The local business tax base is the net sales revenue reduced by the cost of goods sold, subcontractors' work, the costs of materials, mediated services, and research and development (R&D) costs. General service fees, depreciation, and labour costs are typically not deductible for local business tax purposes. 100% of royalty, interest, or dividend income and the local business tax base of a foreign PE of a Hungarian company are exempt from local business tax. The local business tax rate may differ from municipality to municipality but is capped at 2% by law.

Additionally, as of 2011, the special tax base allocation method will be introduced for companies in the telecommunications sector. The allocation will be based on the net revenues a company realises in the municipalities where its clients' billing addresses are located.

## *Innovation contribution*
Companies defined as such in the Accounting Act, except for small and medium-sized enterprises and branches, are also subject to an innovation contribution. The tax base

of the innovation contribution is the same as the local business tax base. The tax rate is 0.3%. Additionally, the direct costs of R&D are deductable from the tax payable (not the tax base).

## *Corporate residence*

Corporations are residents for CIT purposes if they are incorporated in Hungary, although foreign corporations may also be deemed to be Hungarian residents for CIT purposes if their place of effective management is in Hungary.

Foreign entities may carry out business through resident corporations or through PEs (branches). Commercial representative offices may be opened for auxiliary activities which do not create a taxable presence.

### *Permanent establishment (PE)*

Hungary treats PEs as separate and distinct entities, and profit is attributed to a PE based on the principles set out in the Organisation for Economic Co-operation and Development (OECD) guidelines.

In the Corporate Income Tax Act a PE is defined as fixed business premises (machinery or equipment) through which the entrepreneurial activity of an enterprise is partly or wholly carried on, regardless of the title of the taxpayer to those premises. A PE may consist of any of the following: a place of management; offices, including representative offices, registered in Hungary; factories and workshops; and mines, crude oil or natural gas wells, quarries, or other places from which natural resources are extracted.

Construction sites (including assembly) and related supervisory activities constitute a PE if they last, in the aggregate, for at least three months in a calendar year. All activities carried out at the same construction site qualify together as a single PE, regardless of whether they are based on separate contracts or were ordered by different persons. Construction sites are defined as sites which represent a unit for economic, business, and geographical purposes.

PEs are also created by the direct utilisation of natural resources by a foreign person. A foreign person is deemed to have a PE in Hungary if it utilises natural resources or immovable property for consideration, including the alienation of any rights related to the immovable property or natural resources.

A non-resident enterprise is considered to have a PE with respect to activities undertaken on its behalf by another person if its agent is authorised to conclude contracts in Hungary on behalf of the non-resident entity and the agent regularly exercises this right or maintains a stock of goods and products from which it regularly makes deliveries in the name of the non-resident entity.

The insurance of risks occurring in Hungary and insured on behalf of the non-resident person by another person constitutes a PE of the foreign insurer, except for reinsurance activities.

Furthermore, as mentioned above, a foreign taxpayer must also be treated as having a PE if it has a Hungarian branch.

The definition of a PE does not include the following:

- Establishments used solely for the purpose of storing and presenting the goods or products of a non-resident person.
- The stockpiling of goods and products solely for the purpose of storing, presenting, or processing by another person.
- Establishments used for collecting information, or purchasing goods and products, exclusively for the non-resident person.
- Establishments used for other activities of a preparatory or auxiliary nature.
- Activities of independent agents, provided they are acting in their ordinary course of business.

Note that a different definition of a PE is applicable for local business tax, and no definition is available for special 'austerity' tax.

## Other taxes



### Value-added tax (VAT)

VAT is payable on sales of goods and the provision of services. VAT is also payable on the importation of intra-Community acquisitions of goods and on the purchase of certain services provided to Hungarian companies by foreign suppliers.

The general VAT rate is 25%. A reduced VAT rate of 5% is available for most medicines.

Certain services are exempt from VAT, including most transactions in land (an option to be taxed under the general rule is available); the letting of residential property (an option to be taxed under the general rule is available); medical, cultural, sporting, and educational services provided as public services; and financial and insurance services. Intra-Community supplies of services and exports are also treated as exempt transactions. For the rental of industrial sites and office buildings, VAT exemption is optional.

VAT deduction is available for the business-related element of purchases made partially for non-business purposes.

Under the new general VAT liability regulations, VAT is also chargeable if an invoice is issued but the supply is not carried out.

#### Place-of-supply rules

The general rule for business to business (B2B) services is that the place of supply is where the customer is established. Some exceptions to this rule have been introduced (e.g. for catering services and services connected to immovable property, the place of supply is where the supplier is established). The general rule for business to consumer (B2C) services is that the place of supply is where the supplier is established.

#### VAT recovery

If a taxpayer has a negative VAT balance in a return period, this amount can be recovered provided that the tax balance reaches or exceeds an absolute value of HUF 1 million for monthly filers, HUF 250,000 for quarterly filers, or HUF 50,000 for annual filers. The VAT Act extends the application of the reverse-charge mechanism to a variety of activities in addition to the sale of waste materials, including construction and assembly and services related to real property (repairs, maintenance). The condition that only the VAT content of financially settled invoices is reclaimable continues to apply.

**Directive for refunds of foreign European Union (EU) taxable persons**
EU-registered non-Hungarian taxable persons can recover local VAT. In the new system, refund applications have to be submitted electronically, and the rules governing the time available/deadlines for tax authorities in certain phases of the procedure have changed. Reclaim requests should be submitted to the Tax Authority of the country where the taxable person is established.

**Reporting obligations for cross-border transactions**
A new requirement is that suppliers of cross-border services must submit full statements for each VAT return period of all the services supplied to taxable and non-taxable legal persons where the latter are liable for VAT in their own country. Please note that purchase lists are required in Hungary in addition to European Community (EC) sales.

**Group taxation**
The VAT Act allows all companies that have established business presences in Hungary and qualify as related enterprises to form a VAT group. The essence of a VAT group is that its members act under a single VAT number in their transactions (i.e. they issue invoices under a shared VAT number and submit a single, joint tax return), and product and service supplies between the members do not qualify as business transactions from a VAT perspective.

***Excise taxes***
The following goods are subject to excise duty:

- Petroleum products.
- Alcohol and alcoholic beverages. Any product with an alcohol content of 1.2% or more by volume qualifies as an alcohol product.
- Beers.
- Wines.
- Sparkling wines.
- Intermediate alcoholic products.
- Tobacco products.

As of 1 January 2011, the excise duty rates are as follows:

- Petroleum products: HUF 97,350 to HUF 124,200 (approximately EUR 340 to EUR 450) per thousand litres or HUF 4,425 to HUF 116,000 (approximately EUR 15 to EUR 400) per thousand kilograms, depending on the type of petroleum product.
- Alcohol products: HUF 276,100 (approximately EUR 1,050) per hectolitre of pure alcohol.
- Beer: HUF 633 (approximately EUR 2) per hectolitre per Balling (Plato) grade. For flavoured beers that contain less than 2.8% alcohol, HUF 1,400 (approximately EUR 5) per alcohol degree and per hectolitre.
- Wines: HUF 0 for grape wines; HUF 9,400 (approximately EUR 40) per hectolitre for wines made from other types of fruit.
- Sparkling wines: HUF 14,250 (approximately EUR 50) per hectolitre.
- Intermediate alcoholic products: HUF 22,100 (approximately EUR 80) per hectolitre.
- Tobacco products:
  - Cigarettes: HUF 9,750 (approximately EUR 35) per thousand cigarettes plus 28.4% of the retail sale price but a minimum of HUF 18,080 (approximately EUR 65) per thousand cigarettes. The tax base per cigarette also depends on the length of the cigarette (without filter). It is double if the length of the cigarette is 8cm to 11 cm, triple if the length is 11cm to 14 cm, and so on.
  - Cigars and cigarillos: 28.5% of the retail price.

- Fine-cut tobacco: 52% of the retail price, but a minimum of HUF 7,860 (approximately EUR 30) per kilogram.
- Other tobacco: 32.5% of the retail price, but a minimum of HUF 7,860 (approximately EUR 30) per kilogram.

The Customs Body of the National Tax and Customs Authority is responsible for excise duty. The European Union's excise duty rules apply in Hungary.

### *Registration taxes*

Registration tax is charged on passenger cars, motor homes, and motorcycles before they can be registered and put into service in Hungary. The duty is payable with the first domestic registration or in the case of a conversion.

The registration tax rate is applied as follows:

- Passenger cars: HUF 250,000 to HUF 9,622,000 (approximately EUR 950 to EUR 37,000), depending on the technical features of vehicles (cc, engine type) and environmental classification.
- Hybrid or electrical cars: HUF 190,000 (approximately 750 EUR).
- Motorcycles: HUF 20,000 to HUF 230,000 (approximately EUR 70 to EUR 900), depending on technical features of the motorcycles (cc).

The registration tax is levied by the Customs Body of the National Tax and Customs Authority.

### *Customs duties*

Hungarian customs legislation and policies have been fully harmonised with EU legislation.

The EU customs legislation is comprised of the following main regulations:

- Council Regulation 2913/92/EEC establishing the Community Customs Code.
- Council Regulation 2454/93/EEC laying down provisions for the implementation of Council Regulation 2913/92/EEC establishing the Community Customs Code.
- Council Regulation 918/83/EEC setting up a Community system of reliefs from customs duty.
- Council Regulation 2658/87/EEC on the tariff and statistical nomenclature and on the Common Customs Tariff.

### *Environmental protection product fee*

The following products are subject to the environmental protection product fee: other crude oil products, tyres, packaging, batteries, commercial printing paper, and electrical and electronic products (based on customs tariff numbers applicable on 1 January 2010).

The following entities are liable to pay the product fee:

- The first domestic distributor or user for own purposes.
- In the case of domestically manufactured commercial printing paper and other crude oil products, the first buyer from the first domestic distributor.
- In the case of toll manufacturing, the party that orders the toll manufacturing.

The product fee is calculated on the basis of the weight of the product multiplied by the fee rate. For example, it is HUF 6 to HUF 44 (approximately EUR 0.02 to EUR 0.18) /

kg for packaging and HUF 83 to HUF 1,000 (approximately EUR 0.33 to EUR 4) /kg for electrical and electronic products.

The Customs Body of the National Tax and Customs Authority controls the payment and reporting of the product fee and carries out product fee inspections. The Customs Authority registers taxpayers by Economic Operators Registration and Identification (EORI) customs numbers and Global Location Number (GLN), the environmental identification numbers, thus taxpayers will need to obtain both. As of 1 January 2010, the product fee is self-assessed. The product fee return must be submitted quarterly to the Customs Authority via its electronic system.

The product fee penalty is generally 100% of the product fee shortfall in cases of non-payment or underpayment.

The product fee payment liability can be reduced in certain instances (e.g. by meeting the mandatory recycling rate).

### *Environmental load charges*

Environmental pollution charges were introduced to protect the natural environment, to reduce its impairment, to encourage the users of the environment to engage in activities aimed at the preservation of the natural environment, and to provide funding from the central budget for environmental protection and nature preservation.

Emitting entities liable to pay charges include those who operate point-source emitters subject to registration, pursue activities subject to a water right permit, or who do not use available public drainage systems and dispose of their sewage under a water right permit or a permit from the local water management authorities.

Qualifying materials include sulphur dioxide, nitrogen oxides, mercury, phosphorous, cyanides, and others.

The load charge is calculated on the basis of the quantity of emitted materials multiplied by the fee rate. Basically, the amount of the fee payable depends on the hazard level of the emitted material, e.g. HUF 50 (approximately EUR 0.2) /kg for sulphur dioxide and HUF 220,000 (approximately EUR 846) /kg for mercury.

### *Energy tax*

Goods are subject to energy tax at the following rates:

- Electricity: HUF 295 (approximately EUR 1) per megawatt hour.
- Coal: HUF 2,390 (approximately EUR 9) per thousand kilograms.
- Natural gas: HUF 88.5 (approximately EUR 0.3) per gigajoule.

As of 1 January 2010, the following entities are subject to energy tax:

- Energy traders.
- End-users.
- Producers.

The tax is self-assessed, except in the case of imports, and the Customs Body of the National Tax and Customs Authority is responsible for the related customs administration procedures.

### *Stamp duties*
The most common types of stamp duty are gift duty and duty on transfers of property for consideration. Stamp duty is levied on movable and immovable property and property rights if they were acquired in Hungary, unless an international agreement rules otherwise.

#### Gift duty
Gift duty arises on the date when a contract concerning a gift is concluded.

Transfers of movable property, immovable property, and property rights without consideration are subject to gift duty. In these cases, however, gift duty is only incurred if the transaction was formally documented; except for immovable property with a market value of more than HUF 150,000, where gift duty must be paid in any event.

The base of gift duty is the net value of the gift, which is the market value minus any liabilities related to the gift. The general duty rates vary, depending on the base, as follows:

- 21% for a base of up to HUF 18 million.
- 30% on the part of the base exceeding HUF 18 million, up to HUF 35 million.
- 40% on the part of the base exceeding HUF 35 million.

Transfers of assets without consideration and acquisitions of claims without consideration including waivers of claims and assumptions of debts are exempt from gift duty, provided that the recipient is a company.

Furthermore, if a company is 100% owned by the other company in the transaction, or both companies are 100% owned by a third party, a reduced rate should be applied as follows:

- 11% for a base of up to HUF 18 million.
- 15% on the part of the base exceeding HUF 18 million, up to HUF 35 million.
- 21% on the part of the base exceeding HUF 35 million.

#### Duty on transfer of property for consideration
The obligation to pay duty on the transfer of movable and immovable property for consideration arises on the date when the contract is concluded.

For acquisitions of real estate, the stamp duty is 4% of the market value of the property. For acquisitions of direct or indirect participations (stocks, shares, co-operative shares, investor shares, converted investor shares) in a company that owns real estate, the duty base is the part of the market value of the company's properties held that represents the percentage of the participation, except when the transaction is between related parties. The stamp duty for real estate company sales is 4% up to HUF 1 billion and 2% of the amount exceeding HUF 1 billion up to a maximum of HUF 200 million.

There are special rules for real estate trading companies and credit institutions. Under certain circumstances, exemptions are available more generally.

Stamp duties are also levied on certain court procedures (e.g. Court of Registration) and on submissions to certain authorities (e.g. appeals to the Tax Authority). Stamp duty is, for instance, levied in an amount of:

- HUF 100,000 on the registration of a private stock company or a limited liability company
- HUF 600,000 on the registration of a public stock company or a European Company
- HUF 100,000 on the registration of any other entity with legal personality
- HUF 50,000 on the registration of a branch office, and
- HUF 50,000 on the registration of a representative office.

### *Property and land taxes*
Hungarian municipalities can levy property tax and land tax at their own discretion.

#### Property tax
The owner of a building is subject to property tax liability annually on the first day of the calendar year.

The local government can determine the tax base in either of the following ways:

- The net floor space of the building expressed in square metres, with a maximum tax rate of HUF 900/m2.
- The adjusted market value of the building, with a maximum tax rate of 3% of the adjusted market value.

#### Land tax
The owner of the land is subject to land tax liability annually on the first day of the calendar year. Undeveloped plots of land situated within the area of jurisdiction of a local government are subject to this tax. The local government can determine the tax base in either of the following ways:

- The actual area of the plot expressed in square metres, with a maximum tax rate of HUF 200/m2.
- The adjusted market value of the plot, with a maximum tax rate of 3% of the adjusted market value.

#### Stamp duty
Stamp duty has to be paid on the acquisition of a direct or indirect participation of at least 75% in a company that owns real estate (even if the real estate is a minor part of its total assets). Exceptions may be available if certain criteria are met.

There is no transfer tax in Hungary, but transfers of direct or indirect participations in companies that own real estate may be subject to stamp duty.

As of 1 July 2010, transfers of real estate-owning companies' shares between related parties have been exempt from real estate transfer tax.

#### CIT
A company and its related parties are defined as real estate holding companies if at least 75% of the market value of their assets is domestic real estate and if they have a foreign shareholder that is not resident in a country that has a double tax treaty (DTT) with Hungary or the treaty allows capital gains to be taxed in Hungary.

The tax base of real estate holding companies in cases of share transfers and share capital decreases is the positive amount of the consideration minus the acquisition price of the shares less the costs of acquisition and of administration. *The tax rate is the same as was mentioned in the Taxes on corporate income section.*

Please note that the definition of the payer for CIT purposes is very different from the definition used for stamp duty purposes.

## Branch income

Foreign companies may establish branch offices in Hungary. A branch office is an organisational unit of a foreign company without legal personality, vested with financial autonomy, and registered in the Hungarian companies register as a branch office of the foreign company. The provisions of the Hungarian Accounting Act apply to branch offices, which must prepare reports using double-entry bookkeeping. Statutory audits are obligatory, except for the branches of corporations whose registered office address is in the European Union.

A branch office is regarded as established when it has been entered into the companies register. A branch office may start operating once the application for registering the branch office has been submitted to the Court of registration, provided that it indicates 'under registration' on its corporate correspondence. Until a branch has been registered, it cannot carry out any activities that are subject to official permission. A branch office is considered dissolved upon its removal from the companies register.



Branch offices are treated as PEs for taxation purposes. They must determine their tax base according to the general rules applicable to Hungarian companies. The profit for the year (calculated on the basis of the Hungarian accounting system and adjusted by specific provisions of the Corporate Tax and Dividend Tax Act or CDTA) is subject to CIT of 10% on the first HUF 500 million of the positive CIT base. The tax base above this limit is subject to 19% CIT. The definition of PE is similar to that in the tax treaties but somewhat broader. For treaty countries, the respective treaty definition applies.

A foreign company's CIT base is determined for all its domestic PEs (except for branches) collectively and for its branches separately. A branch should account for costs and revenues as if it were independent from its foreign parent company.

For a Hungarian PE, earnings before taxes are reduced by cumulated administrative costs incurred proportionately at the headquarters and any of its PEs, with the maximum proportion defined as the revenues of the PE compared to all revenues of the foreign company.

The increasing items for a Hungarian PE are the administrative costs accounted by the PE plus 5% of the revenue earned by the PE's activities but accounted elsewhere.

However, if there is a treaty between Hungary and the other country, the provisions of the treaty have priority over domestic law. Therefore, the provisions of the treaty have to be followed in the first instance, and all costs related to the activity of the branch have to be allocated to the branch, without the above restrictions in domestic law, and all profit realised with respect to the branch must also be allocated to the branch. The allocation method must be consistent from year to year, unless there is a good reason for changing it.

The foreign parent must continuously provide the assets and funds required for the operation of the branch office and the settlement of its liabilities. The employees of a branch office are in a legal relationship with the foreign company, and the foreign parent exercises employer's rights. A branch is considered to be related to its parent company/headquarters. Therefore, the prices used in inter-company transactions have to be at arm's length, and transfer pricing documentation has to be prepared.

## *Income determination*

The CIT base should be calculated by modifying the accounting pre-tax profit by adjustments and deductions as provided by the CDTA.

### *Inventory valuation*

Inventories are generally valued at their historical cost unless their fair market value is significantly lower than their book value, in which case, the fair market value should be recorded. Cost may be determined on the basis of first in first out (FIFO) or average cost.

### *Capital gains*

Capital gains (losses) are treated as ordinary income (losses) for tax purposes. The gain on the sale of depreciable assets equals the sales revenue reduced by the net value of the asset for CIT purposes.

If a participation (of at least 30%) is registered within 30 days of acquisition and held continuously for at least one year, capital gains from the sale or contribution in kind of the participation is exempt from CIT in general. As of 2010, any additional acquisitions may also be registered, provided that the 30% participation was already registered.

### *Stock transactions*

Shareholders of a real estate holding company are also subject to CIT on their income from the sale of the shares in the real estate holding company. Transfers of direct or indirect participations in companies that own real estate may be subject to CIT.

### *Dividend income*

Except in the case of CFCs *(see the Group taxation section),* dividends received and accounted for as income in the given tax year are tax-free.

### *Interest income*

No specific provision exists in Hungary for interest income. Therefore, interest income is taxable for CIT purposes.

### *Royalty income*

50% of royalty income is deductible for CIT purposes, up to 50% of pre-tax profit. Royalties as revenues are derived from (i) permission for the exploitation of patents, from the industrial design of assets under industrial law, and from know-how; (ii) permission to use trademarks, business names, and business secrets; (iii) permission to use copyrights and similar rights attached to protected work; (iv) transfers of the property described above (except for trademarks, business names, and business secrets).

### *Unrealised exchange gains/losses*

Tax deferral is applicable to unrealised exchange gains/losses.

### *Foreign income*

Taxpayers resident in Hungary and foreign entrepreneurs must calculate their CIT base exclusive of any income that is subject to taxation abroad, if so prescribed by an international treaty. In any other case, a foreign tax credit is available for income taxes paid abroad *(see Foreign tax credit in the Tax credits and incentives section for more information)*.

In Hungary, there are no provisions under which income earned abroad may be tax deferred.

## Deductions

In general, costs and expenses incurred in relation to the taxpayer's income-generating business activity are deductible for CIT purposes.

### Accrued expenses

Accrued expenses are recognised for taxation purposes in the tax year they affect.

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### Depreciation and amortisation

Accounting depreciation that is accounted as expenditure, and thus included in the accounting profit, should be added to the CIT base. Tax depreciation calculated according to the CDTA reduces the tax base, even if the tax depreciation is higher than the accounting depreciation. The tax depreciation of tangible assets should be calculated using the straight-line method, on the basis of the historical value from the time when the asset was first used for business purposes.

Examples of tax depreciation rates include the following:

| Assets | Depreciation rate (%) |
|---|---|
| Computers and other high-tech machinery | 33 or 50 |
| Vehicles | 20 |
| Other tangible assets | 14.5 |
| Buildings (long-life structure) | 2 |
| Rented buildings | 5 |

Assets newly acquired since 2003 can be depreciated at 50% annually; these instruments include, among other items, machinery and intellectual property.

There is no prescribed amortisation rate for intangibles. The historical value, the residual value, and the useful life should be considered.

Additionally, goodwill cannot be amortised either for accounting or tax purposes if it does not lose its value during its use. However, if extraordinary amortisation is accounted on goodwill, the extraordinary amortisation will also be recognised for CIT purposes. In the case of transformations, specific amortisation rules apply.

### Organisational and start-up expenses

Companies are not obliged to capitalise the costs of formation/reorganisation. The capitalisation of these costs is at the company's discretion, but the company should comply with its accounting policy. Furthermore, only the direct costs of formation/reorganisation that are not classified as investments or renovations and are likely to be recovered ultimately can be capitalised.

### Development reserve
50% of pre-tax profit may be assigned as development reserve. The maximum value of the reserve is HUF 500 million; however, it has increased from four years to six years for development reserves included in the 2008 financial statement. For other development reserves, the period remains four years.

### Tax base allowance regarding R&D
A tax base allowance is only applicable for R&D activities if the taxpayer carries out basic research, applied research, or experimental research activities for its own purposes. The direct cost of the basic research, the applied research, and the experimental research, or the amount of depreciation on the research activity (if the cost of R&D activity is capitalised), is deductible from the tax base.

300% of the direct costs of research activity (up to a maximum of HUF 50 million) are deductible from the tax base if the research activity is carried out jointly with a higher education institution, the Hungarian Academy of Sciences, or a research institute established by them.

### Bad debts
Under the Accounting Act, bad debts are only deductible for CIT purposes if they are supported by legally valid third-party documents that the receivable cannot be collected. Expenses claimed that cannot be enforced in court and expired claims are not deductible for CIT purposes.

In addition to the above, 20% of eligible bad debts are deductible from the CIT base if the debt was not settled within 365 days from the due date.

### Charitable contributions
Grants made or assets that are transferred without consideration, as well as liabilities assumed or services provided free of charge, will qualify as business expenses if the taxpayer has a declaration from the recipient stating that the recipient's profit will not be negative without the income received.

Grants will always qualify as non-business expenses if they are provided to a foreign person or foreign resident company.

In the case of film and sports (football, basketball, handball, ice-hockey, and water polo) sponsorship grants, the amount of support is deductable both from the CIT base (as an expense) and from the CIT amount, provided that an official sponsorship certificate is available.

### Employee benefit expenses
Employee benefits and the fringe benefit tax payable on them are tax-deductible.

### Fines and penalties
Fines and penalties are not deductible for CIT purposes.

### Bribes, 'kickbacks', other illegal payments
Bribes, 'kickbacks', and illegal payments are not recognised as business costs for CIT purposes and are non-deductible from the tax base.

### Net operating losses
Losses can be carried forward indefinitely, and the Tax Authority's approval is not required. However, the Tax Authority may later audit whether a company has exercised

its rights in accordance with the intended purpose of these rights when carrying losses forward. Furthermore, from 2011, financial institutions can also carry losses forward.

Note that earlier tax losses must be used first (FIFO principle), and the losses of predecessors are also deductible from the successor company's CIT base.

Losses cannot be carried back (except for agricultural companies, who may account deferred losses by self-revision or by correcting the amount of tax paid in the previous two tax years).

### *Payments to foreign affiliates*

There is no general restriction on the deductibility of a consideration due to a foreign entity provided the payment is a justifiable business cost. General anti-avoidance provisions (abuse of law, substance-over-form) may also result in non-deductibility. If the parties are considered to be related parties under the definition of the CDTA, the Hungarian tax office is entitled to adjust the Hungarian party's tax base to reflect the market price (arm's-length price) if the parties did not make the adjustment themselves.



Considerations due for services are only deductible if the actual performance of the services is supported and the Hungarian taxpayer can prove that it benefits from the service.

Thin capitalisation rules may apply to interest on any non-banking debt in excess of three times the equity *(see Thin capitalisation in the Group taxation section)*.

The consideration paid to a CFC is not deductible for CIT purposes unless the taxpayer is able to prove that it serves the purposes of business operations. *For further details on the CFC rules, see the Group taxation section.*

## *Group taxation*

Group taxation is not available for CIT purposes in Hungary. *See Value-added tax in the Other taxes section for a description of group taxation for VAT purposes.*

### *Transfer pricing regime*

If parties qualify as related parties (as defined in the Hungarian CDTA) and the price applied differs from the arm's-length price, the CIT base should be modified by a proper transfer pricing adjustment. In addition, the foreign PEs of a Hungarian company and the Hungarian head office also qualify as related entities and are subject to transfer pricing regulations.

Taxpayers are obliged to prepare transfer pricing documentation on intra-group transactions. The documentation has to be prepared for every contract between related parties (including in-kind contributions made at the time of establishment).

As of 2011, when determining the transfer prices applied between related companies, in addition to the traditional methods (comparable uncontrolled price, resale-minus, and cost-plus methods), it is also possible to use the transactional net margin method and the profit-split method. In addition to these methods, companies may continue to use other methods if the traditional methods are inadequate.

Taxpayers are allowed to prepare two types of documentation (as opposed to the previous practice): country-specific documentation or consolidated transfer pricing documentation. Taxpayers may prepare consolidated transfer pricing documentation if this does not jeopardize comparability, and the contracts:

- have the same subject matter and all their terms and conditions are identical or only slightly different or
- closely relate to each other.

Taxpayers are required to make a declaration in their CIT returns as to which type of documentation they choose.

In summary, the requirements of the country-specific documentation have not changed as of 2010 compared to previous documentation requirements. This type of documentation must include, for example, the following:

- A functional analysis.
- Industry and company analyses.
- An economic analysis.
- A financial analysis.
- An account of the process of selecting the transfer pricing methodology.

Consolidated transfer pricing documentation must consist of two main parts:

- The core documentation, which includes the standard data for each company within the group which is resident in any EU member state.
- Country-specific documentation, which describes the agreements between the taxpayer and its related parties.

The documentation has to be available no later than the filing deadline for the CIT return in any given year, otherwise the Tax Authority may assess a default penalty up to HUF 2 million for each case of missing or deficient documentation. Note, however, that this documentation only has to be prepared and kept in the company's files, rather than being filed with the Tax Authority.

### *Thin capitalisation*

Thin capitalisation rules may apply to interest on any non-banking debt in excess of three times the equity.

Where debt means the average daily balance of outstanding loans, outstanding debt securities offered privately and bills payable (with the exception of bills payable on account of suppliers' debts), and any other liability other than loans, debt securities, and bills payable shown in the balance sheet that entails the payment of interest from the taxpayer's profit (with the exception of debts of credit institutions and financial companies incurred in connection with and for the purposes of financial service activities); and equity means the average daily balance of subscribed capital, capital reserve, retained earnings, and tied-up reserves (or own funds of the like).

### *Controlled foreign company (CFC) regime*

CFCs are foreign persons or entities established abroad and/or foreign resident entities if, among other conditions, they are owned by a resident private individual/entity who is deemed to be the beneficial owner (i.e. has a certain ownership share or voting ratio or dominant influence in the enterprise) or if the majority of their income derives from Hungarian sources and, in both cases, the effective tax rate of the persons/entities is lower than 10%. Certain exceptions may be available (for companies in EU member states, OECD member states, and treaty countries, if a real economic presence can be proved).

## Tax credits and incentives

### Foreign tax credit

Foreign tax credit is available for income taxes paid abroad, up to the Hungarian tax payable on the creditable income (at a maximum of 90% of income tax paid abroad) after increasing the tax base by the tax paid abroad.

The foreign income has to be classified by country of origin and revenue type. The deducted tax may not exceed the lesser of either the applicable foreign tax or the applicable tax based on the taxation treaty between Hungary and the given country.

If there is no taxation treaty, 90% of the tax payable abroad is credited against the tax liability up to a hypothetical tax liability calculated by using the average Hungarian tax rate. Full tax credit is applicable if so described by a tax treaty. The average tax rate is the CIT rate, reduced by the applicable tax allowances, divided by the tax base. Indirect costs should be allocated in proportion to the revenue of the branch office to the total revenue of the whole company, as per Section 28 (4) of CDTA.



### Development tax incentive

Each development tax incentive may be claimed for a ten-year period (beginning on the completion of the development) on the CIT returns over a maximum period of 14 years from the original application for the incentive. In any given tax year, the tax incentive is available for up to 80% of the tax payable but in total up to the state aid intensity ceiling. Applications for the tax incentive only have to be submitted to the Ministry of Finance if the aggregated eligible costs of the investment exceed EUR 100 million. If the investment is below this threshold, taxpayers only need to notify the Ministry of Finance before starting the investment. Tax incentives are available for investments if:

- the current value of the investment is at least HUF 3 billion or
- the current value of the investment is at least HUF 1 billion in certain designated areas and provided that:
  - the investment results in the creation of new facilities or the extension of existing facilities
  - the investment results in substantially changed products or production processes (excluding investments in basic research, applied research, and experimental development), or
  - in the four years following the year in which the tax incentive is first used against the tax base:
    - the annual average number of employees has increased by at least 150 compared with either the year before the investment was made or the average number of employees for the three years preceding the investment (by 75 in certain designated areas) or
    - the annual wage costs have increased by 600 times the minimum wage effective on the first day of the tax year (by a multiple of 300 in certain designated areas) compared with either the annual wage costs of the year before the investment was commenced or the average annual wage cost for the three years preceding the investment.

Provided that the investment results in the creation of new facilities or the extension of existing facilities, or substantially changed products or production processes, the government may also grant incentives to companies that invest:

- at least HUF 100 million in equipment for zoogenic food production
- at least HUF 100 million in environmental protection projects
- at least HUF 100 million in broadband Internet services
- at least HUF 100 million in the production of films and videos
- at least HUF 100 million in basic research, applied research, and experimental development projects
- at least HUF 100 million in projects financed by an issue of stock market-quoted shares, if (i) the project is started before the last day of the third calendar year following the date of issue, (ii) the total nominal value of the shares issued by the fifth year following the start of the project continuously reaches 50% of the value of the registered shares, (iii) the total issue price reaches 50% of the eligible costs, and (iv) at the date of the application for the incentive the company has at least 25 shareholders or at least 25% of the issued shares are owned by shareholders where each of them does not have more than 5% of the issued shares' nominal value, and
- at least HUF 500 million in projects initiated by small and medium-sized enterprises, if certain criteria are met.

Tax incentives may also be granted for projects that create new jobs. The restrictions prescribed in the CDTA regarding the headcount of staff and the percentage of new entrants to the labour market that may be claimed for such investments have been abolished, although the conditions prescribed in the relevant decree must still be met.

### *Tax holidays*

Ongoing tax holidays granted before Hungary's accession to the European Union can be used until 31 December 2011.

### *Other tax incentives*

Film production companies that receive a state subsidy for their activity may deduct the amount of the subsidy from their CIT base.

A tax incentive is available for small and medium-sized enterprises (basically, those with a maximum of 250 employees; annual net revenue of a maximum of EUR 50 million; or a maximum annual balance sheet total of EUR 43 million). Taxpayers that take a loan from a financial institution for the acquisition or production of tangible assets may deduct 40% of the interest paid on the loan from their tax due, up to a maximum deduction of HUF 6 million. However, taxpayers engaged in certain business sectors cannot use this tax incentive (e.g. transportation, agricultural activity).

In the case of software development, a taxpayer may decrease its calculated CIT by 10% (or 15% in the case of small and medium-sized companies) of wage costs which were accounted for as the costs of basic research or applied research or experimental development or which arose through employing software developers. The tax incentive may be claimed in the tax year in which these costs are incurred and in the following three years, in equal instalments. However, the tax incentive claimed may not exceed 70% of the calculated CIT decreased by the tax incentives specified in the CDTA (including development tax incentives).

In addition, a new type of tax allowance may be used in the future to support team sports (football, basketball, handball, ice-hockey, and water polo). The regulations on tax allowances related to supporting team sports will take effect 15 days after the European Commission's approval.

## Withholding taxes

Under the domestic rules, there is no WHT on dividends, interest, or royalties.

As of 1 January 2011, foreign organisations are no longer subject to 30% WHT on interest, royalties, and service fees received from Hungarian resident companies.

Hungary has an extensive treaty network with maximum WHT rates as follows:

| Payer (1) | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Albania | 5/10 (2) | 0 | 5 |
| Australia | 15 | 10 | 10 |
| Austria | 10 | 0 | 0 |
| Azerbaijan | 8 | 8 | 8 |
| Belarus | 5/15 (2) | 5 | 5 |
| Belgium | 10 | 15 (3) | 0 |
| Brazil | 15 | 10/15 (4) | 15/25 (5) |
| Bulgaria | 10 | 10 | 10 |
| Canada | 5/10/15 (6) (7) | 10 | 10 |
| China, P.R (8) | 10 | 10 | 10 |
| Croatia | 5/10 (2) | 0 | 0 |
| Cyprus | 15/5 | 10 | 0 |
| Czech Republic | 5/15 (2) | 0 | 10 |
| Denmark | 5/15 (2) | 0 | 0 |
| Egypt | 15/20 | 15 | 15 |
| Estonia | 5/15 (2) | 10 | 5/10 (10) |
| Finland | 5/15 (2) | 0 | 5 |
| France | 5/15 (2) | 0 | 0 |
| Germany | 5/15/25 (2) | 0 | 0 |
| Greece | 10/45 | 10 | 10 |
| Hong Kong | 5/10 (12) | 5 | 5 |
| Iceland | 5/10 (2) | 0 | 10 |
| India | 10 (19) | 10 (12) | 10 (11) |
| Indonesia | 15 | 15 | 15 |
| Ireland, Rep. of | 5/15 (2) | 0 | 0 |
| Israel | 5/15 (2) | 0 | 0 |
| Italy | 10 | 0 | 0 |
| Japan | 10 | 10 | 10 (13) |
| Kazakhstan | 5/15 (2) | 10 | 10 |
| Korea, Rep. of | 5/10 (2) | 0 | 0 |
| Kuwait | 0 | 0 | 10 |
| Latvia | 5/10 (2) | 10 | 5/10 (20) |
| Lithuania | 5/15 (2) | 10 | 5/10 (20) |
| Luxembourg | 5/15 (2) | 0 | 0 |
| Macedonia | 5/15 (14) | 0 | 0 |

# Hungary

| Payer (1) | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Malaysia | 10 | 15 | 15 |
| Malta | 5/15 | 10 | 10 |
| Moldova | 5/15 (2) | 10 | 0 |
| Mongolia | 5/15 (2) | 10 | 5 |
| Morocco | 12 | 10 | 10 |
| Netherlands | 5/15 (2) | 0 | 0 |
| Norway | 10 | 0 | 0 |
| Pakistan | 15/20 (2) | 15 | 15 |
| Philippines | 15/20 (2) | 15 | 15 |
| Poland | 10 | 10 | 10 |
| Portugal | 10/15 | 10 | 10 |
| Romania | 5/15 (9) | 15 | 10 (21) |
| Russia | 10 | 0 | 0 |
| San Marino | 0/5/15 (2) | 0 | 0 |
| Serbia and Montenegro | 5/15 | 10 | 10 |
| Singapore | 5/10 (2) | 5 | 5 |
| Slovakia | 5/15 (2) | 0 | 10 |
| Slovenia | 5/15 (2) | 5 | 5 |
| South Africa | 5/15 (2) | 0 | 0 |
| Spain | 5/15 (2) | 0 | 0 |
| Sweden | 5/15 (2) | 0 | 0 |
| Switzerland | 10 | 10 | 0 |
| Taiwan | 10 | 0/10 (22) | 5 |
| Taipei | 10 | 10 | 10 |
| Thailand | 15/20 (15) | 10/25 (16) | 15 |
| Tunisia | 12/10 (2) | 12 (19) | 12 |
| Turkey | 10/15 (2) | 10 | 10 |
| Ukraine | 5/15 (2) | 10 | 5 |
| United Kingdom | 5/15 (2) | 0 | 0 |
| United States | 5/15 (17) | 0 | 0 |
| Uruguay | 15 | 15 | 10/15 (18) |
| Uzbekistan | 10 | 10 | 10 |
| Vietnam | 10 | 10 | 10 |

Notes

1. List of the DTTs Hungary is a party to and the highest rates of WHT a foreign-source country may charge on (the gross) income paid to Hungarian residents.
2. The lower rate applies if the recipient has a stake of at least 25% in the distributing company.
3. Interest is exempt if paid in respect of (i) commercial claims (including claims represented by negotiable instruments) and instalment payments for the delivery or supply of goods and/or services, (ii) current accounts or registered loans placed by a financial institution, and (iii) funds and deposits not represented by bearers' securities placed at any of the financial institutions (including public credit institutions).
4. 10% applies to bank loans used for industrial purposes, R&D, or public works.
5. 25% applies to royalties paid for the use of or the right to use trademarks.
6. The lower rate applies if the recipient has control, directly or indirectly, of 25% of the voting rights in the distributing company.
7. 10% is applicable if a non-resident owned investment corporation pays dividends to a recipient that has control, directly or indirectly, of 25% of the voting rights in the distributing company.
8. The China-Hungary Treaty does not apply to Hong Kong.
9. The lower rate applies if the recipient has a stake of at least 40% in the distributing company.
10. The lower rate applies to royalties for the use of industrial, commercial, or scientific equipment, or for transmission by satellite, cable optic fibre, or similar technology.

11. The same rate applies to technical service fees.
12. The lower rate applies if the recipient has a stake of at least 10% in the distributing company.
13. Cultural royalties are exempt.
14. The lower rate applies if the recipient (other than a partnership) has a stake of at least 25% in the distributing company.
15. The lower rate applies if the recipient has a stake of 25% in the distributing company that carries out industrial activities.
16. 10% applies if the recipient of the interest is a financial institution, including an insurance company.
17. The lower rate applies if the recipient has voting stock of at least 10% in the distributing company.
18. 10% applies to technical service fees.
19. If a lower rate is set in a treaty or agreement or minutes between India and any OECD country (excluding Hungary), then this lower rate should also be applied for India-Hungary.
20. 5% applies for the use of industrial, commercial or scientific facilities or for transmissions by means of satellite, cable, optical fibre, or any similar technology.
21. 5% for commission.
22. 0% on interest paid on inter-bank loans.

## Tax administration



### Returns

CIT must be calculated by reference to the accounting year, which is either the calendar year or, for group companies, the group's accounting year. Returns must be lodged within 150 days following the last day of the accounting year. The tax payable is determined by self-assessment.

Tax returns may be submitted either electronically or in paper format. However, those who are legally obliged to submit monthly tax and contribution returns (e.g. employers and payers) may only submit tax returns electronically.

### Payment of tax

CIT instalments must generally be reported and paid quarterly or monthly (above HUF 5 million tax payable). In the case of taxpayers with net sales revenues of over HUF 100 million, 100% of the expected final payment is due by the 20th day of the last month of the accounting year. However, a late payment penalty is only levied if the company fails to pay at least 90% of the expected final payment by the above deadline. The late payment penalty is 20% of the difference between the tax advances paid (including the top-up payment) and 90% of the actual CIT liability.

### Statute of limitations

In general, the statute of limitation is five years from the end of the calendar year in which the tax return should be filed. Self-revision interrupts the term of limitation.

### Topics of focus for tax authorities

The tax authority will take more stringent measures against 'aggressive tax planning' (tax planning that takes advantage of unintended administrative or legal loopholes) using its international experience and cooperation agreements.

Generally, the following categories of taxpayers may expect to be scheduled for tax audits:

- Taxpayers whose records show frequent changes in registered address or ownership.
- Businesses that have operated for several years with substantial loans from their shareholders.
- Taxpayers that declared significant amounts of payable and deductible VAT during their pre-company period.
- Taxpayers that have been in continuous operation despite continuing losses.
- Taxpayers that spend a significant portion of their sales revenues on services.

- Taxpayers that have significant tax base decreasing items, tax allowances, and subsidies related to investments.
- Taxpayers that deduct R&D expenses.

The tax authority will also pay more attention to the actual content of transactions conducted between related parties and to the methods companies use to determine the arm's-length price.

## *Other issues*

### *Principal forms of doing business*

- Branch.
- Partnership.
- Limited liability company.
- Private company limited by shares.
- Public company limited by shares.

### *Mergers and acquisitions (M&A) from a business and tax perspective*

Mergers in Hungary are tax-free transformations provided that they qualify under the definition of preferential transformation. Preferential transformation means that a company, without going into liquidation, transfers all its assets and liabilities to another company in exchange for the issue to its shareholders of securities representing the capital of that other company, and a cash payment not exceeding 10% of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities.

In a preferential transformation, the predecessor company does not have to amend its tax base by the difference between the adjusted book value and the book value. The adjusted book value means the historical value of assets less any depreciation deducted from the tax base plus the readjusted amount of extraordinary depreciation. Furthermore, for shareholders, the income accounted in excess of the historical value of the shares they acquire in the preferential transformation is also not taxable for CIT purposes for as long as the shareholder holds its participation.

In any other case, if two companies merge, the difference between the market value and the book value of the assets and liabilities is taxable for the successor company. Furthermore, the predecessor company may decrease its tax base by the amount of the difference between the adjusted book value of its assets and their book value if the adjusted book value is the higher of the two. The company will increase its tax base if the book value is higher than the adjusted book value.

### *International Financial Reporting Standards (IFRS) adoption*

Since 2005, companies defined in Section 4 of Decision no. 1606/2002/EC (mainly companies listed on the stock exchange) have had to prepare their consolidated annual reports according to the IFRS, although it was possible to obtain an exemption until 2007 due to the ongoing harmonisation of the Hungarian regulations. However, non-listed subsidiaries of EU-listed entities are exempt from the preparation of IFRS consolidated financial statements. If a company chooses IFRS, Hungarian Accounting Rules (HAR) financial statements must also be prepared and filed with the Court of Registration.

# Iceland

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## Significant developments

### Corporate income tax (CIT)

In January 2011, the following taxes were raised:

- CIT rate for limited liability companies was raised from 18% to 20%.
- CIT rate for partnerships was raised from 32.7% to 36%.
- Capital income tax was raised from 18% to 20%.



### Dividends as remuneration

Taxpayers who are self-employed and are required to determine remuneration for themselves shall file 50% of the received dividends, as per laws on limited companies, as salary income insofar as the company's allowed dividend distribution totals more than 20% of its tax net worth (book value) at the end of the fiscal year.

### Value-added tax (VAT)

As of 1 January 2011, those who sell goods or services for under 1 million Icelandic kronur (ISK) every 12 months do not have to register for VAT purposes. This limit used to be ISK 500,000.

Those who sell goods or services for less than ISK 3 million only need to file VAT returns once a year instead of the average of six times a year.

Conditions for VAT registrations have become stricter.

A penalty of ISK 5,000 is applied for late submission of a VAT return. This also applies to null returns.

VAT filing is electronic unless a special permission is granted by tax authorities to file on paper.

### Tax on financial services

Financial services permitted to operate as banks and savings banks are subject to 0.041% tax on total debt at year end.

### Deduction for dividends and capital gains from sales of shares

Received dividends and gains from sales of shares can only be deducted if the ownership of the company paying dividends or being sold is at least 10%. Also beginning in and including the 2012 fiscal year, all operating loss carryforward will be required to be offset before any deduction is allowed.

### Forgiveness of debt
Temporary rules stating that forgiveness of debt is not implicitly to be treated as taxable income were introduced. The rules also include a possibility to distribute a part of forgiven debt over the period of 2015 to 2019.

### Pending legislation
Please note the information in this summary is current as of 1 June 2011. Typically, pending legislation is announced in June. Please visit the Worldwide Tax Summaries website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

## Taxes on corporate income

Resident corporations pay tax on their worldwide income less operating expenses. Deductible operating expenses are comprised of all the expenses and costs needed to provide, insure, and maintain income.

CIT for limited liability companies and limited partnership companies is assessed at a rate of 20%.

CIT for other types of legal entities (e.g. partnerships) is assessed at a rate of 36%.

## Corporate residence

In general, all corporations incorporated and registered in Iceland are considered to be tax residents in Iceland. The same applies to corporations which have their home address in Iceland according to their articles of association or if the management of the company is carried out in Iceland.

Foreign corporations are regarded as Icelandic tax residents if the effective management is carried out in Iceland.

The Internal Revenue Directorate can decide with a ruling whether a corporation's residence is in Iceland. The ruling can be appealed to a court of law.

## Other taxes

### Valued-added tax (VAT)
VAT was established in Iceland with the Value Added Tax Act no. 50/1988 which came into effect on 1 January 1990. VAT is a consumption tax levied on all stages of domestic business transactions. VAT is levied on all goods and services, as well as on the imports of goods and services, unless specific exemptions apply.

#### VAT rates
The general VAT rate is 25.5%.

The following goods and services are subject to a reduced VAT rate of 7%:

- Rental of hotel and guest rooms and other accommodation.
- Subscription to radio and television.
- Newspapers, periodicals, and magazines.

- Books, both Icelandic and translated, and well as their audio recordings.
- Geothermal hot water, electricity, and fuel oils used for heating houses and swimming pools.
- Food and other consumables for people as detailed in an addendum to the Value Added Tax Act.
- Access to roads and other transport related constructions.
- Compact discs, records, audiocassettes, and other equivalent mediums for music only and not videos.

Certain services and goods are zero-rated, which means that there is, in fact, no VAT charge. All VAT information for zero-rated services and goods must be shown on invoices, and the transactions, as well as input VAT which can be reclaimed, must also be included in VAT returns. Zero-rated VAT mainly applies to exported goods and services provided abroad. As per Article 12 of the VAT Act, the following are zero-rated:

- Export of goods and services. Output tax is not levied on goods exported from the country nor on and services provided abroad.
- Transport of goods between countries. The same applies to domestic transport of goods when the transport is part of a contract for the transport of goods between countries.
- Production of goods at the expense of a foreign party when the production company exports the goods upon completion, as well as the processing and formation of goods at the expense of a foreign party when the production takes place abroad.
- The design, planning, and other comparable services related to construction and other real property abroad.
- Provisions, fuel, instruments, and other equipment delivered for use on board of inter-country vessels, as well as the service provided to such vessels. This exemption does not cover fishing vessels selling their catch abroad, pleasure boats, or private aircraft, only vessels used for the transport of freight.
- The sale and leasing of aircraft and ships. This exemption does not cover boats less than six metres in length, pleasure boats, or private aircraft.
- Shipbuilding and repair and maintenance work on ships and aircraft and their fixed equipment, as well as materials and goods used or provided by the company providing the repair work. This exemption does not cover boats less than six metres in length, pleasure boats, or private aircraft.
- Contractual payments from the Treasury related to the production of milk and sheep farming.
- Services provided to foreign fishing vessels related to the landing or sale of fish catches in Iceland.
- A service of refunding VAT to parties domiciled abroad.
- Sales of services to parties neither domiciled nor having a venue of operations in Iceland, provided that the services are wholly used abroad. A taxable service provided in connection with cultural activity, arts, sports, education, and other similar activity taking place in Iceland, and is tax-exempt cf. Paragraph 3, Article 2 of this Act, is always deemed as being used here. Sales of services to parties neither domiciled nor having a venue of operations in Iceland are, in the same manner, exempt from taxable turnover, even if the service is not wholly used abroad, provided the purchaser could, if its operations were subject to registry in Iceland, count the VAT on the purchase of the services as part of the input tax, cf. Articles 15 and 16. The following services come under this point:
  - The sale or lease of copyright, patent rights, registered trademarks and copyrighted designs, and the sale or lease of other comparable rights.
  - Advertising services.

- Services of consultants, engineers, lawyers, accountants, and other similar specialised services as well as data processing and delivery of information, except for labour or services related to liquid assets or real property in Iceland.
- Electronic services; these services are considered used where the buyer is domiciled or having a venue of operations; the same applies to data centres' sale of mixed services to buyers neither domiciled nor having a venue of operations in Iceland.
- Obligations and duties related to business or production activity or the use of rights listed under this point.
- Employment agency services.
- The rental of liquid assets, except for means of transport.
- The services of agents acting on behalf of others and for their account as regards the sale and delivery of services listed under this point.
- Telecommunications services.

### VAT-able entities

Businesses engaged in the trade of taxable goods and services for business purposes must register and collect VAT.

### Services exempt from VAT

The Value Added Tax Act details certain services that are exempt from the tax, such as healthcare services, social services, the operation of schools, various education services, cultural activities, athletic activities, passenger transportation, postal services, sale of real estate (not including the rental of hotel and guest accommodation), rental of car workshops, insurance activity, services of financial banks as well as securities trading, lotteries and betting pools, artistic activities, services of travel agencies, funeral services, and all services of ministers of the church.

Those selling taxable goods and services totalling less than ISK 1 million per year are also exempt from paying VAT.

### Agents for non-resident parties

Non-residents who are engaged in taxable transactions in Iceland but are neither domiciled nor have permanent residence in Iceland must appoint VAT agents with residence in Iceland to report on their behalf. Both parties are liable for the VAT payments (responsible for ensuring remittance of VAT). If a non-resident does not appoint a VAT agent, the purchaser of the services/goods is responsible for paying the VAT (reverse charge).

### Tax base

Tax base is the price the buyer pays for goods or services before VAT is added and before any costs or service expenses are deducted from the price. VAT is therefore added to the sales price.

### VAT accounting periods and due dates

VAT is generally filed and paid on a bi-monthly basis for the following periods: January and February; March and April; May and June; July and August; September and October; November and December. The due date for payment of VAT is one month and five days after the end of the settlement period. For example, the due date for the January and February payments is 5 April.

If the VAT is not paid on the due date, a 1% penalty charge is added for every day up to a total of 10%. Late penalty interests also apply.

Should the total input tax exceed the total output tax, the Treasury will refund the difference within 15 days from the due date.

Those selling goods and services totalling less than ISK 3 million during a full calendar year can return the VAT payments on a yearly basis. The due date for filing and paying is 5 February each year.

Parties that do not file a VAT report within the required deadline will have their VAT estimated. The tax authorities are allowed to deregister parties of VAT register if they have had their VAT estimated for two years or longer.

If a VAT report is submitted after the tax authorities have estimated VAT, a penalty of ISK 5,000 is imposed.

### VAT reimbursement

Under the provisions of Regulation no 288/1995, issued by the Ministry of Finance, foreign enterprises, which are neither residents of Iceland nor have a permanent establishment here, may obtain reimbursement of VAT paid on goods and taxable services which have been purchased or imported for the commercial purposes of such enterprises in Iceland after 1 March 1995.



Such reimbursement can be effected to foreign enterprises that would be subject to registration in Iceland according to Article 5 and Article 6 of the Value Added Tax Act if the enterprises in question were engaged in such business in Iceland. This means that such enterprises as travel agencies, insurance companies, banks, and other financial institutions cannot obtain such reimbursement.

Another prerequisite shall be that the enterprise shall have sold neither goods nor taxable services in Iceland during the period to which the application refers.

Any reimbursement of VAT to foreign enterprises shall be only to the same extent as Icelandic enterprises can include the VAT on purchases of a corresponding nature in the tax on purchases according to Article 15 and Article 16 of the Value Added Tax Act.

No reimbursement shall thus be granted in respect of VAT on purchases relating to meals for the owners and employees of the enterprises or relating to entertainment expenses and presents.

Parties domiciled abroad can get partial VAT reimbursement on goods they have bought in Iceland if they take them abroad with them within three months from the date of purchase. They then must provide the goods, along with any necessary documents, to the appropriate reimbursement company or to the customs authorities on the date of departure, and the purchase price must amount to at least ISK 4,000.

## *Property taxes*

A municipal property tax is applied on the assessed value of real estate in Iceland.

## *Customs duties/import tariffs*

Iceland, Liechtenstein, Norway, and Switzerland are members of the European Free Trade Association (EFTA). The EFTA Convention established a free trade area among its member states. In addition, the EFTA states have jointly concluded free trade agreements with a number of countries in Central and Eastern Europe as well as in the Mediterranean region, Mexico, and Singapore. Also the EFTA states entered into the Agreement on the European Economic Area (EEA) in 1992. The current contracting parties are, in addition to the three EFTA states, the European Community (EC) and the 15 EC member states. Iceland also has a bilateral agreement with its two neighbouring countries, Greenland and Faeroe Islands.

### *Excise tax*
Excise tax is levied on a variety of goods, specified in the Icelandic Excise Tax Act. The tax base is either the quantity of the product or a specific percentage of the manufacturing price of taxable goods.

### *Turnover taxes*
There is an agricultural charge of 1.20% of agricultural turnover.

### *Stamp taxes/transfer taxes*
Stamp duty is levied on the execution of various documents at rates ranging from 0.4% to 2%.

A stamp duty of 0.5% is levied on the nominal value of all new share certificates issued to shareholders in a public limited liability company. Private limited companies are not required to issue share certificates and, therefore, are not subject to stamp duty.

The endorsement of documents is generally not subject to stamp duty.

When issuing deeds and purchase agreements of real estate and land, a 0.4% stamp duty is levied on the officially registered value of the real estate. The same applies to the deeds and purchase agreements of ships. Lease agreements are subject to a 2% stamp duty of the rental price.

### *Taxes on natural resources*
#### Carbon tax
A carbon tax for liquid fossil fuels is paid to the treasury. Liquid fossil fuels are gas and diesel oils, petrol, aircraft and jet fuels, and fuel oils. All importers of fossil fuels are liable for the carbon tax regardless of whether it is for retail or personal use. The tax rate is:

- ISK 4.35 per litre of gas and diesel oils.
- ISK 3.80 per litre of petrol.
- ISK 4.10 per litre of aircraft and jet fuels.
- ISK 5.35 per kilo of fuel oil

#### Tax on electricity/hot water
A special tax is collected from parties that sell electricity and/or hot water to end users.

#### Carbohydrate tax
Corporations licensed for carbohydrate investigations, research, and/or processing, as well as anyone who directly or indirectly participates in the processing or distribution of carbohydrates, must either pay a processing tax, which is independent of processing performance, or a carbohydrate tax, which is collected after the processing starts making a profit.

### *Other taxes*
There is a National Broadcasting Fee of ISK 17,900 per year.

## Branch income

A branch is treated as an extension of a trading activity of the overseas parent company incorporated in another jurisdiction and is not a separate legal entity.

Due to the fact that a branch acts in the name of the overseas parent company, a branch's income is taxable in accordance with the parent company (i.e. if the parent company is a limited liability company, the branch is subject to a CIT rate of 20%).

Tax treaties may allow Icelandic CIT as a credit against foreign income tax imposed on the parent company.

There is no branch profits remittance tax on the repatriation of profits to the parent company.

## Income determination



Resident corporations pay tax on their worldwide income less operating expenses.

### Inventory valuation

The valuation method of raw materials and finished goods is on a first in first out (FIFO) basis or via the average cost method. When computing the value of produced goods, both direct and indirect production cost must be taken into account. For tax purposes, inventories can be further written down at a rate of 5% of calculated value.

Last in first out (LIFO) is not permitted.

### Capital gains

Capital gains are treated as taxable income in the year that transfer of ownership occurs and, as such, taxed as part of the general corporate income. Capital gains are generally not subject to withholding tax (WHT). There are rules that allow full deduction of net capital gains from the sale of shares, provided certain conditions are met; so, in general, corporations are not subject to taxation on capital gains from sale of shares.

### Dividend income

Dividend income is treated as taxable income and taxed as a part of corporate income. There are extensive rules that allow full deduction of the dividend, provided certain conditions of ownership (time and quantity) are met; so, in general, corporations are not subject to taxation on dividends. Dividends are subject to WHT (currently 20%), which is a temporary payment towards the final tax assessment.

### Foreign income

Income earned abroad is generally taxed as a part of corporate income since a resident company is subject to CIT on its worldwide income.

Controlled foreign company (CFC) rules stipulate that profits of companies in low-tax jurisdictions must pay income tax of such a profit in direct proportion to shares, regardless of distribution. A low tax jurisdiction is defined as a jurisdiction where the CIT rate is less than two-third of the Iceland´s tax rate (i.e. 13.3%, being two-thirds of 20%). *See Controlled foreign company (CFC) regime in the Group taxation section for more information.*

Double taxation of foreign income is avoided either through tax treaties or domestic tax provisions.

## Deductions

Deductible operating expenses are comprised of all the expenses and costs needed to provide, insure, and maintain income (e.g. interest expense, employee expense, travel expense, insurance expense).

### Bad debt

As a general rule, 5% of bad debt can be written off. Certain conditions must be met in order to write off a higher percentage of bad debts.

Temporary provisions in Icelandic tax law allow corporations to make a credit entry for only 50% of debt write-off totalling ISK 50 million and 75% of debt write-off for amounts over ISK 50 million in income years 2009-2011. The requirement for the provision is that the debt is business-related and operating loss and transferable loss has been offset.

The debt write-off can be carried forward from the income year 2010 to the income year 2014. The transferrable amount that can be carried forward on a yearly basis is the amount that exceeds the transferable operating losses and the possible operating loss, tax depreciation, and write-down each year. All assets that can be depreciated have to be depreciated and all possible write-downs on receivables and stock have to be done to fulfil the requirements of the provisions. No dividend can be distributed for the income years 2010-2014 and the company can also not be merged, wound up, or be jointly taxed with another company during the period. At the end of this five year period (i.e. at the end of the income year 2014), it will be possible to transfer any debt write-off that exceeds ISK 500 million as profit with an equal amount each year from the income year 2015 to the income year 2019. If the write-off does not exceed ISK 500 million, the amount will not be subject to taxation.

### Charitable contributions

Charitable contributions up to 0.5% of total income are deductible.

### Depreciation

| Assets | Depreciation rate (%) |
|---|---|
| Ships, ship equipment, and personal vehicles | 10 to 20* |
| Aircraft and accessories | 10 to 20* |
| Heavy machinery, industrial machinery, and equipment | 10 to 30* |
| Office equipment | 20 to 35* |
| Machinery, equipment, and vehicles that are not covered in the above categories | 20 to 35* |
| Residential, commercial, and office accommodation | 1 to 3 |
| Factory buildings, garages, warehouses, etc. | 3 to 6 |
| Purchased proprietary rights for ideas and trademarks, such as copyrights, publishing rights, information rights, patents, and logos | 15 to 20 |
| Purchased goodwill | 10 to 20 |

*The depreciation base for these assets is their purchase value less earlier depreciations (book value).

### *Start-up expenses*
Purchased fishing rights (quotas) cannot be depreciated.

Start-up costs for agricultural production rights can be depreciated without revaluation over five consecutive years. The following assets can be depreciated in full in the year they are initiated or paid with steady payments over five years:

- Start-up costs, such as enterprise registration and obtaining operation licences.
- Cost of research, developments, marketing, obtaining patents and trademarks. If the use of individual assets does not fall into the same depreciation category, the depreciation base will be dependent on how much of it is used, so that if an asset is used for three-quarters or more for the same operation, the whole asset will have the same depreciation percentage.

### *Goodwill*
Purchased goodwill can be written down at 10% to 20% per year.



### *Pension expenses*
Payments to obligatory pension funds for employees at a minimum of 8% of wages are deductible.

### *Fines and penalties*
Fines and penalties are not deductible.

### *Bribes, kickbacks, and illegal payments*
Bribes, kickbacks, and other illegal payments are not deductible.

### *Net operating losses*
Operating losses may be deducted from income from business and independent economic activity. Tax losses can be carried forward ten years and utilised over ten years from the year that the loss was incurred.

No carryback of losses is allowed.

### *Payments to foreign affiliates*
An Icelandic corporation can claim a deduction for royalties, management fees, and similar payments made to foreign affiliates, provided that such amounts are made on an arm's-length basis and reflect services received. Interest at normal commercial rates paid to foreign affiliates generally will be allowed as a deduction conditional though that the loan terms are comparable to those that would have been agreed upon by unrelated parties.

## *Group taxation*

Companies may opt for consolidated taxation if a company owns at least 90% share in another company. Consolidated taxation means, among other things, that losses of one company can be offset against profits of other companies. Consolidated taxation cannot be extended to non-resident companies or permanent establishments of foreign companies.

### *Transfer pricing*
The statutory authority for addressing transfer pricing issues is found in the application of general legal concepts, such as the anti-avoidance rule.

Article 57 of the Icelandic Income Tax Act No. 90/2003 (originally included in the tax code in 1971) includes a general anti-avoidance rule that states that business transactions between all parties should be based on the arm's-length principle. With reference to the general concept of this Article, tax authorities can, in cases where transfer prices are not at arm's length, adjust the taxpayer's revenues and expenses in order to reflect market value. These adjustments can be performed only within the domestic statute of limitation period, i.e. six years. Authorities have thus based their transfer pricing conclusions on Article 57.

The Income Tax Act includes several separate rules that can be identified as transfer pricing rules, but those rules generally concern transactions between individuals and not companies, including a rule that obligates employees who receive their wages in kind to account for them on their tax return based on market value.

### *Treatment of inter-company dividends*
Inter-company dividends are deductible if loss of the year and carry forward losses have been offset. Another condition is that the receiver of the dividend must own at least 10% of the company paying the dividend at the end of the year which the dividend payment is related to.

### *Thin capitalisation*
There are no specific rules regarding thin capitalisation in Iceland, but anti-avoidance principles can be applied *(see Transfer pricing above)*.

### *Controlled foreign company (CFC) regime*
Any individual who either directly or indirectly owns a share in any kind of a company, fund, or organisation domiciled in a low-tax jurisdiction must pay income tax on the profit of such corporations in direct proportion to one's own share, regardless of distribution.

The same applies to taxpayers chairing companies, funds, organisations, or associations in a low-tax jurisdiction from which they receive direct or indirect benefits. In order for the above to apply, the foreign party must be domiciled in the low-tax jurisdiction, half the ownership of the foreign party must be directly or indirectly in the hands of Icelandic taxpayers, or they must have effective management and executive control during the income year.

CFC regulations do not apply if a fund or an organisation is protected by a double taxation treaty between Iceland and the low-tax country or if such entities are registered in another EEA member country where they have legitimate business operations and the countries have assigned a double taxation treaty between them.

## *Tax credits and incentives*

### *Temporary Reimbursements in Respect of Filmmaking in Iceland*
On account of Act no 43/1999 on Temporary Reimbursement in Respect of Filmmaking in Iceland, it is possible to have 20% of production expenses incurred in the production of films or television material in Iceland reimbursed. When more than 80% of the total production cost of a motion picture or television programme is incurred in Iceland, the reimbursement shall be calculated from the total production cost incurred within the EEA. Production costs refer to all costs incurred in Iceland deductible from the revenues of enterprises pursuant to the provisions of the Act on Income Tax. Payments pertaining

to employees and contractors are only to be included in production costs if they are verifiably taxable in Iceland.

Application for reimbursement of production costs shall be submitted to the Ministry of Industry. The application, with supporting documentation, shall be submitted before production commences in Iceland.

In assessing whether a proportion of the production costs of a motion picture or television programme shall be reimbursed, the following conditions must be fulfilled:

- The production shall be suitable for promoting Icelandic culture and the history and nature of Iceland.
- The production shall be suitable for enhancing the experience, knowledge, and artistic ambition of the parties involved. A specific company shall be established in Iceland for the production; an Icelandic branch or agency of a company registered in another member state of the EEA shall be considered a specific company.
- Information on the principal parties involved in the film or television programme shall be made available.
- Information on domestic parties and their share in the production of the film or television programme shall be made available.
- An itemised estimate of the production costs and sources of funding shall be made available, together with confirmation by the funding parties and a declaration by the applicant to the effect that the production conforms to the aims of the Act.
- Information about the content of the proposed production of a motion picture or a television programme shall be made available, such as a script and information about filming locations.
- A statement shall be made available to the effect that the material to be produced is intended for general distribution to cinemas or television stations.
- The subject matter of the film or television programming should not violate the provisions of law relating to film inspection and the ban on violent films, nor the provisions of the General Penal Code concerning pornography.

Act No. 43/1999 on Temporary Reimbursements in Respect of Filmmaking in Iceland expires at year end 2011. All projects approved by that date will be reimbursed in accordance with the law.

### *Research and development (R&D)*

Innovative companies are entitled to a special deduction from CIT amounting to 20% of expenses incurred on the projects, provided certain conditions are met.

The maximum amount on which the deduction is calculated within each company shall not exceed ISK 100 million for each operating year. In the case of purchased R&D services, maximum expenses shall not exceed ISK 150 million.

## *Withholding taxes*

Dividends paid to a resident company are subject to a 20% WHT. Dividends paid to a non-resident company are subject to 18% WHT. The final taxation of dividends paid to a company within the EEA is nil, as WHT will be reimbursed in the year following payment upon filing a tax return.

Interest paid to resident company is subject to a 20% WHT, and interest paid to non-resident company is subject to 18% WHT.

Gross royalties paid to a non-resident are taxable at the standard 20% CIT rate and subject to withholding.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Non-resident corporations/individuals: | | | |
| Non-treaty | 18/20 | 18/20 | 20/37.31 to 46.21 |
| Treaty rates: | | | |
| Belgium | 5/15 (1) | 10 | 0 |
| Canada | 5/15 (1) | 10 | 0/10 (3) |
| China, P.R. | 5/10 (2) | 10 | 10 |
| Czech Republic | 5/15 (2) | 0 | 10 |
| Denmark | 15 | 10 | 0 |
| Estonia | 5/15 (2) | 10 | 5/10 (4) |
| Faroe Islands | 0/15 (1) | 0 | 0 |
| Finland | 0/15 (1) | 0 | 0 |
| France | 0/15 (1) | 0 | 0 |
| Germany | 5/15 (2) | 0 | 0 |
| Greece | 5/15 (2) | 8 | 10 |
| Greenland | 5/15 (2) | 0 | 15 |
| Hungary | 5/10 (2) | 0 | 10 |
| India | 10 | 10 | 10 |
| Ireland, Rep. of | 5/15 (2) | 0 | 0/10 (5) |
| Italy | 5/15 (6) | 0 | 5 |
| Korea, Rep. of | 5/15 (2) | 10 | 10 |
| Latvia | 5/15 (2) | 10 | 5/10 (4) |
| Lithuania | 5/15 (2) | 10 | 5/10 (4) |
| Luxembourg | 5/15 (2) | 0 | 0 |
| Malta | 5/15 (1) | 0 | 5 |
| Mexico | 5/15 (1) | 10 | 10 |
| Netherlands | 0/15 (1) | 0 | 0 |
| Norway | 0/15 (1) | 0 | 0 |
| Poland | 5/15 (2) | 10 | 10 |
| Portugal | 10/15 (2) | 10 | 10 |
| Romania | 5/10 (2) | 3 | 5 |
| Russia | 5/15 (7) | 0 | 0 |
| Slovakia | 5/10 (2) | 0 | 10 |
| Spain | 5/15 (2) | 5 | 5 |
| Sweden | 0/15 (1) | 0 | 0 |
| Switzerland | 5/15 (2) | 0 | 0 |
| Ukraine | 5/15 (2) | 10 | 10 |
| United Kingdom | 5/15 (1) | 0 | 0 |
| United States | 5/15 (1) | 0 | 0/5(8) |
| Vietnam | 10/15 (2) | 10 | 10 |

Notes

1. The lower rate applies to corporate shareholders with a minimum ownership of 10%.
2. The lower rate applies to corporate shareholders with a minimum ownership of 25%.

3. The lower rate applies to copyright royalties (except films, etc.) and royalties for computer software or patent, or for information concerning industrial, commercial, or scientific experience (except information provided in connection with a rental or franchise agreement).
4. The lower rate applies to royalties paid for the use of industrial, commercial, or scientific equipment.
5. The lower rate applies to the right to use computer software or patent concerning industrial, commercial, or scientific experience.
6. The lower rate applies to corporate shareholders with a minimum ownership of 10%, and which has been held for a period of at least 12 months preceding the date the dividends were declared.
7. The lower rate applies to Russian corporate shareholders with a minimum ownership of 25% of capital in the Icelandic company and the foreign capital invested exceeds USD 100,000.
8. The higher rate applies to royalties for the use of trademarks, know-how in relation to a trademark, and films, etc.

## Tax administration

### Returns

The tax year is the calendar year. However, in certain circumstances, the Internal Revenue Directorate can allow a different fiscal year from the calendar year upon application.

At the beginning of every year, the Internal Revenue Directorate determines the time limit for taxpayers to submit their tax returns and supporting documentation. The deadline for receipt of tax returns from corporations is 31 May each year. This deadline is extended upon application. Those who have their tax returns prepared by professional services can have the deadline extended until 10 September each year.

The final assessment must be completed no later than ten months after the end of the income year. Tax assessments for corporations will be available at the end of October.

### Payment of tax

Advance tax payments are due on the first day of every month, except January and October. Corporations pay income tax in advance, which is in turn deducted from the final tax assessment in October each year. The advance tax is collected in the months of February to September and amounts to 8.5% of the 2010 income tax on each due date. In total the advance tax payments amount to 68% of the income tax for 2010. Any deficit remaining when final tax is assessed must be paid in equal instalments in November and December.

Income tax payments on dividends and interest income are due every quarter. Due dates in 2011 are 20 April, 20 July, 20 October, and 20 January, and the final deadline for payment is 15 days later.

### Statute of limitations

Tax authorities in Iceland have the right to reassess tax returns for CIT six years prior to the year of the assessment (i.e. the statutory period of limitation is six years). The statutory period only reaches a maximum of two years in time if tax returns have been filled out properly and all necessary information presented for tax authorities to establish a correct assessment. This means that in the year 2011, tax authorities can, in theory, reassess the company´s tax back to income year 2005.

### Topics of focus for tax authorities

The topic of focus for tax authorities in Iceland is tax avoidance in general.

## Other issues

### Foreign currency financial statements / accounting in foreign currencies

Companies can apply to the Registry of Annual Accounts for an authorisation to keep their books and prepare their annual accounts in a foreign currency. An application must be filed no later than two months before the beginning of the company's fiscal year. The authorisation is valid for five years, and the Registry of Annual Accounts is responsible for ensuring that the authorised companies continue to fulfil one or more of the following necessary conditions:

- The company's main business operations take place abroad or the company is a part of a foreign company group.
- The company owns foreign subsidiaries or shares in foreign companies and its main business transactions are with those companies.
- The company's main place of business is Iceland, while a considerable number of their transactions are in foreign currencies.
- A considerable portion of the company's investments and related debts are in foreign currencies.

If the company deems that it no longer fulfils the conditions, it must notify the Registry of Annual Accounts. The Registry can postpone its decision of the authorisation's discontinuance for two fiscal years if the situation that is causing the fact that the company does not continue to fulfil the necessary conditions is deemed to be temporary.

The average exchange rate for the fiscal year must be used when converting income and expenses, depreciations included, into ISK. The exchange rate at the end of the fiscal year must be used when converting assets, debts, and capital. Exchange rate differences that may arise do not affect income on profit and loss accounts.

### Rules on foreign exchange

In 2008, the Central Bank of Iceland issued new rules on foreign exchange in order to restrict or temporarily prevent certain types of cross-border capital movements or foreign exchange transactions related thereto, which, according to the Central Bank of Iceland, can cause serious and considerable instabilities in exchange rates and financial matters.

The Act on Foreign Exchange defines capital movements as:

- The issue, sale, or purchase of shares, debt instruments, drafts, unit shares in mutual funds, and other long-term and short-term securities.
- Deposits in and withdrawals from accounts with depository institutions.
- Lending, borrowing, and the issue of securities not related to international transactions with goods and services.
- The import and export of share certificates and domestic and foreign currencies.
- Forward contracts, options, currency and interest-rate swaps, and other related foreign exchange transactions in which the ISK is one of the denominated currencies.
- Presents, grants, or other transactions equivalent to the ones detailed above.

### *Capital movements of foreign currencies*
All capital movements of foreign currencies between countries are prohibited, with the exception of payments for the purchase of goods and services or other capital movements specifically exempt from the regulations, according to Rules no. 370/2010 on Foreign Exchange, issued by the Central Bank of Iceland.

### *Capital movements of domestic currencies*
Capital movements between countries in domestic currencies are also prohibited. There are several exceptions to this rule.

Capital movements specifically exempt from the above regulations are as follows:

- Capital movements in relation to the purchase or sale of goods and services (not including lending, borrowing, and the issue of securities not related to international transactions with goods and services) and payments in cash or by withdrawals from an account the buyer has in an Icelandic depositary institution.
- Capital movements in relation to real estate purchases in Iceland or business transactions with securities issued in the domestic currency and payments by withdrawals from an account the buyer has in an Icelandic depositary institution.
- Capital movements in relation to claims from a liquidated company and payments of contractual debts according to composition agreements, according to Act no 21/1991.

# India

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## Significant developments

Over the past year there have been numerous developments in the Indian corporate tax regime. The most significant developments are as follows.

### Corporate income tax (CIT)

Indian companies are liable to pay CIT at 30% (plus a surcharge).The rate of surcharge has been reduced from 7.5% to 5% on the amount of income tax if the total income exceeds 10 million Indian rupees (INR). For foreign companies, the rate remained unchanged (i.e. 40% and a 2% surcharge).

### Minimum alternate tax (MAT)

Indian companies are liable to pay MAT on their income. The rate of MAT increased from 19.93% to 20.01% (including surcharge, education cess, and secondary and higher education cess). For foreign companies, the rate has increased from 18.91% to 19.44% (including surcharge, education cess, and secondary and higher education cess). Surcharge is payable only where total taxable income exceeds INR 10 million.

A Special Economic Zone (SEZ) developer, and a unit in an SEZ, is now liable to pay MAT by virtue of amendment to section 115JB by the Finance Act, 2011 with effective from tax year 2011-12. An SEZ is a designated area which has special economic regulations and where an assessee is eligible for a tax holiday.

Limited liability partnerships (LLPs) pay Alternative Minimum Tax (AMT) at an effective rate of 18.5% (plus surcharge, education cess, and secondary and higher education cess) with credit available for up to ten years.

### Withholding tax (WHT)

There are certain specified payments made to residents which are liable for WHT. The WHT for a fiscal year is required to be deposited with the government treasury on or before the due date of the filing of the tax returns; otherwise, the expense payment is not eligible as a tax deductible expense. In relation to payments made to non-residents, or to foreign companies, WHT is now required to be deposited with the government treasury within the timeline provided on a month-to-month basis with effect from 1 April 2012.

### Research and development (R&D) expenditures

The weighted deduction available in respect of expenditures incurred on scientific research in an in-house R&D facility approved by the prescribed authority has been increased from 150% to 200% for companies engaged in specified businesses.

Contributions made to the National Laboratory, approved scientific research associations, universities, and the Indian Institute Technology are now 200% deductible instead of 175% deductible.

### *Conversion of a company into an LLP*

Conversion of a private company, or an unlisted public company, into a LLP will no longer attract capital gains tax, if the following prescribed conditions are fulfilled:

- Turnover or gross receipts of the company being converted do not exceed INR 6 million in any of the three preceding tax years.
- All the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP.
- All the shareholders of the company immediately before conversion become the partners of the LLP and their capital contribution and profit sharing ratio in the LLP are in the same proportion as their shareholding on the date of conversion.
- The shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the LLP.
- The aggregate of the profit sharing ratio of the shareholders of the company in the LLP is not less than 50% at any time during the period of five years from the date of conversion.
- No amount is paid, directly or indirectly, to any partner out of the balance of the accumulated profit appearing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

One may also note the following:

- Any unabsorbed business loss or depreciation allowance of the company is eligible for carry forward and set-off in the hands of the successor LLP.
- Any unutilised MAT credit in the hands of a company is not available to the successor LLP.
- Transfer of shares by the shareholders of the company under this conversion will not attract capital gains tax subject to fulfilment of the prescribed conditions.

### *Social Security agreements*

India has, so far, entered into social security agreements with the following eleven countries: Belgium, Germany, France, the Netherlands, Luxembourg, Switzerland, Denmark, Hungary, the Czech Republic, the Republic of Korea, and Norway. However, only agreements with Belgium, Germany, and Switzerland are currently operational.

## *Taxes on corporate income*

For India, the tax year ends on 31 March. A resident company is taxed on its worldwide income. A non-resident company is taxed only on income that is received in India, or that accrues or arises, or is deemed to accrue or arise, in India.

The CIT rate applicable to an Indian company for the tax year 2011-2012 is 30% (plus surcharge, education cess, and secondary and higher education cess). Resident companies are liable to pay surcharge at the rate of 5% on the amount of CIT if the total income exceeded INR 10 million.

Foreign companies operating in India are taxed at 40% (plus surcharge, education cess, and secondary and higher secondary education cess). For tax year 2011-12, surcharge for non-resident companies is 2%.

The education cess is 2%, and the secondary and higher education secondary cess is 1%.

### *MAT*

Resident companies are liable to pay the MAT on their adjusted book profits where the tax liability for the year is less than 20.01% of the adjusted book profits for the tax year 2011-12 (19.93% for assessment year 2011-12). In such cases, the tax liability is fixed at 20.01% of the adjusted book profits of the company.

Non-resident companies are liable to pay MAT on their adjusted book profits from India-sourced income where the tax liability for the year is less than 19.44% of the adjusted book profits from India-sourced income for tax year 2011-12 (18.91% for assessment year 2011-12). In such cases, the tax liability is fixed at 19.44% of the adjusted book profits of the company from India-sourced income.

Surcharge is payable only where total taxable income exceeds INR 10 million.

Sick companies (loss companies which have made losses continuously and may or may not be revived to making profits) are not subject to MAT.

From tax year 2010-11, companies are allowed to take the benefit of carrying forward the credit of tax paid under MAT for ten years.

A SEZ developer and a unit in an SEZ are now liable to pay MAT by virtue of amendment in section 115JB by the Finance Act, 2011 with effect from tax year 2011-12.

### *Tonnage tax scheme*

The tonnage tax scheme can be elected by an Indian company which has a place of effective management in India, owns at least one qualifying ship, and whose main object is to carry on the business of operating qualifying ships. The tonnage tax scheme is in place of CIT and is levied on the basis of tonnage of vessels owned, operated, or chartered by it instead of net income generated by commercial operations.

In relation to non-resident shipping companies that have regular/occasional shipping income, presumptive tax provisions are applicable. Under the tonnage tax scheme, deemed income shall be assessed at a rate of 7.5% of the amount paid or payable (whether in or out of India) for carriage of passengers, livestock, mail, or goods shipped at any port in India and the amount received or deemed to be received in India on account of carriage of passengers, livestock, mail, or goods shipped at any port outside India shall be treated as profits and gains of the business or profession.

Tax rates applicable to a non-resident should take into consideration any treaty provisions.

Under a presumptive tax system, taxpayers can opt to be taxed on their income at a pre-designated tax rate.

A government company, or a public company, formed and registered in India with the main object of operating ships is eligible for a deduction not exceeding 50% of the profits to the extent that it is transferred to a special reserve created for the purpose which is utilised in accordance with the provisions of the Act.

### *Direct taxes code*

A new direct taxes code replacing the existing Income-tax Act, 1961 is proposed and is expected to be introduced by 1 April 2012.

## *Corporate residence*

A company is treated as a resident of India if:

- it is an Indian company, or
- during the tax year, the control or management of its affairs is situated wholly in India.

A company that does not fulfil either of these conditions is treated as a non-resident.

A partnership firm or an LLP is treated as a resident in India, if any portion of its control and management is in India. A partnership firm or LLP is a non-resident, if its control and management is situated wholly outside India.

### *Permanent establishment (PE)*

A permanent establishment (PE) is defined in India as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

## *Other taxes*

### *Value-added tax (VAT) / Central sales tax (CST)*

The sale of movable goods in India is chargeable to tax at the central or state level. The Indian regulatory framework has granted power to state legislatures to levy tax on goods sold within that state. Such sales are, therefore, chargeable to VAT at the rates notified under the VAT laws of the relevant state. All goods sold in the course of interstate trade are subject to CST.

Where goods are bought and sold by registered dealers, for trading or for use as inputs in the manufacture of other goods or specified activities (such as mining or telecommunication networks), the rate of sales tax is 2%, provided Form 'C' is issued by the purchasing dealer. In the absence of Form 'C', the applicable rate would be the rate of VAT on such goods in the originating state. Interstate procurement, on which CST is charged by the originating state, is not eligible for input tax credit in the destination state and hence is a cost to a buyer.

State level sales tax has been replaced by VAT in all the states. Under the VAT regime, the VAT paid on goods purchased within the state is eligible for VAT credit. The input VAT credit can be utilised against the VAT/ CST payable on the sale of goods. It is, thus, ensured that the cascading effect of taxes is avoided and only the value addition is taxed.

Currently, there is no VAT on imports into India. Exports are zero rated. This means that while exports are not charged to VAT, VAT charged on inputs purchased and used in the manufacture of export good or goods purchased for exports is available to the purchaser as a refund.

The state VAT is charged at tax rates of 1%, 4% to 6% (range). Goods other than those notified to be covered under the above rates are charged in the range of 12.5% to 16.5%. The rate of VAT depends on the nature of goods involved and varies from state to state.

Turnover threshold is prescribed so as to exclude small traders from the ambit of the VAT. A tax under composition scheme, at a lower rate, may be levied on such small traders in lieu of VAT.

### *Dividend distribution tax (DDT)*

Indian companies distributing or declaring dividends are liable to pay dividend distribution tax (DDT) at 15% (plus surcharge, education cess, and secondary and higher education cess). This tax is payable on declaration, distribution, or payment, whichever is earlier, and it is in addition to the CIT payable on business profits.

As of tax year 2009-10, a holding company does not have to pay DDT on dividends paid to its shareholders to the extent that it has received dividends from its subsidiary company on which DDT has been paid by the subsidiary. However, the benefit will not be available if the holding company is itself a subsidiary of another company which has a shareholding of more than 50%. SEZ developers and units in a SEZ are liable to pay DDT at 15% (plus surcharge, education cess and secondary and higher education cess) with effect from 1 June 2011.

### *Securities transaction tax (STT)*

STT at the rate of 0.125% is applicable to transactions involving the purchase or sale of equity shares, derivatives, units of equity-oriented funds through a recognised stock exchange, or the sale of a unit of an equity-oriented fund to any mutual fund. STT paid is eligible to be claimed as a tax-deductible expenditure when computing the tax on income from the sale of securities.

### *Wealth tax*

All companies are liable to pay wealth tax assessed at 1% of the value of specified net assets, if the value of net wealth exceeds INR 3 million. Valuation of assets is in terms of specific rules notified by the government.

### *Customs duty*

Customs duty is levied by the Central Government on the import of goods into, and export from, India. The rate of customs duty applicable to a product proposed to be imported or exported depends upon its classification under the Customs Tariff. With regard to exports from India, customs duty is levied only on a very limited list of goods.

The Customs Tariff is aligned with the internationally recognised Harmonised System of Nomenclature (HSN) provided by the World Customs Organisation.

Customs duty is levied on the transaction value of the imported or exported goods. According to section 14 of The Customs Act, 1962 (CA), the concept of transaction value is the sole basis for valuation for the purposes of import and export of goods. While the general principles adopted for valuation of goods in India are in conformity with the World Trade Organisation (WTO) agreement on customs valuation, the Central Government has notified independent Customs Valuation Rules applicable to export and import of goods.

India does not have one uniform rate of customs duty, and the customs duty applicable to any product is composed of a number of components. The types of customs duty applicable are as follows:

- The Basic Customs Duty (BCD) is the basic component of customs duty levied at the effective rate notified under the First Schedule to the Customs Tariff Act (CTA) and applied to the landed value of the goods (i.e. the cost, insurance, and freight (CIF) value of the goods plus landing charges at 1%). Typically, the rate of BCD is 10%.
- The additional customs duty in lieu of excise duty (CVD) is equivalent to, and is charged in lieu of, the excise duty applicable on like goods manufactured or produced in India. CVD is calculated on the sum of landed value of the goods and the applicable BCD. However, the CVD on specific consumer goods intended for retail sale in India is calculated on the basis of the maximum retail price (MRP) less specified abatement printed on their packs. The general rate of excise duty is currently 10%, and, consequently the rate of CVD is also 10%. In addition, education cess at 2% and secondary and higher education cess at 1% are also levied on the CVD.
- Education cess at 2% and secondary and higher education cess at 1% are also levied on the aggregate of the custom duties (except in cases of safeguard duty, countervailing duty, and anti-dumping duty).
- Additional duty of customs (ADC) to countervail state taxes and VAT of 4% is charged in addition to the above duties on all imports, subject to a few exceptions. ADC is calculated on the aggregate of the assessable value of the imported goods, the total customs duties (i.e. BCD and CVD) and the applicable education cess and secondary and higher education cess.



BCD, education cess, and secondary and higher education cess levied on the aggregate of duties of customs are a cost of any import transaction. The duty incidence arising on account of all other components may be set off or refunded subject to prescribed conditions. Where goods are imported for purposes of manufacture, the Indian manufacturer may take a credit of the CVD and ADC paid at the time of import for offset against the output excise duty. In the case of service providers, the credit of only the CVD is available. Similarly, the Central Government provides exemption from payment of ADC on import of certain specified goods. The Central Government also has prescribed a refund mechanism in relation to ADC paid on goods imported for the purpose of trading in India, subject to fulfilment of the conditions prescribed under the governing notifications and circulars issued in this regard.

### *CENVAT (Excise duty)*

Central Value Added Tax (CENVAT) is an excise duty levied by the Central Government on the manufacture or production of movable and marketable goods in India.

The rate at which excise duty is leviable on the goods depends on the classification of the goods under the Excise Tariff. The Excise Tariff is primarily based on the eight digit HSN classification adopted so as to achieve conformity with the Customs Tariff.

The excise duty on most consumer goods, which are intended for retail sale, is chargeable on the basis of the MRP printed on the package of the goods. However, abatements are admissible at rates ranging from 20% to 50% of the MRP. Goods, other than those covered by MRP based assessments, are generally chargeable to duty on the ‘transaction value’ of the goods sold to an independent buyer. In addition, the Central Government has the power to fix tariff values for charging *ad valorem* duties on the goods.

Typically, the duty rate is 10%. However, notifications granting partial or complete exemption for specified goods from payment of excise duties are also available. Education cess at 2% and secondary and higher education cess at 1% are applicable on the aggregate of excise duties.

The central excise duty is a modified VAT wherein a manufacturer is allowed credit of the excise duty paid on locally sourced goods and the CVD and ADC paid on imported goods. The CENVAT credit can be utilised for payment of excise duty on the clearance of dutiable final products manufactured in India. In light of the integration of goods and services tax initiated in 2004, manufacturers of dutiable final products are also eligible to avail CENVAT credit of the service taxes paid on input services used in or in relation to the manufacture of final products and clearances of final products from the place of removal, subject to fulfilment of conditions.

### *Service tax*

Service tax is levied on specified taxable services identified under Chapter V of the Finance Act, 1994 (the Act). At present, over 100 services are classified as taxable under the Act. The existing rate of service tax is 10%. In addition, an education cess of 2% and secondary and higher education cess of 1% of the service tax have also been levied on taxable services. Thus, the effective rate of service tax is 10.30%. There is no service tax on the services which qualify as exports, subject to fulfilment of prescribed conditions.

The onus of payment of service tax lies with the provider of services. However, in the case of specified services, such as transport of goods by road, sponsorship services, and import of services, the service tax liability rests with the recipient of the services as against the service provider.

In light of the integration of goods and services tax, a service provider can avail CENVAT credit of excise duties paid on capital goods and inputs used for providing output services, apart from availing CENVAT credit of the service taxes paid on input services, subject to fulfilment of conditions.

Taxable services provided by service providers located outside India to a recipient in India are subject to service tax in terms of the Services (Provided from Outside India and Received in India) Rules, 2006. In terms of these Rules, where the taxable services are provided from outside India and received in India, the service recipient is required to become registered and to pay the tax in accordance with the relevant provisions of law.

Further, the Central Government has introduced the Point of Taxation Rules, 2011 which envisages the point in time when a service shall be deemed to have been provided, thereby creating a deeming fiction for imposing the tax even prior to receipt of consideration for the services rendered.

### *Advance ruling for customs, excise, and service tax*

In order to enable foreign investors to ascertain their indirect tax liabilities arising from proposed business ventures in India, the Central Government has constituted the Authority for Advance Rulings (AAR) as a high level quasi-judicial body. The functions of the AAR comprise of giving advance rulings on a specific set of facts relating to specified matters under customs, central excise, and service tax.

Advance rulings may be sought by any non-resident investor entering into a joint venture in India in collaboration with another non-resident, or a resident of India, or a resident setting up a joint venture in India in collaboration with a non-resident.

Through the Finance Act 2005, this facility has also been made available to an existing Joint Venture in India. The Central Government is also empowered to notify any other class or category of persons as eligible for availing the benefit of an advance ruling.

### *Entry tax/Octroi duty*

'Entry tax' is a tax on entry of goods into the state from outside the state for use, consumption, or sale therein. Entry tax continues to exist under the VAT regime; however, in most states, it has been made VAT-able and can be offset against the output VAT liability in the state. The only exception is where entry taxes have been imposed in lieu of Octroi for which no offset is allowed, and hence it is a cost. It is levied on the purchase value, which is defined to mean the amount of the valuable consideration paid or payable by a person for the purchase of any goods. The value of the specified goods can be ascertained from the original invoice for purchase of such goods.

Further, it is important to note that the levy of entry tax has been considered as unconstitutional by the High Courts of a few of the states. The state governments have filed petitions before the Supreme Court to challenge the decision of the High Courts, and at present, the matter is pending for final adjudication before the Supreme Court.



Octroi is a municipal levy which is levied at the time of entry of specified goods into the limits of the relevant municipal corporation. Thus, Octroi is leviable, if there is movement of goods from one city to another in the same state, in the event the cities fall under the jurisdiction of two different municipal corporations.

### *Goods and services tax (GST)*

The Central Government took a major step towards the transition to a national integrated GST in 2006. In this regard, a Joint Working Group (JWG) was constituted by the Empowered Committee (EC) to study global GST models and identify suitable models for introduction in India. In 2007, the JWG recommended a dual GST model for India which was subsequently studied and approved by the EC and the Ministry of Finance.

The EC released the First Discussion Paper on the proposed GST in India on 10 November 2009). In the discussion paper, the Government indicated that GST shall have two components. One levied by the Centre (Central GST or CGST) and the other levied by the states (State GST or SGST). The CGST and the SGST would be applicable on all transactions of goods and services made for a consideration except for exempted goods and services, goods which are outside the purview of GST, and transactions which are below the prescribed threshold limits. The exact date of implementation of GST is not yet decided. Details of taxes which would be subsumed in the dual GST are as follows.

The following taxes will be subsumed in the CGST:

- Excise duty.
- CVD/ADC.
- Service tax.

The following taxes will be subsumed in the SGST:

- VAT.
- Entertainment tax.
- Luxury tax.
- Lottery taxes.

- State cesses and surcharges.
- Entry tax not in lieu of octroi.

It is likely that CST will be phased out in the GST regime.

The input tax credit (ITC) for the CGST and SGST would operate in parallel and would be available for utilisation only against the output payment of CGST and SGST. Both CGST and SGST will be levied on import of goods and services into the country. The incidence of tax will follow the destination principle. Full and complete offset will be available on the GST paid on import of goods and services.

The Union Finance Minister (FM) met the EC on 21 July 2010, and the key highlight of the meeting was a single rate structure with unification of the rate for goods and services proposed to be achieved in a phased manner as below:

| | Year one | Year two | Year three |
|---|---|---|---|
| Goods | | | |
| Standard rate | 10% | 9% | 8% |
| Lower rate | 6% | 6% | 8% |
| Services | 8% | 8% | 8% |

The FM has requested that the states adopt similar rates for the SGST.

In the Budget speech, while the FM did not indicate a specific deadline by which the GST would be introduced, he mentioned that there has been considerable progress in the last four years and that the areas of divergence of opinion with the states have been narrowed. He also said that work is underway on drafting of the model legislation for the Central and State GST. Various amendments in the Central Excise, Customs and Service tax law, which include withdrawal of certain exemptions, retaining the present tax/duty rates and structure were done to align the present tax/duty structures consistent with the intended GST rates.

## *Branch income*

Branches of foreign companies are taxed on income that is received in India, or which accrues or arises in India, at the rates applicable to foreign companies. There is no WHT on remittance of profits to the company's head office.

## *Income determination*

### *Inventory valuation*

Inventories are generally valued at cost or net realisable value, whichever is lower. Generally, there is conformity between book and tax reporting. The first in first out (FIFO) and average cost methods are acceptable, provided that they are consistently applied.

### *Capital gains*

Capital gains refer to the gains made on the transfer of a capital asset, including extinguishment of the rights in an asset. Capital assets are classified into short-term capital assets and long-term capital assets. Long-term capital gains are eligible for concessional rate of tax.

Short-term capital assets are capital assets held for a period of less than 36 months. In the case of shares, listed securities, or units of specified mutual funds or zero-coupon bonds, the short-term holding period is less than 12 months. Capital assets that do not qualify as short-term capital assets are considered as long-term capital assets.

Normally, long-term capital gains are determined after increasing the cost by prescribed inflation factors. In the case of foreign companies, capital gains on the transfer of shares or debentures in Indian companies are computed in the foreign currency in which the shares or debentures were acquired, and the capital gains are reconverted into Indian currency.

Capital gains are taxed as follows:

- Long-term capital gains on the transfer of shares in a company, or units of an equity-oriented fund, which are subject to STT are exempt from taxation. However, such gains are taxable under MAT provisions.
- Other long-term capital gains are subject to taxation at 20% (plus the surcharge, education cess, and secondary and higher secondary education cess). However, long-term capital gains arising from the transfer of listed securities, units, or zero-coupon bonds are taxed at 10% (without adjusting the cost for inflation) or at 20% (after adjusting the cost for inflation), whichever is more beneficial to the taxpayer. These rates exclude surcharge, education cess, and secondary and higher education cess.
- Short-term capital gains on the transfer of shares in a company or units of an equity-oriented fund which are subject to STT are taxed at 15% (plus the surcharge, education cess, and secondary and higher secondary education cess).
- Other short-term capital gains are subject to taxation at the normal corporate rates applicable to a company.

In the case of certain overseas financial organisations (e.g. off-shore funds and foreign institutional investors), long-term capital gains arising on the transfer of units purchased in foreign currency are taxable at 10% (plus the surcharge, education cess, and secondary and higher education cess) on the gross amount.

Long-term capital gains earned by non-residents on the transfer of bonds relating to Indian companies (issued abroad in accordance with government guidelines or approved schemes and acquired in foreign currency) are taxable at 10% (plus surcharge, education cess, and secondary and higher education cess) on the gross amount of gains.

The rules of carryforward and offset of loss for capital gains are as follows:

- Capital losses arising from the transfer of a short-term capital asset can be offset against capital gains arising from any other asset. However, capital losses arising from the transfer of a long-term capital asset can be offset only against capital gains arising from the transfer of any other long-term capital asset.
- Capital losses that cannot be offset can be carried forward and offset against the future capital gains. Losses can be carried forward for offset for a period of eight years after the year of loss.
- Gains and losses arising on the sale of depreciable assets are classified as short-term capital gains or losses, and the gains are taxed at the same rate as business income.

The transfer of unlisted (not tradable and not listed on any stock exchanges) shares of a company to a firm or a company without consideration or for inadequate consideration is taxable as income in the hands of the recipient firm or company.

### *Dividend income*

Dividend income received from Indian companies is not taxable in the hands of all the shareholders. This applies to resident as well as non-resident shareholders.

Income received by overseas financial organisations (offshore funds) from units of specified mutual funds, or from the Unit Trust of India, that is purchased in foreign currency, as well as interest received by non-residents on bonds issued abroad by Indian companies following in terms of government guidelines and acquired in foreign currency, are taxable at 10% on the gross amount of income. Dividends (other than those received from Indian companies) and interest earned by foreign financial institutions from investment in the Indian capital market are taxable at 20% on the gross amount.

Income received from units of specified mutual funds is not taxable in the hands of the recipient. The distributing mutual fund is liable to pay a distribution tax of 25% or 30% (plus surcharge, education cess, and secondary and higher education cess). The above tax is not chargeable in respect of income distributed by an equity oriented fund in respect of distribution under such scheme.

Stock dividends (bonus shares) distributed are not taxed at the time of receipt in the hands of the recipient shareholders, but capital gains provisions are applicable to the sale of these stock dividends.

### *Interest income*

Interest income received by a resident company is taxable at normal CIT rates. Interest income received by a non-resident company is taxed at a concessional rate of withholding at 20%, subject to conditions.

### *Partnership/LLP income*

A partnership firm and an LLP are taxed as a separate legal entity. The share of income of partners from a partnership firm or an LLP is exempt from tax. The partnership and LLP is taxed at the rate of 30% (plus education cess and secondary and higher education cess).

An LLP is required to pay Alternative Minimum Tax (AMT) at the rate 18.5% of its adjusted total income with effect from 1 April 2012, where the regular income tax liability is less than the AMT calculated. The credit of AMT is available to an LLP to be carried forward (for offset in a subsequent year) for a period of ten years.

The interest payment to the partner on the capital or current account is allowed as a tax deductible expenditure; however, the maximum interest allowable for tax purposes is 12% per annum. A working partner can be paid salary, bonus, commission, or remuneration. The maximum permissible deduction in respect of remuneration payable collectively to all working partners would be based on the book profit at a specified percentage for different quantum slabs of the book profit.

### *Unrealised exchange gains/losses*

There are no specific rules under the tax law for determining the nature of unrealised foreign exchange gains or losses. However, there are various judicial precedents available which lay down certain principles for classification of foreign exchange gains or losses.

- Profit/loss is considered to be trading profit/loss if foreign currency is held on revenue account or as trading assets or as a part of circulating capital invested in the business.
- Profit/loss is considered to be of a capital nature if a foreign currency loan is taken for capital asset or fixed asset.

### *Foreign income*
A resident company is taxed on its worldwide income. A non-resident company is taxed only on income that is received in India, or that accrues or arises, or is deemed to accrue or arise, in India. This income is subject to any favourable tax treaty provisions. Double taxation of foreign income for residents is avoided through treaties that generally provide for the deduction of the lower of foreign tax, or Indian tax, on the doubly taxed income from tax payable in India. Similar relief is allowed unilaterally where no treaty exists, in which case a resident would be taxed at the rate which would be the lower of the Indian tax rates or the rate of the other country in which income is already taxed.



## *Deductions*

Expenditures which are revenue in nature are allowed as a deduction if they are:

- incurred wholly and exclusively for the purpose of the business
- not in the nature of a personal expense, and
- not in the nature of a capital expense.

### *Depreciation*
Depreciable assets are grouped in blocks, and each block is eligible for depreciation at a prescribed rate (usually 15% to 100% for machinery, 5% to 100% for buildings, 10% for furniture, and 25% for intangible assets) on the opening value (net of depreciation charged in preceding years), plus cost of acquisition, less deletions, during the year. A deletion is the reduction by way of sale, discarding, demolition, or destruction of the assets and the amount realised is reduced.

Depreciation is restricted to 50% of the prescribed rate if the asset acquired is used for less than 180 days during the year of acquisition. If money receivable on the transfer exceeds the opening written-down value plus acquisitions of the block concerned, the excess is taxed as a short-term capital gain at the same tax rates as that applicable to business income.

Additional depreciation of 20% on the cost of new plant and machinery (other than ships or aircrafts) is allowable in the year of commissioning for manufacture. Power-generating or power-distributing companies have the option either to apply the reducing balance method provided under the normal schedule or to charge depreciation on a straight-line basis. The straight-line rates are aligned to the power companies' book depreciation rates.

Know-how, patents, licenses, franchises, and similar intangible assets form part of the block of depreciable assets, provided that they are owned and put to use in the course of their business and are eligible for depreciation at the prescribed rate, which is 25%.

Tax depreciation is not required to conform to book depreciation.

### Interest
Any interest paid by an assessee (taxpayer) on capital borrowed for the purposes of their business or profession is a tax deductible expense. If the capital is borrowed for acquiring a capital asset for the purpose of extension of an existing business or profession, then interest liability pertaining to the period, until the time the asset is put to use, cannot be allowed as a tax deductible expense and will have to be added back to the cost of such asset.

### Organisational and start-up expenses
Certain expenses are incurred by taxpayers either before the start-up of a business or after start-up of business, in connection with extension of the industrial undertaking, or in connection with setting-up a new unit. One fifth of such expenditure is allowed as a deduction each year, over a period of five years.

### Bad debts
The amount of any bad debt, or part thereof, which has been written off as irrecoverable in the accounts of the assessee (taxpayer) for the year, is allowed as a tax deductible write-off.

### Charitable contributions
Any charitable contribution made by a company to any charity is allowed as a tax deductible expense. This is subject to certain conditions. The tax deductibility ranges from 50% to 100% of the charitable contribution, depending upon the nature of charity. The tax deductibility of charitable contribution is restricted to 10% of the total taxable income.

### Bribes, kickbacks, illegal payments
Expenditures incurred by a taxpayer which are illegal are not deemed to have been incurred for the purpose of the business or profession, and no deduction will be allowed.

### Taxes
All taxes (tax, duty, cess, or fees by whatever name called) relating to business (other than income tax and wealth tax) incurred during the tax year are deductible in that year, provided they are paid by the following 30 September. Otherwise, they are deductible in the year of payment.

### Expenses allowable on actual payment basis
Certain expenses, such as, but not limited to, employees' provident fund dues (i.e. retirement benefit funds), bonus to employees, and interest payable to financial institutions and banks are allowed as tax deductible expenses only on actual payment.

### Net operating losses
Losses can be carried forward and offset against income from subsequent year(s) for periods set out in the following table:

| Types of losses | Time limit |
|---|---|
| Unabsorbed depreciation | Perpetually |
| Other business losses (other than speculation business losses) | 8 years |
| Speculation business losses | 4 years |
| Capital losses | 8 years |

There are no provisions in India for carrying losses back.

### *Payments to foreign affiliates*
Indian companies can claim deduction for payment of royalties, and for interest and fees for technical or management service provided by foreign affiliates, as long as they are not capital in nature, are incurred wholly and exclusively for the purpose of the business, and requisite tax is withheld from such payment. However, if the requisite tax is not withheld from such payment, or is not paid into the government treasury after withholding, a tax deduction of the payment is available in the year of payment of tax into the government treasury.

## *Group taxation*

Group taxation is not permitted under the Indian tax law.

### *Transfer pricing*
The Indian transfer pricing (TP) regulations stipulate that income arising from 'international transactions' between 'associated enterprises' should be computed at 'arm's-length price'. Furthermore, any allowance for expenses or interest arising from any international transaction is also to be determined at 'arm's length price'.

The expressions 'international transactions' and 'associated enterprises' have been defined in the Indian TP regulations. Various (presently five) methods for computation of arm's-length price have been specified under the Indian TP regulations, which are broadly in line with the Organisation for Economic Co-operation and Development (OECD) Guidelines, and taxpayers are required to adopt the most appropriate method. Taxpayers are also required to maintain a comprehensive set of prescribed information and documents relating to international transactions which are undertaken between associated enterprises, on an annual basis, within the prescribed timelines (due date of filing the Income-tax return). Further, taxpayers are required to obtain an Accountant's Report (in prescribed Form 3CEB) from an independent accountant certifying the nature and amount of international transactions. The certificate needs to be filed along with the Income-tax return. The burden of proving the arm's-length character of the transaction is primarily on the taxpayer.

The Indian TP regulations adopt an arithmetic mean of comparable prices as the arm's-length price with a flexibility of the percentage as may be notified by the Central Government across different segments of business activity.

Where the transfer pricing officer is of the opinion that the arm's-length price was not applied, the officer may re-compute the taxable income after giving the taxpayer an opportunity to be heard. Stringent penalties are prescribed in cases of failure to comply with the provisions of the Indian TP regulations.

To facilitate quick resolution of disputes, the Central Board of Direct Taxes (CBDT) has provided for an alternative dispute resolution mechanism and constituted a Dispute Resolution Panel (DRP) comprised of three Commissioners of Income Tax. In cases of foreign companies, the transfer pricing orders passed by the tax officer (TO) on or after 1 October 2009 and which are prejudicial to the taxpayer, the TO shall be required to issue a draft order to the taxpayer. The taxpayer can file objections against the draft order before the DRP. After considering all evidence or objections and further enquiries, the DRP is required to issue binding directions to the TO within a period of nine months. The TO is required to pass an order within one month, in conformity with the directions of the DRP. Orders passed by a TO on the basis of directions of the DRP are appealable directly before the Income Tax Appellate Tribunal (ITAT).

In order to lessen the litigation under transfer pricing regulations, provisions empowering the issue of safe harbour rules are contained in the tax law which would be separately issued by the CBDT. The safe harbour rules are not yet issued. The rules would provide the circumstances under which the tax authorities would accept the transfer price as declared by the assessee.

Taxpayers enjoying a tax holiday in India are also required to comply with the Indian TP regulations.

### *Thin capitalisation*
No prescribed debt-equity ratios or thin capitalisation rules exist under India taxation law.

### *Controlled foreign company (CFC) regime*
India currently has no CFC rules, so there will be no India tax on foreign profits that remain unremitted from offshore subsidiaries.

## *Tax credits and incentives*

Tax incentive provisions normally have conditions applicable for the period within which the preferred activity should be undertaken and the period for which the tax incentive is available. It may also be necessary to fulfil certain other conditions such as 'forming' of a 'new' undertaking.

### *Tax incentives for undertakings other than infrastructure development undertakings*
New industrial undertakings located in specified 'backward' states and districts are entitled to full tax exemption of profits for the first three or five years of operation, followed by a partial tax exemption of 30% of profits for the next five years. The list of backward districts has been streamlined into category A and category B districts, depending upon the current level of infrastructure development in those areas. The initial tax holiday period is five years in the case of category A districts and three years in the case of category B districts. A similar incentive is also applicable for hotels satisfying prescribed conditions.

If certain conditions are met, a tax holiday is permitted on the profits of an undertaking engaged in any of the following:

- Integrated business of handling, storage, and transportation of food grains.
- Developing and building of housing project.
- Scientific research.
- Commercial production or refining of mineral oils.
- Setting up and operating a cold chain for agricultural produce.
- Processing, preservation, and packaging of fruits or vegetables.
- Operating and maintaining a hospital in a rural area.

The tax holiday periods range from five to ten years, and the percentage of the rebate is either 30%, 50%, or 100% in initial years and 30% in the later years. The number of years constituting 'initial' and 'later' years varies from sector to sector.

### *Tax incentives for infrastructure development undertakings*

Enterprises engaged in the business of power generation, transmission, or distribution; developing or operating and maintaining a notified infrastructure facility, industrial park, or SEZ; making substantial renovation and modernisation of the existing network of transmission or distribution lines (between specified periods); or laying and operating a cross country natural gas distribution network are eligible to a tax exemption of 100% of profits for any ten consecutive years falling within the first 15 years of operation (20 years in the case of infrastructure projects, except for ports, airports, inland waterways, water supply projects, and navigational channels to the sea).

'Infrastructure facility' means roads, including toll roads, bridges, rail systems, highway projects, water supply projects, water treatment systems, irrigation projects, sanitation and sewerage systems or solid waste management systems, ports, airports, inland waterways, inland ports, or navigational channels to the sea.

### *Tax incentives for exports*

The export profits from a new industrial undertaking satisfying prescribed conditions established in a Free Trade Zone (FTZ), Software Technology Park (STP), or Electronic Hardware Technology Park (EHTP), or a 100% export-oriented undertaking (EOU) or a unit in a SEZ are exempt from income tax for ten years, commencing from the first year of manufacture. However, this exemption was available only if the manufacturing activity commenced before the end of the tax year 2010-2011.

The export profits from a new industrial undertaking satisfying the prescribed conditions established in an SEZ is eligible for tax exemption of 100% of profits for the first five years, from the year of commencement of manufacturing, followed by a partial tax exemption of 50% of profits for the next five years. A further tax exemption of 50% of the profits for five years is also available after that, subject to an equal amount of profit being retained and transferred to a special reserve in the books of account.

### *Tax incentives for units in the North Eastern Region of India*

Measures are in place to facilitate the development of the Indian North Eastern Region and of the state of Sikkim. Undertakings located in these states which (i) begin to manufacture or produce any eligible article, (ii) undertake substantial expansion, or (iii) commence an eligible business between 1 April 2007 and 1 April 2017 are eligible for a 100% deduction of profits for ten consecutive years.

A list of eligible businesses has been provided by the Indian government. The eligible businesses include hotels (not below two-star category), adventure and leisure sports including ropeways, the provision of medical and health services in nursing homes with a minimum capacity of 25 beds, operating a vocational training institute for hotel management, catering and food crafts, entrepreneurship development, nursing and para-medical training, civil aviation related training, fashion design and industrial training, running information technology related training centre, manufacturing of information technology hardware, and bio-technology. Businesses other than the above listed eligible businesses are not entitled to claim the tax holiday.

### *Tax incentives for hotels/convention centres located in specified districts*

A tax holiday of five years is provided to hotels (two, three, or four star) and convention centres located in the National Capital Territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar, and Ghaziabad, provided the date of functioning of the hotel or completion of the construction of convention centre was started by 31 July

2010 (the earlier date was 31 March 2010).Hotels located in a specified district having a World Heritage Site, if such a hotel is constructed and has started functioning at any time during the period 1 April 2008 to 31 March 2013, are eligible for a tax holiday for a period of five years.

### *Tax incentives for certain income relating to offshore banking units and international financial services centre*

A scheduled bank, or any bank incorporated by or under the laws of a country outside India, which has an offshore banking unit in an SEZ or an international financial services centre with a specified income which is subject to prescribed conditions, is eligible for a tax exemption of 100% of the specified income for five consecutive years beginning from the year in which the permission under the Indian Banking Regulation Act, 1949 was obtained and for 50% of the specified income for five consecutive years.

### *Tax incentive of capital expenditure on certain specified businesses*

Capital expenditure is allowed at 100% in respect of the following specified businesses:

- Setting up and operating cold chain facilities.
- Setting up and operating warehousing facilities for storage of agriculture produce.
- Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such a network.
- Building and operating a hotel of two-star or above category in India.
- Building and operating a hospital with at least 100 beds.
- Developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the government.
- Developing and building specified housing projects under an affordable scheme of the central/state government.
- Investment in a new plant or newly installed capacity in an existing plant for production of fertilizer.

The following characteristics and conditions may be noted:

- Any sum received or receivable in cash or in kind on transfer, etc. of the capital asset shall be considered as business income, if expenditure on such an asset has been allowed as a deduction under this section.
- Any loss computed in respect of the above specified businesses shall be allowed to be offset or carried forward and offset only against the profits and gains of specified businesses.
- The specified business should:
  - not be set up by splitting up or reconstruction of a business already in existence
  - not be set up by transfer of used machinery or plant exceeding 20% of the total value of the machinery or plant used in such business, and
  - have been approved by the prescribed authority (i.e. the government).

### *Research and development (R&D) expenditures*

The weighted deduction available in respect of expenditures incurred on scientific research in an in-house R&D facility approved by the prescribed authority has been increased from 150% to 200% for companies engaged in specified businesses.

A payment made to an approved research association undertaking research in social science or statistical research or to an Indian company to be used by it for scientific research is now eligible for a weighted deduction of 125% of the payment made.

Contributions made to the National Laboratory, approved scientific research associations, universities, and the Indian Institute Technology are now 200% deductible instead of 175% deductible.

## Withholding taxes

There is an obligation on the payer (either resident or non-resident) of income to deduct tax at source (i.e. withhold tax) when certain specified payments are credited and/or paid. Some of the expenses which require tax withholding are as follows.

### Payments by resident companies

| Nature of payment | Payment threshold for WHT (INR) (1) | WHT rate (%) |
|---|---|---|
| Specified type of interest | None | 10 |
| Non-specified type of interest | 5,000 (2) | 20 |
| Professional or technical service | 30,000 | 10 |
| Commission and brokerage | 5,000 | 10 |
| Rent of plant, machinery, or equipment | 180,000 | 2 |
| Rent of land, building, or furniture | 180,000 | 10 |
| Contractual payment (except for individual/Hindu undivided family (HUF)) | 30,000 (single payment)<br>75,000 (aggregate payment) | 2 |
| Contractual payment to individual/HUF | 30,000 (single payment)<br>75,000 (aggregate payment) | 1 |
| Royalty or fees for technical services | 30,000 | 10 |

Notes

1. Payments have different threshold limits. The payer is only required to withhold tax if the payment is above the limit.
2. The threshold limit for WHT for non-specified type of interest is INR 5,000 except in the case of interest received from a bank, co-operative society, or deposit with post office, for which it is INR 10,000.

### Payment to non-resident companies

| Nature of payment | WHT rate (%) |
|---|---|
| Dividend | 0 |
| Interest on foreign currency | 10 |
| Royalty and technical fees | 10 |
| Long-term capital gains other than exempt income | 20 |
| Income by way of winning from horse races | 30 |
| Other income | 40 |

Notes

1. Percentage to be increased by a surcharge, education cess, and secondary and higher education cess to compute the effective rate of tax withholding.
2. Income from units of specified mutual funds is exempt from tax in the hands of the unit-holders.
3. Dividends received from Indian companies are tax-free in the hands of the shareholder.
4. Short-term capital gains on transfer of shares of a company or units of an equity oriented fund would be taxable at 15%, if they have been subjected to STT.
5. Long-term capital gains on transfer of shares (through stock exchange) in listed companies or units of an equity oriented fund are exempt from tax if they have been subjected to STT.
6. There is no threshold applicable for payment to non-residents companies up to which no tax is required to be withheld.

### *Treaty rates*

Some tax treaties provide for lower WHT rates from certain types of income, as follows:

| Recipient | Dividend (%) (1) | Interest (%) | Royalty (%) (12) | Fee for technical services (%) (12) |
|---|---|---|---|---|
| Armenia | 10 | 10 | 10 | 10 |
| Australia | 15 | 15 | 10/15 (2) | 10/15 |
| Austria | 10 | 10 | 10 | 10 |
| Albania | Government Press Release dated 29 January 2009. Treaty yet to be notified. | | | |
| Bangladesh | 10 (3)/15 | 10 | 10 | N/A (5) |
| Belarus | 10(9)/15 | 10 | 15 | 15 |
| Belgium | 15 | 10 (11)/15 | 10 | 10 |
| Botswana | 7.5 (9)/10 | 10 | 10 | 10 |
| Brazil | 15 | 15 | 25 (15)/15 | N/A (5) |
| Bulgaria | 15 | 15 | 15 (7)/20 | 20 |
| Canada | 15 (3)/25 | 15 | 10 (2)/15 | 10 (2)/15 |
| China (People's Republic of China) | 10 | 10 | 10 | 10 |
| Croatia | Union cabinet approved the signing of tax treaty on 19 January 2006. Treaty yet to be notified. | | | |
| Cyprus | 10 (3)/15 | 10 | 15 | 10 |
| Czech Republic | 10 | 10 | 10 | 10 |
| Denmark | 15 (9)/25 | 10 (11)/15 | 20 | 20 |
| Finland | 10 | 10 | 10 | 10 |
| France | 10 | 10 | 10 | 10 |
| Germany (Federal Republic of Germany) | 10 | 10 | 10 | 10 |
| Greece | (14) | (14) | (14) | N/A (5) |
| Hungary | 10 (6) | 10 (6) | 10 (6) | 10 (6) |
| Iceland | 10 | 10 | 10 | 10 |
| Indonesia | 10 (9)/15 | 10 | 15 | N/A (5) |
| Ireland | 10 | 10 | 10 | 10 |
| Israel | 10 | 10 | 10 | 10 |
| Italy | 15 (3)/25 | 15 | 20 | 20 |
| Japan | 10 | 10 | 10 | 10 |
| Jordan (Hashemite Kingdom of Jordan) | 10 | 10 | 20 | 20 |
| Kazakhstan | 10 | 10 | 10 | 10 |
| Kenya | 15 | 15 | 20 | 17.5 |
| Kuwait | 10 | 10 | 10 | 10 |
| Kyrgyz Republic | 10 | 10 | 15 | 15 |
| Latvia | Government Press Release dated 18 September 2008. Treaty yet to be notified. | | | |
| Libyan Arab Jamahiriya | (14) | (14) | (14) | N/A (5) |
| Luxembourg | 10 | 10 | 10 | 10 |
| Malaysia | 10 | 10 | 10 | 10 |
| Malta | 10 (9)/15 | 10 | 15 | 10 |
| Mauritius | 5 (3)/15 | (14) | 15 | N/A (5) |

| Recipient | Dividend (%) (1) | Interest (%) | Royalty (%) (12) | Fee for technical services (%) (12) |
|---|---|---|---|---|
| Mexico | 10 | 10 | 10 | 10 |
| Mongolia | 15 | 15 | 15 | 15 |
| Montenegro | 5 (9)/15 | 10 | 10 | 10 |
| Morocco | 10 | 10 | 10 | 10 |
| Myanmar | 5 | 10 | 10 | N/A (5) |
| Namibia | 10 | 10 | 10 | 10 |
| Nepal | 10 (3)/15 | 10 (14)/15 | 15 | N/A (5) |
| Netherlands | 10 (6) | 10 (6) | 10 (6) | 10% (6) |
| New Zealand | 15 | 10 | 10 | 10 |
| Norway | 15 (9)/25 | 15 | 10 | 10 |
| Oman | 10 (3)/12.5 | 10 | 15 | 15 |
| Philippines | 15 (3)/20 | 10 (13)/15 | 15 | N/A (5) |
| Poland | 15 | 15 | 22.5 | 22.5 |
| Portuguese Republic | 10 (9)/15 | 10 | 10 | 10 |
| Qatar | 5 (3)/10 | 10 | 10 | 10 |
| Republic of Korea | 15 (4)/20 | 10 (13)/15 | 15 | 15 |
| Romania | 15 (9)/20 | 15 | 22.5 | 22.5 |
| Russian Federation | 10 | 10 | 10 | 10 |
| Saudi Arabia | 5 | 10 | 10 | N/A (5) |
| Serbia | 5 (9)/15 | 10 | 10 | 10 |
| Singapore | 10 (9)/15 | 10 (11)/15 | 10 | 10 |
| Slovenia | 5 (3)/15 | 10 | 10 | 10 |
| South Africa | 10 | 10 | 10 | 10 |
| Spain | 15 | 15 | 10 (6) | 20 (6) |
| Sri Lanka | 15 | 10 | 10 | 10 (6) |
| Sudan | 10 | 10 | 10 | 10 |
| Sweden | 10 (6) | 10 (6) | 10 (6) | 10 (6) |
| Swiss Confederation | 10 | 10 | 10 | 10 |
| Syria Arab Republic | 5 (3)/10 | 7.5 | 10 | N/A (5) |
| Tazakstan | 5 (3)/10 | 10 | 10 | N/A (5) |
| Tanzania | 10 (3)/15 | 12.5 | 20 | 20 |
| Thailand | 15 (3, 8)/20 (9, 8) | 10 (13)/25 | 15 | N/A (5) |
| Trinidad & Tobago | 10 | 10 | 10 | 10 |
| Turkey | 15 | 10 (11)/15 | 15 | 15 |
| Turkmenistan | 10 | 10 | 10 | 10 |
| Uganda | 10 | 10 | 10 | 10 |
| Ukraine | 10 (9)/15 | 10 | 10 | 10 |
| United Arab Emirates | 10 | 5 (11)/12.5 | 10 | N/A (5) |
| United Arab Republic (Egypt) | N/A (5) | N/A (5) | N/A (5) | N/A (5) |
| United Kingdom | 15 | 10 (13)/15 | 10 (2)/15 | 10 (2)/15 |
| United States of America | 15 (3)/25 | 10 (11)/15 | 10 (2) /15 | 10 (2)/15 |
| Uzbekistan | 15 | 15 | 15 | 15 |
| Vietnam | 10 | 10 | 10 | 10 |

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| Recipient | Dividend (%) (1) | Interest (%) | Royalty (%) (12) | Fee for technical services (%) (12) |
|---|---|---|---|---|
| Zambia | 5 (10)/15 | 10 | 10 | 10 |

Notes

1. The treaty tax rates on dividends are not relevant since under the current Indian tax legislation, most dividend income from Indian companies which is subject to DDT is exempt from income tax in the hands of the recipient.
2. 10% for equipment rental and ancillary services:
   - for other cases in the first five years: 15% if government or specified organisation is the payer and 20% for other payers.
   - for subsequent years: 15% in all cases (income of government organisations is exempt from taxation in the country of source).
3. If at least 10% of capital is owned by the beneficial owner (company) of the company paying the dividend or interest.
4. If at least 20% of capital is owned by the beneficial owner (company) of the company paying dividend or interest.
5. In absence of specific provision, it may be treated as business profits or independent personal services under respective treaties, whichever is applicable.
6. The 'most favored nation' clause is applicable. The protocol to the treaty limits the scope and rate of taxation to that specified in similar articles in treaties signed by India with an OECD or another country.
7. If royalty relates to copyrights of literary, artistic, or scientific work.
8. If the company paying the dividend is engaged in an industrial undertaking.
9. If at least 25% of capital is owned by the beneficial owner (company) of the company paying the dividend
10. If at least 25% of capital is owned by the company during at least six months before date of payment.
11. If paid on a loan granted by a bank/financial institution.
12. The tax rate for royalties and fees for technical services, under the domestic tax laws, is 10%. This rate is to be increased by a surcharge at 2.5% on the income tax and education cess at 2% and secondary and higher secondary education cess at 1% on the income tax including surcharge. As a consequence, the effective tax rate is 10.558%. This rate applies for payments made under an agreement entered into on or after 1 June 2005. Accordingly, a tax resident can either use the Treaty rate or domestic tax rate, whichever is more beneficial.
13. If interest is received by a financial institution.
14. Taxable in the country of source as per domestic tax rates.
15. If royalty payments arise from the use or right to use trademarks.

## *List of limited agreements between India and other countries*

A list of the countries with which India has entered into limited agreements for double taxation relief with respect to income of airlines/merchant shipping, is given here.

| Country | Government Notification Reference |
|---|---|
| Afghanistan | GSR 514(E), dated 30.09.1975 |
| Bulgaria | GSR 184(E), dated 15.04.1977 |
| Ethiopia | GSR 8(E), dated 04.01.1978 as corrected by Notification No. GSR 159(E), dated 02.03.1978 |
| Iran | GSR 284(E), dated 28.05.1973 |
| Kuwait | GSR 302(E), dated 31.03.1983 |
| Lebanon | Nos. GSR 1552 and 1553, dated 28.06.1969 |
| Oman | GSR 313(E), dated 27.03.1985 |
| Pakistan | GSR 792(E), dated 29.08.1989 |
| Peoples Democratic Republic of Yemen | GSR 857(E), dated 12.08.1988 |
| Romania | GSR 2203 dated 20.12.1968 |
| Russian Federation | GSR 943(E), dated 23.12.1976 as modified by GSR 419(E), dated 31.05.1984, dated GSR 952(E), dated 30.12.1992 |

| Country | Government Notification Reference |
|---|---|
| Saudi Arabia | GSR 950(E), dated 29.12.1992 |
| Switzerland | GSR 761, dated 29.08.1958 |
| United Arab Emirates | GSR 969(E), dated 08.01.1989 |
| Yemen Arab Republic | GSR 2(E), dated 01.12.1987 |

## *Tax administration*

### *Returns*

Accounts for tax purposes must be made up to 31 March. The electronic return of income is required to be filed by 30 September of the tax year.

### *Quarterly withholding tax returns*

Quarterly statement of taxes withheld are to be filed electronically with the tax authorities on or before 15 July, 15 October, and 15 January for the first three calendar quarters of the tax year and on or before 15 May following the last calendar quarter of the tax year.



### *Payment of tax*

Tax is payable in advance (if tax for the year exceeds INR 10,000) in specified instalments during the tax year (April to March) in respect of the income of the tax year ending 31 March. Any balance of tax due on the basis of the return must be paid on a self-assessment basis before the return is filed.

### *Audit for income tax purposes*

Persons carrying on business are required to get their books of account audited for income tax purposes where the turnover is INR 6 million. For persons carrying on a profession, the turnover threshold is INR 1.5 million. The penalty for non-compliance with this audit requirement is INR 0.15 million.

## *Other issues*

### *Mergers and acquisitions*

The expression 'merger' has not been defined in the Act but has been covered as part of the definition of the term 'amalgamation'. Amalgamation is defined as a merger of one or more companies with another, or the merger of two or more companies to form a new company, in such a way that all the assets and liabilities of the amalgamating company or companies become the assets and liabilities of the amalgamated company and shareholders holding not less than 75% in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company.

#### Capital gains

No capital gains tax is levied on the transfer of capital assets by an amalgamating company to the amalgamated company, provided the amalgamated company is an Indian company. Similar is the position in case of a demerger by a demerged company to a resulting company.

In cases where shares of an Indian company are transferred by a foreign company or a demerged foreign company to any another foreign company or resulting foreign company, there is no tax payable, provided it satisfies certain specified conditions. Furthermore, the shareholder of the amalgamating company or demerged company is not liable to pay capital gains tax on the exchange of shares with that of amalgamating company or the resulting company under the scheme of amalgamation.

### Carryforward of accumulated losses of amalgamating company

The losses and unabsorbed deprecation of the amalgamating company are deemed to be those of the amalgamated company in the year in which the amalgamation takes place, provided it satisfies certain specified conditions.

In the case of amalgamation of a company owning an industrial undertaking, the amalgamated company shall achieve the level of production of at least 50% of the installed capacity of the undertaking before the end of the four years from the date of amalgamation and continue to maintain the minimum level of production till the end of five years from the date of amalgamation. If the above conditions are violated, the benefit claimed will be taxed in the hands of the amalgamated company in the year of default.

In case of demerger of a company, the accumulated losses or unabsorbed depreciation of the demerged company directly relatable to the undertaking or the division transferred is allowed to be carried forward and offset in the hands of the resulting company.

### Amalgamation or demerger of co-operative banks

An amalgamated or resulting co-operative bank is eligible for offset and carryforward of the unabsorbed losses or accumulated depreciation of the amalgamating or demerged cooperative bank subject to fulfilment of certain conditions.

The following transactions are not liable for capital gains tax and are tax neutral:

- The transfer of a capital asset in business reorganisation by a predecessor co-operative bank to a successor co-operative bank.
- The transfer by a shareholder, in a business reorganisation of capital assets, of a share or shares held, in the predecessor co-operative bank, if the transfer is made as part of an allotment to the predecessor of any share or shares in the successor co-operative bank.

# Indonesia

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## Significant developments

Tax reforms, which started in 2008, covering amendments of the General Tax Provisions Law, Income Tax Law, and the Value-Added Tax (VAT) Law, were completed in 2010. Subsequent to the commencement of the new laws, the government issued several implementing regulations which provide clearer guidance on various matters. The latest Government Regulation pertained to the Income Tax Law and was issued in December 2010. The Minister of Finance (MoF) and the Indonesian Tax Office (ITO) have also issued further implementing regulations in response to queries and discussions on different interpretations of several issues. Developments in implementing these regulations should be monitored closely by business players as well as potential new investors in Indonesia.



Industry specific regulations have also been issued by the government, such as the regulation on Cost Recovery and Income Tax for the Oil and Gas Sector. This landmark regulation is a potential watershed providing the first dedicated regulation dealing with cost recovery and tax arrangements for this important industry.

In May 2011, the MoF issued a revision to the guidance on tax audit procedures. The tone of the regulation is friendlier to taxpayers as it provides a clearer procedure and strengthens the control of the tax auditors at the same time.

The focus of the ITO has been increasingly directed at tax treaty abuse and cross-border related party transactions, which was shown with the introduction of the ITO's regulations regarding Transfer Pricing Compliance, Mutual Agreement Procedures, and Advance Pricing Agreements.

Transfer pricing is still the main focus of the ITO in its ongoing audits, and it has commenced with a number of transfer pricing specific audits. Taxpayers must make detailed disclosures in their annual corporate income tax (CIT) return pertaining to their level of transfer pricing documentation, the method used, and the reasons why the method is appropriate. Taxpayers that have not prepared adequate documentation can likely expect a tax audit.

The amendments to the VAT law, which took effect as of 1 April 2010, generally only reflect changes of an administrative nature, rather than a fundamental change in the VAT system. However, the new requirement that a valid VAT invoice be delivered at the time of the taxable delivery (as opposed to the previous deadline of the end of the month following the taxable delivery) has forced a change in the administrative practices of many taxpayers.

### Industry-based profitability benchmarking

The ITO has introduced profitability benchmarking based on taxpayer industries. The benchmarking is based on analysis conducted internally by the ITO and is intended to be used in assessing the risk profile of Indonesian corporate taxpayers as a tool in its audit selection process. Taxpayers with profitability that falls below the ITO's benchmarks for their industry may be asked for further information, asked to amend a tax return, or possibly be subject to an audit.

The benchmarking contains a range of financial ratios for the industries examined, including gross profit margin, operating profit margin, net profit margin, and corporate tax to turnover. Up to now, the ITO has released benchmarking guidelines of 115 industries. Further benchmarking regulations are likely to be issued in the future which cover additional industries.

## *Taxes on corporate income*

Taxable business profits are calculated on the basis of normal accounting principles as modified by certain tax adjustments. Generally, a deduction is allowed for all expenditure incurred to obtain, collect, and maintain taxable business profits. A timing difference may arise if an expenditure recorded as an expense for accounting, cannot be immediately claimed as a deduction for tax *(see the Deductions section)*.

Resident corporations are taxed based on worldwide income. A foreign company carrying out business activities through a permanent establishment (PE) in Indonesia will generally be required to assume the same tax obligations as a resident taxpayer.

Resident taxpayers and Indonesian PEs of foreign companies have to settle their tax liabilities either by direct payments, third party withholdings, or a combination of both. Foreign companies without a PE in Indonesia have to settle their tax liabilities for their Indonesian-sourced income through withholding of the tax by the Indonesian party paying the income.

### *CIT rates*

A flat CIT rate of 25% applies as of 2010.

#### Public company discount

Public companies that satisfy a minimum listing requirement of 40% and certain other conditions are entitled to a tax discount of 5% off the standard rate, providing an effective tax rate of 20%.

#### Small company discount

Small enterprises (i.e. corporate taxpayers with an annual turnover of not more than 50 billion Indonesian rupiahs (IDR)) are entitled to a tax discount of 50% off the standard rate, which is imposed proportionally on taxable income on the part of gross turnover up to IDR 4.8 billion.

### *Final income tax*

Certain types of income are subject to a 'final' income tax at a specified percentage of the gross amount of income, without regard to any attributable expenses:

| Income | Tax rate (%) |
|---|---|
| Rental of land and/or building | 10 |
| Proceeds from transfers of land and building rights | 5 |
| Fees for construction work performance | 2/3/4 |

| Income | Tax rate (%) |
|---|---|
| Fees for construction work planning | 4/6 |
| Fees for construction work supervision | 4/6 |
| Interest on time or saving deposits and on Bank of Indonesia Certificates (SBIs) other than that payable to banks operating in Indonesia and to government-approved pension funds | 20 |
| Interest on bonds other than that payable to banks operating in Indonesia and government-approved pension funds | 15 |
| Sale of exchange-traded shares on the Indonesian stock exchange | 0.1 |
| Income from lottery prizes | 25 |
| Forward contract derivatives | 2.5 |

Resident companies, PEs, representatives of foreign companies, organisations, and appointed individuals are required to withhold the above final tax from the gross payments to resident taxpayers and PEs.

### *Special industries and activities*

Companies engaged in upstream oil and gas and geothermal industries typically have to calculate CIT in accordance with their production sharing contracts (PSCs). Certain companies engaged in metal, mineral, and coal mining are governed by a contract of work (CoW) for the income tax calculation. Different provisions may apply to them pertaining to corporate tax rates, deductible expenses, and how to calculate taxable income.

## *Corporate residence*

A company is treated as a resident of Indonesia for tax purposes by virtue of having its establishment or its place of management in Indonesia.

## *Other taxes*

### *Value-added tax (VAT)*

With a few exceptions, VAT is applicable on deliveries (sales) of goods and services within Indonesia at a rate of 10%. VAT on export of goods is zero-rated while the import of goods is subject to VAT at a rate of 10%. As of 1 April 2010, zero-rated VAT is also applicable on exported services, but subject to a MoF limitation. Currently, only certain exported services, including toll manufacturing services, are subject to the 0% VAT rate. Inbound use or consumption of foreign services or intangible goods, with a few exceptions, is also subject to a self-assessed VAT at a rate of 10%.

The VAT law allows the government to change the VAT rate within range of 5% to 15%. However, since the enactment of the VAT law in 1984, the government has never changed the VAT rate.

As of 1 April 2010, a valid VAT invoice must be delivered at the time of the taxable delivery (as opposed to the previous deadline of the end of the month following the taxable delivery). VAT filing is done on a monthly basis, with payment and filing being due no later than the last day of the month following the taxable delivery.

### *Luxury-goods sales tax (LST)*
In addition to VAT, some goods are subject to LST upon import or delivery by the manufacturer to another party at rates ranging from 10% to 200%.

### *Import duty*
Import duty is payable at rates from 0% to 150% on the customs value of imported goods. Customs value is calculated on cost, insurance, and freight level (CIF).

| Group | Good | Rate (%) |
|---|---|---|
| Automobiles | Passenger and commercial vehicles | 0 to 50 |
| Automobile parts | | 0 to 10 |
| Vessel | Ship, boats, and floating structure | 0 to 5 |
| Electronic goods | | 0 to 12,5 |
| Footwear | | 5 to 25 |
| Beverages, ethyl alcohol, and alcoholic drinks | Ethyl alcohol, beer, wine, spirits, and other beverages | 5 to 30, IDR 14,000 to IDR 125,000/ltr |
| Essential oils and resinoids | Odoriferous substances | 5 to 150 |
| Agricultural products | Animal and vegetable products | 0 to 25 |
| Textile, textile products, and accessories | Bags, harness, apparels, and clothing accessories, etc. | 5 to 15 |
| Other | Chemicals, pharmaceutical products, plastic, and rubber products, etc. | 0 to 25 |

As a commitment to liberalising trade, the Indonesian government is progressively lowering import duty rates on most products. Higher duty rates remain to protect certain industries and goods regarded as sensitive for security or social and cultural reasons.

#### Duty relief/exemption/deferral
The Indonesian government offers duty relief, duty exemption, and duty deferral concessions to foreign and domestic investors in order to promote the development of local and export industries. Such concessions include the Investment Coordinating Board (Badan Koordinasi Penanaman Modal or BKPM) Masterlist, Bonded Zone, Bonded Warehouse, KITE, and Free Trade Zone (FTZ) in Batam, Bintan, and Karimun.

### *Land and buildings taxes*
Land and buildings tax (Pajak Bumi dan Bangunan or PBB) is due annually at 5% of the government-determined sales value.

In a land and building transfer, the acquirer is liable for duty on the acquisition of land and building rights (Bea Pengalihan Hak atas Tanah dan Bangunan or BPHTB) at 5% of the greater of the transaction value or the government-determined value.

### *Stamp duty*
Stamp duty is nominal and payable as a fixed amount of either IDR 6,000 or IDR 3,000 on certain documents.

### *Regional taxes*
A corporate taxpayer may be liable for a number of regional taxes and retributions. The rates range from 1.5% to 35% of a wide number of reference values determined by the relevant regional governments. The followings are regional taxes that may apply:

- Motor vehicle tax.
- Motor vehicle ownership transfer fee.
- Motor vehicle fuel tax.
- Surface water tax.
- Cigarette tax.
- Hotel tax.
- Restaurant tax.
- Entertainment tax.
- Advertisement tax.
- Road illumination tax.
- Non-metal and rock minerals tax.
- Parking tax.
- Ground water tax.
- Swallow-nest tax.

### *Jamsostek*
Employers are held responsible for ascertaining that their employees are covered by Jamsostek (workers social security program) which provides compensation in the event of working accidents, deaths, and old age (55 years) as well as sickness or hospitalisation. The program calls for premium contributions from both the employers and the employees. Employees' contributions are collected through payroll deductions. The premium contributions are calculated as a percentage of regular salaries/wages, ranging from 0.24% to 3%.



## *Branch income*

Branch profits are subject to the ordinary CIT rate of 25%. The after-tax profits are subject to a withholding tax (WHT) (i.e. branch profits tax or BPT) at 20%, regardless of whether the profits are remitted to the home country. However, a concessional WHT rate may be applicable where a tax treaty is in force *(see the Withholding taxes section for more information)*. The BPT may be exempt if the profits are entirely reinvested in Indonesia *(see the Tax credits and incentives section for more information)*.

## *Income determination*

### *Inventory valuation*
Inventories must be measured at cost by using either the average or first in first out (FIFO) methods. Once a costing method is adopted, it must be applied consistently.

### *Capital gains*
Capital gains are generally assessable together with ordinary income and subject to tax at the standard CIT rate. However, gains from the transfer of land and buildings are not subject to regular CIT but rather are subject to final income tax at a rate of 5% of the transaction value or the government-determined value, whichever is higher.

The proceeds from sales of shares listed on Indonesian stock exchanges are not subject to normal CIT. Instead, the proceeds are subject only to a final WHT of 0.1% of the gross sales consideration. An additional tax of 0.5% applies to the share value of founder shares at the time an initial public offering takes place, irrespective of whether the shares are held or sold. Shareholders may elect not to pay this tax, in which case the actual gain will be subject to normal tax at the time the shares are sold.

### *Dividend income*
In principle, dividend income received by a resident taxpayer from a limited liability company (generally referred to as a Perseroan Terbatas or PT) is taxable as ordinary income for the taxpayer receiving the dividend. However, if the dividend recipient is a PT with a minimum shareholding of 25% in the company paying the dividend and the dividend is paid out of retained earnings, it is exempt from CIT.

Where the recipient is not resident in Indonesia, a WHT rate of 20% applies, subject to variation by tax treaties *(see the Withholding taxes section for more information)*.

The same rules apply to stock dividends (bonus shares), including dividends paid out of share premium (agio).

### *Exchange gains and losses*
Gains and losses arising from currency fluctuations are generally recognised on an accrual basis in accordance with the prevailing Indonesian Accounting Standards, which resemble International Accounting Standards in most respects.

### *Foreign income*
Foreign branch income of an Indonesian company must be accounted for as Indonesian taxable income under the controlled foreign corporations (CFCs) regulation. These rules apply to Indonesian tax residents owning at least 50% of the paid-up capital (shares) in a CFC. The rules make no reference to such terms as tax avoidance or tax evasion and therefore apply even if the CFC is domiciled in a non-tax haven country. The only situation in which the rules do not apply is when the CFC's shares are listed on a recognised stock exchange. In very broad terms, under the CFC rules, the Indonesian shareholder of the CFC is deemed to receive a dividend with respect to the CFC profits based on a shareholding proportional calculation.

## *Deductions*

Note that expenses relating to gross income subject to final income tax are not deductible for CIT purposes.

### *Depreciation, amortization, and depletion*
Depreciable/amortisable assets include both tangible and intangible property with a useful life of more than one year, except land that is owned and used in business. Depreciation and amortisation may be calculated under the straight-line method or the declining-balance method on an individual asset basis. Once a method is chosen, it should be applied consistently. In calculating depreciation, depreciable assets are divided into the following classes:

| | Depreciation rate | |
|---|---|---|
| **Class** | **Straight-line method (%)** | **Declining-balance method (%)** |
| Property: | | |
| Useful life of four years | 25 | 50 |
| Useful life of eight years | 12.5 | 25 |
| Useful life of 16 years | 6.25 | 12.5 |
| Useful life of 20 years | 5 | 10 |
| Buildings: | | |
| Permanent | 5 | – |

| Class | Depreciation rate | |
|---|---|---|
| | Straight-line method (%) | Declining-balance method (%) |
| Non-permanent | 10 | – |

Special rules apply for assets used in certain business fields and/or certain areas. Tax depreciation need not conform to book depreciation.

The cost incurred for acquiring the rights, with a beneficial life of more than one year, for mining, oil, and natural gas concessions; forest concessions; and other rights to exploit natural resources should be amortised by the production-unit method. Except for the right to acquire oil and natural gas concessions, the depletion rate used should not exceed 20% per annum.

### *Benefits in kind*
Most benefits received in-kind by employees, such as free housing, are not tax-deductible to the entity providing the benefit. Free motor vehicle and telephone expenses, including depreciation, are tax-deductible but only for 50% of the total expenses incurred. Expenses for meals and transportation made available to all staff are tax-deductible. Apart from these, certain benefits in kind (e.g. housing provided in remote areas as designated by the MoF, Integrated Economic Development Areas as designated by Presidential Decree) can also be claimed as tax-deductible expenses.



### *Taxes*
Land and buildings tax and regional taxes may be deducted from taxable income. With several exceptions, input VAT is also deductible against taxable income as long as it is not claimed as a credit against output VAT.

### *Net operating losses*
Losses may be carried forward for a maximum period of five years. Carrying back of losses is not permitted. Offsetting losses within a corporate group is not permitted.

### *Payments to foreign affiliates*
WHT is applied as a final tax on the recipient for payments of royalties, interest, and service fees to foreign non-resident companies. Excessive and non-arm's-length payments to related parties are disallowed as deductions. The tax law denies deductions for all payments from a branch to its head office for royalties, interest, and services provided by the head office (exceptions apply for loans between bank branches and their head offices).

## *Group taxation*

Consolidated returns are not allowed in Indonesia.

### *Transfer pricing*
Transactions between related parties must be consistent with the arm's-length principle. If the arm's-length principle is not followed, the Director General of Tax (DGT) is authorised to recalculate the taxable income or deductible costs arising from such transactions applying the arm's-length principle.

Under the General Tax Provisions Law, the government requires specific transfer pricing documentation to prove the arm's-length nature of related-party transactions. Transfer pricing documentation is frequently requested during tax audits because transfer pricing issues are subject to close scrutiny by the ITO.

Detailed transfer pricing disclosures are required in the CIT return for 2009 and later tax years. The disclosures required include the following:

- The nature and value of transactions with related parties.
- The transfer pricing methods applied to those transactions and the rationale for selecting the methods.
- Whether the company has prepared transfer pricing documentation.

Transfer pricing disputes may be resolved through the domestic objection and appeal process, or, where the dispute involves a transaction with a related party in a country that is one of Indonesia's tax treaty partners, the parties may request double tax relief under the Mutual Agreement Procedures (MAP) article of the relevant tax treaty. However, the ITO may terminate the MAP process if certain conditions exist, such as the Indonesian resident taxpayer making the request for MAP submits an objection letter to the DGT or an appeal to the tax court.

The tax law authorises the DGT to enter into Advance Pricing Agreements (APAs) with taxpayers and/or another tax country's tax authority on the future application of the arm's-length principle to transactions between related parties. The process may or may not involve cooperation with foreign tax authorities. Once agreed, an APA will typically be valid for a maximum of three tax years after the tax year in which the APA is agreed. The APA can also be applied to tax years before it was agreed if certain conditions are met, such as the tax year has not been audited and there is no indication of tax crime. However, the rollback of an APA to prior years is not automatic and will be subject to agreement between the taxpayer and the DGT.

### Increase in transfer pricing focused investigations

The number of tax audits with transfer pricing as the key focus area has significantly increased following the issuance of new regulations relating to transfer pricing. Transactions under particularly close scrutiny include payments of royalties and technical or management services fees, inter-company services, royalty and financing transactions, and exports to related parties.

Where a taxpayer has no documentation available to substantiate these transactions, there is a high risk that deductions for the payments will be denied in full. In this regard, the 30-day time limit within which a taxpayer must produce any documentation requested by the ITO during an audit is being strictly enforced. Any documentation provided after the 30-day time limit is being disregarded by the ITO in its decision making process.

Several transfer pricing specific audits have been conducted by the ITO for the past year. The ITO will identify high priority targets for transfer pricing specific audits based on:

- profit performance of the company (companies that have incurred consistent losses will be the highest priority but there is also a risk of being selected for companies with profits below industry norms) and
- materiality of the company's related party transactions.

In addition to transfer pricing audit activity, the ITO has also issued questionnaires to several taxpayers who are not under an audit that focus primarily on transfer pricing issues. It is possible that the information gathered by the ITO from these questionnaires will lead to follow-up investigations or audits in some cases.

### *Thin capitalisation*

The MoF is authorised to make a determination on an appropriate ratio of debt to equity. Under the law, debt between related parties may be recharacterised as equity, thus giving rise to the disallowance of a tax deduction for related costs. However, the MoF has not yet issued a ruling on these matters.

## *Tax credits and incentives*

### *Inbound investment incentives*

The DGT, on behalf of the MoF and based on the recommendation of the BKPM chairman, may provide the following tax concessions to PT companies following their investment in certain designated business areas or in certain designated regions:

- A reduction in net income of up to 30% of the amount invested (generally amount spent on assets), prorated at 5% for six years from commercial production date, provided that the assets invested are not transferred out within six years.
- Acceleration of fiscal depreciation deductions.
- Extension of tax loss carryforwards for up to ten years.
- A reduction of the WHT rate on dividends paid to non-residents to 10%.

The same tax facilities may be granted by the DGT to companies conducting business in an Integrated Economic Development Area (Kawasan Pengembangan Ekonomi Terpadu or KAPET). Specific approval must be obtained from the DGT for these tax facilities. If the company has bonded zone (Kawasan Berikat or KB) status, the tax facilities will also include those typically enjoyed by a KB company, for example:

- Non-collection of VAT and sales tax on certain luxury goods transactions.
- Exemption from prepaid income tax on the importation of capital goods and other equipment directly relating to production activities.
- Postponement of import duty on capital goods and equipment and goods and materials for processing.
- Exemption from import duty for four years on machinery and certain spare parts.

The designation of an area as a KAPET is set out in a specific presidential decree. Currently, there are approximately 25 areas designated as KAPETs.

### *Reinvestment of branch profits*

PEs that reinvest their after-tax profits in Indonesia within the same year or no later than the following year are exempt from branch profit tax on these profits. The reinvestment should be one of the following forms:

- As a founder or a participant founder in a newly established Indonesian company through capital participation.
- As a shareholder of an established Indonesian company through capital participation.
- Acquisition of a fixed asset used by the PE to conduct its business or activities in Indonesia.
- Investment in the form of an intangible asset used by the PE to conduct its business or activities in Indonesia.

Shares in a newly established company shall not be transferred until, at a minimum, two years from the date that the company commences commercial production. In regard to the investment in an established Indonesian company, acquisition of a fixed asset, or investment of an intangible asset, the investment shall not be transferred until, at a minimum, three years after the investment.

### *Other incentives*

Income earned by venture capital companies in the form of profit-sharing from their investments in Indonesia is exempt from tax, provided that the following conditions are met:

- Entities are small or medium-scale businesses in one of the sectors designated by the Indonesian government.
- Investments are not listed on the Indonesian stock exchange.

## *Withholding taxes*

Indonesian income tax is collected mainly through a system of withholding taxes. Where a particular income item is subject to WHT, the payer is generally held responsible for withholding or collecting the tax. These withholding taxes are commonly referred to using the relevant article of the Income Tax Law, as follows.

### *Article 23/26 WHT*

Article 23/26 WHT is levied on a variety of payments to corporations and individuals, resident and non-resident, at the following rates:

| | Dividends (%) | | | | |
|---|---|---|---|---|---|
| | Portfolio | Substantial holdings | Interest (%) | Royalties (%) | Branch profits (%) |
| Resident corporations (6) | 15 | 0 | 15 | 15 | N/A |
| Resident individuals | 10 | 10 | 15 | 15 | N/A |
| | | | | | |
| Non-resident corporations and individuals | | | | | |
| Non-treaty: | 20 | 20 | 20 | 20 | 0/20 |
| Treaty: | | | | | |
| Algeria | 15 | 15 | 0/15 | 15 | 10 |
| Australia | 15 | 15 | 0/10 | 10/15 | 15 |
| Austria | 15 | 10 | 0/10 | 10 | 12 |
| Bangladesh | 15 | 10 | 0/10 | 10 | 10 |
| Belgium | 15 | 10 | 0/10 | 10 | 10 |
| Brunei | 15 | 15 | 0/15 | 15 | 10 |
| Bulgaria | 15 | 15 | 0/10 | 10 | 15 |
| Canada | 15 | 10 | 0/10 | 10 | 15 |
| China | 10 | 10 | 0/10 | 10 | 10 |
| Czech Republic | 15 | 10 | 0/12.5 | 12.5 | 12.5 |
| Denmark | 20 | 10 | 0/10 | 15 | 15 |
| Egypt | 15 | 15 | 0/15 | 15 | 15 |
| Finland | 15 | 10 | 0/10 | 10/15 | 15 |
| France | 15 | 10 | 0/10/15 | 10 | 10 |

| | Dividends (%) | | | | |
|---|---|---|---|---|---|
| | Portfolio | Substantial holdings | Interest (%) | Royalties (%) | Branch profits (%) |
| Germany (1) | 15 | 10 | 0/10 | 10/15 | 10 |
| Hungary (3, 4) | 15 | 15 | 0/15 | 15 | 20 |
| India | 15 | 10 | 0/10 | 15 | 10 |
| Iran | 7 | 7 | 0/10 | 12 | 7 |
| Italy | 15 | 10 | 0/10 | 10/15 | 12 |
| Japan | 15 | 10 | 0/10 | 10 | 10 |
| Jordan (3) | 10 | 10 | 0/10 | 10 | 20 |
| Korea (North) | 10 | 10 | 0/10 | 10 | 10 |
| Korea (South) (2) | 15 | 10 | 0/10 | 15 | 10 |
| Kuwait (4) | 10 | 10 | 0/5 | 20 | 0/10 |
| Luxembourg (1) | 15 | 10 | 0/10 | 12.5 | 10 |
| Malaysia (5) | 10 | 10 | 0/10 | 10 | 12.5 |
| Mexico | 10 | 10 | 0/10 | 10 | 10 |
| Mongolia | 10 | 10 | 0/10 | 10 | 10 |
| Netherlands | 10 | 10 | 0/10 | 10 | 10 |
| New Zealand (3) | 15 | 15 | 0/10 | 15 | 20 |
| Norway | 15 | 15 | 0/10 | 10/15 | 15 |
| Pakistan (1) | 15 | 10 | 0/15 | 15 | 10 |
| Philippines | 20 | 15 | 0/10/15 | 15 | 20 |
| Poland | 15 | 10 | 0/10 | 15 | 10 |
| Portugal | 10 | 10 | 0/10 | 15 | 10 |
| Qatar | 10 | 10 | 10 | 5 | 10 |
| Romania | 15 | 12.5 | 0/12.5 | 12.5/15 | 12.5 |
| Russia | 15 | 15 | 0/15 | 15 | 12.5 |
| Seychelles | 10 | 10 | 0/10 | 10 | 20 |
| Singapore | 15 | 10 | 0/10 | 15 | 15 |
| Slovakia | 10 | 10 | 0/10 | 10/15 | 10 |
| South Africa (3, 4) | 15 | 10 | 0/10 | 10 | 20 |
| Spain | 15 | 10 | 0/10 | 10 | 10 |
| Sri Lanka (3) | 15 | 15 | 0/15 | 15 | 20 |
| Sudan | 10 | 10 | 0/15 | 10 | 10 |
| Sweden | 15 | 10 | 0/10 | 10/15 | 15 |
| Switzerland (1) | 15 | 10 | 0/10 | 10 | 10 |
| Syria | 10 | 10 | 10 | 15/20 | 10 |
| Taiwan | 10 | 10 | 0/10 | 10 | 5 |
| Thailand | 20 | 15 | 15 | 15 | 20 |
| Tunisia | 12 | 12 | 0/12 | 15 | 12 |
| Turkey | 15 | 10 | 0/10 | 10 | 10 |
| Ukraine | 15 | 10 | 0/10 | 10 | 10 |
| United Arab Emirates | 10 | 10 | 0/5 | 5 | 5 |
| United Kingdom | 15 | 10 | 0/10 | 10/15 | 10 |
| United States | 15 | 10 | 0/10 | 0/10 | 10 |
| Uzbekistan | 10 | 10 | 0/10 | 0/10 | 10 |
| Venezuela | 15 | 10 | 0/10 | 10/20 | 10 |

| | Dividends (%) | | | | |
|---|---|---|---|---|---|
| | Portfolio | Substantial holdings | Interest (%) | Royalties (%) | Branch profits (%) |
| Vietnam | 15 | 15 | 0/15 | 15 | 10 |

Domestic Article 23 WHT is also payable at the rate of 2% for most types of services where the recipient of the payment is an Indonesian resident.

Notes

1. Fees for technical, management, and consulting services rendered in Indonesia are subject to WHT at rates of 5%, 7.5%, 10%, and 15% for Switzerland, Germany, Luxembourg, and Pakistan, respectively.
2. VAT is reciprocally exempt from the income earned on the operation of ships or aircraft in international lanes.
3. The treaty is silent concerning branch profit tax rate. The ITO interprets this to mean that the tax rate under Indonesian Tax Law (20%) should apply.
4. Tax only applies if the profits are remitted.
5. Labuan offshore companies (under the Labuan Offshore Business Activity Tax Act 1990) are not entitled to the tax treaty benefits.
6. In the case of dividends received by a resident shareholder, 'portfolio shareholding' refers to share ownership of less than 25% of the paid-up capital. In this respect, the dividend tax withheld by the payer constitutes a prepayment of the income tax liability of the shareholder. 'Substantial shareholding' refers to the share ownership of 25% of the paid-up capital or more.

The issue of beneficial ownership has come under tax office scrutiny. For treaty WHT rates to apply to passive income such as interests, dividends, and royalties, the recipient of such income must be the beneficial owner. The recipient must also provide a Certificate of Domicile (CoD) in the form required by the ITO certified by their home country tax authority, certifying that the recipient is a tax resident of that country. The CoD in the form prepared by the other country's tax authority may only be used in limited circumstances. Further, the CoD form also requires a number of declarations to be made by the recipient that acknowledges that the use of the treaty jurisdiction was not merely for obtaining the benefit of the treaty. These declarations place onerous obligations on both the Indonesian payer and the recipient entity. Without a certified CoD, a WHT at a rate of 20% will apply. These aspects need to be considered when paying income of this nature.

### *Article 22 Income Tax*

Article 22 income tax is typically applicable to the following:

| Event | Tax rate (%) | Tax base |
|---|---|---|
| 1. The import of goods using an Importer Identification Number (Angka Pengenal Impor or API) | 2.5 | Import value (i.e. CIF value plus duties payable) |
| 2. The import of goods without an API | 7.5 | Import value (i.e. CIF value plus duties payable) |
| 3. The sale of goods to the government requiring payment from the State Treasury and certain state-owned companies Proxy of Budget User (Kuasa Pengguna Anggaran or KPA) | 1.5 | Selling prices |
| 4. The purchasing of steel products | 0.30 | Selling prices |
| 5. The purchasing of automotive products | 0.45 | Selling prices |
| 6. The purchasing of paper products | 0.10 | Selling prices |
| 7. The purchasing of cement | 0.25 | Selling prices |
| 8. The purchasing of luxury goods | 5 | Selling prices |

Notes

1. The tax does not apply, either automatically or given an Exemption Certificate issued by the DGT, on the following types of imports:
   - Goods exempted from import duties and VAT.
   - Goods that have been temporarily imported (i.e. goods for re-export).
   - Goods for re-importing (i.e. to be repaired or tested for subsequent re-exporting).
2. In event 3, the tax collector (the State Treasury, state-owned company, etc.) must withhold Article 22 income tax from the amount payable to a particular supplier (vendor). In the other events, the importer or the buyer of the designated goods must pay Article 22 income tax in addition to the amounts payable for the goods imported or purchased.
3. Vendors of goods under events 4 through 8 can only collect Article 22 income from buyers if they have been appointed by the DGT to undertake this role (i.e. if there has been a specific DGT Appointment Decision).
4. Article 22 income tax constitutes a prepayment of corporate/individual income tax liabilities for events 1 through 8.
5. Tax exemption applies to certain categories of goods or to the importing/purchasing of goods for non-business purposes.

## *Tax administration*

### *Payments of tax and tax returns filing*

Tax liabilities for a particular period or year must typically be paid to the State Treasury through a designated tax-payment bank (bank persepsi) and then accounted for at the DGT office through the filing of the relevant tax returns. The tax payments and tax return filing for a particular tax must be undertaken monthly or annually, depending upon the tax obligation in question.

Corporate tax liabilities may be settled either by direct payments, third party withholdings, or a combination of both. Monthly tax instalments constitute the first part of tax payments to be made by taxpayers as a prepayment of their current year CIT liability. A monthly tax instalment is generally calculated using the most recent CIT return. The tax withheld by third parties on certain income or tax to be paid in advance on certain transactions (i.e. imports) also constitute prepayments for the current year corporate tax liability of the income recipient or the party conducting the import. If the total amounts of tax paid in advance through the year are less than the total CIT due, the company concerned has to settle the shortfall before filing its CIT return. Returns for transaction taxes such as WHT must be filed on a monthly basis.

A summary of these tax obligations is as follows:

#### Monthly tax obligations

| Type of tax | Tax payment deadline | Tax return filing deadline |
|---|---|---|
| Article 21/26 WHT | The 10th of the following month | The 20th of the following month |
| Article 23/26 WHT | The 10th of the following month | The 20th of the following month |
| Article 25 Income Tax Instalment | The 15th of the following month | The 20th of the following month |
| Article 22 Income Tax on imports / Payments to Tax Collectors | The 10th of the following month | The 20th of the following month |
| Article 4(2) Final Income Tax | The 10th of the following month | The 20th of the following month |
| VAT and LST | Prior to the tax return filing deadline | The end of the following month |

# Indonesia

## Annual tax obligations

| Type of tax | Tax payment deadline | Tax return filing deadline |
|---|---|---|
| Corporate Income Tax | The end of the fourth month after the book year end before filing the tax return | The end of the fourth month after the book year end |
| Land and Building Tax (PBB) | Six months after the receipt of a Tax Due Notification Letter from the ITO | N/A |

## Penalties

Late payments of the above taxes incur interest penalties at 2% per month, with a maximum of 48%. Part of a month, for example a single day, is considered a full month.

Late filing of a tax return or failure to file a tax return incurs an administrative penalty at the following amounts:

| Type of tax return | IDR |
|---|---:|
| VAT return | 500,000 |
| Other monthly tax returns | 100,000 |
| Corporate income tax return | 1,000,000 |

### *Tax assessments*

Indonesia uses a self-assessment system under which taxpayers are trusted to calculate, pay, and report their own taxes in accordance with prevailing tax laws and regulations. However, the DGT may issue tax assessment letters to a particular taxpayer if it finds that, based on a tax audit or on other information, the taxpayer has not fully paid all tax liabilities. A tax assessment letter may also be issued by the DGT to a taxpayer who ignores a warning letter to file a tax return within a specified period. Failure to maintain books in accordance with the prescribed standards is another condition that may lead the DGT to issue an official tax assessment.

### *Statute of limitation*

Under the current Tax Administration Law, the DGT can issue an underpaid tax assessment letter for the years up to 2007 only within ten years after the incurrence of a tax liability, the end of a tax period (month), or the end of (part of) a tax year, but no later than 2013. For years from 2008 onwards, the time spans for the issuing of underpaid tax assessment letters is reduced to five years.

### *Tax audits*

The tax audit of a company may cover only a particular tax or all taxes for a particular tax period (a tax month) or tax year. It may be conducted at the company's premises, at the DGT offices, or at both.

### *Conditions triggering a tax audit*

A tax refund request will always trigger a tax audit. Due to the requirement for the DGT to decide on a refund request within 12 months, a tax audit will typically begin from a few weeks to several months from the refund request date. A corporate tax refund request will normally trigger a complete tax audit covering all taxes. A refund request of any other tax will normally trigger a tax audit covering only one particular tax. The DGT will likely broaden the tax audit scope to include other taxes.

Other events which may trigger a tax audit include the following:

- A tax return in an overpayment position (not necessarily accompanied by a refund request).
- An annual income tax return presenting/claiming a tax loss.
- A tax return not filed within the prescribed time.
- A tax return meeting certain (undisclosed) DGT criteria.

### *Industry-based profitability benchmarking*
The ITO has introduced profitability benchmarking based on taxpayer industries. The benchmarking is based on analysis conducted internally by the ITO and is intended to be used in assessing the risk profile of Indonesian corporate taxpayers as a tool in its audit selection process. Taxpayers with profitability that falls below the ITO's benchmarks for their industry may be asked for further information, asked to amend a tax return, or possibly be subject to an audit.

The benchmarking contains a range of financial ratios for the industries examined, including gross profit margin, operating profit margin, net profit margin, and corporate tax to turnover. Up to now, the ITO has released benchmarking guidelines of 115 industries. Further benchmarking regulations are likely to be issued in the future which cover additional industries.



## *Other issues*

### *M&A from a business and tax perspective*
Transfers of assets in business mergers, consolidations, or business splits must generally be dealt with at market value. Gains resulting from this kind of restructuring are assessable, while losses are generally claimable as a deduction from income.

However, a tax-neutral merger or consolidation, under which assets are transferred at book value, can be conducted but subject to the approval of the DGT. To obtain this approval, the merger or consolidation plan in question must pass a business-purpose test. Tax-driven arrangements are prohibited, and tax losses from the combining companies may not be passed to the surviving company.

Subject to a similar, specific DGT approval, the same concession is also available for business splits that constitute part of an initial public offering (IPO) plan. In this case, within one year of the DGT's approval being given, the company concerned must have made an effective declaration regarding registration for an IPO with the Capital Market Supervisory Board (Badan Pengawas Pasar Modal or BAPEPAM). In the event of complications beyond the company's control, the period may be extended by the DGT for up to four years.

# Iraq

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## Significant developments

The supplier will be subject to withholding tax (WHT) at the rate of 3% to 3.3%. Note that for the oil and gas industry, these rates are expected to double in the near future, reaching the rate of 7%. New instructions issued in this regard are expected to soon be approved by the legislators.

## Taxes on corporate income

All income derived from Iraq is subject to tax in Iraq regardless of the residence of the recipient.

The effective corporate income tax (CIT) system presented in Iraq for juristic persons (except partnerships) is based on a statutory CIT rate of 15% at all income levels with no progressive tax rate scale.

### Foreign oil company income tax

The income realised in Iraq from contracts concluded with foreign oil companies, their branches or offices, and subcontractors working in Iraq in the oil and gas production sector and related industries are taxed at a rate of 35%.

## Corporate residence

One of the key issues in determining when a company becomes taxable in Iraq is whether the foreign company is considered to be doing business 'in Iraq' or 'with Iraq'. In 2009, with Instructions No. 2/2008, the Iraqi tax administration provided a clearer distinction between business 'in Iraq' and business 'with Iraq'.

Once the determination has been made that the company is trading 'in Iraq', the company should legally register in Iraq and then register with the General Commission for Taxes (GCT). A company that is registered with the GCT will be subject to CIT and will be required to file a CIT return.

### Permanent establishment (PE)

It is important to note that the current Iraq income tax law does not clearly define a PE; therefore, it is important to monitor commercial activity being performed in the country to ensure compliance with the registration requirements and tax law. The company should consult with their internal tax department and external advisers if they have signed a contract to provide any type of services inside Iraq to determine if the company should have a legal registration and begin to file CIT returns.

## Other taxes

### Sales tax
A sales tax of 10% of the value of services is imposed on services rendered by deluxe and first class restaurants and hotels in Iraq.

### Custom duty
The customs duty system and procedures in Iraq are currently evolving. In March 2010, the Iraqi Presidency Counsel issued Law 12 of 2010 (Custom Tariff Law). The new law is comprised of 11 articles and primarily addresses custom duties on goods imported into Iraq. The law notes that customs duties shall be levied based on percentages set in the custom tariff and agricultural agenda that is annexed to the Custom Tariff Law. For the purposes of the Custom Tariff Law, the custom tariff and agricultural agenda refers to the schedule comprised of itemised and codified sections and notes based on the international harmonised system adopted by the World Customs Organization (WCO).

### Excise taxes
There is no tax provision in the Iraqi Tax Law addressing excise taxes.



### Property taxes
A basic tax of 10% is assessed on the annual revenue for all real-estate collected from the real estate owner or the long-term lessee (five years). In cases where the owner or long-term lessee cannot be located, the person occupying the real-estate will be assessed. Note that the annual revenue for each real-estate is discounted by 10% for expenses and maintenance before assessing the tax on that real-estate.

### Transfer taxes
There are no restrictions or taxes on transferring funds into or out of Iraq.

### Stamp duty
All direct and indirect contracts related to credit facilities and other bank's activities (e.g. letter of credit contracts) are subject to the stamp fees at a rate of 0.2% of the contract value.

## Branch income

The tax treatment for the branch is similar to the local Iraqi corporation. In general, CIT is imposed on corporate entities and foreign branches with respect to taxable profit from all sources arising or deemed to arise in Iraq. However, certain limitations apply to head office expenses.

## Income determination

A corporation has to determine its profit/loss according to its income statement for a tax period as established under the Unified Accounting System (Iraqi GAAP). However, to reach the taxable income, positive or negative adjustments have to be made to the profit/loss as determined according to GAAP.

### Inventory valuation
There is no tax provision in the Iraqi Tax Law addressing inventory valuation.

### *Capital gains*
Capital gains on sales of depreciable assets are taxed at the normal CIT rate. Gains derived from the sale of shares and bonds not in the course of a trading activity are exempt from tax. Capital gains derived from the sale of shares and bonds in the course of a trading activity are taxable at the normal CIT rate.

### *Dividend income*
Under the tax law, dividends paid out of profits that have been subject to tax are not taxed again in the hands of the shareholder.

### *Interest income*
Interest income deemed to arise in Iraq is taxed at the normal CIT rate.

### *Rent/royalties income*
Rent and royalties income deemed to arise in Iraq are taxed at the normal CIT rate.

### *Foreign income*
There is no tax provision in the Iraqi Tax Law addressing foreign income.

## *Deductions*

In general, all expenses incurred by the taxpayer in order to produce income during the year are deducted from income, provided that such expenses are confirmed by acceptable documents, with some exceptions.

### *Bad debt*
Bad debt is deductible if it was included in earlier income and there is proof of the unsuccessful steps to collect it.

### *Charitable contributions*
Charitable contributions to the Government and Socialist Sector departments and to scientific, cultural, educational, charitable, and spiritual organisations, which are legally recognised (provided that the Minister of Finance has issued a list containing the names of these organisations), are deductible.

### *Depreciation*
The Iraqi Depreciation Committee sets the maximum depreciation rates for various types of fixed assets. If the rates used for accounting purposes are greater than the prescribed rates, the excess is disallowed.

The depreciation method is either a straight-line method or declining-balance method.

### *Bribes and illegal payments*
Bribes and illegal payments are not allowed or deductable.

### *Net operating losses*
Under the tax law, loss of a taxpayer in some sources of income arising in Iraq, substantiated by legally accepted documents, are generally deducted from profits arising from other sources.

Losses which cannot be settled in this manner shall be carried forward and deducted from the income of the taxpayer over five consecutive years, provided that losses may not offset more than half of the taxable income of each of the five years and the loss is from the same source of income from which it has arisen.

## Group taxation

Iraqi law does not contain any provisions for filing consolidated returns or for relieving losses within a group of companies.

### Transfer pricing

The precise meaning of transfer pricing under the effective Iraqi tax system is rather unclear from a tax and legal perspective.

We note that whilst having no specific transfer pricing legislation, Iraq does have a 'third party' arm's-length provision contained within its tax legislation; whereby, if a non-resident taxpayer is engaged in business with a resident and it appears to the tax authority that due to the connection existing between the resident and the non-resident, and the substantial control of one over the other, that the business relationship is arranged in a manner that leaves no profits to the resident, or the profits left are much less than what is normally earned, the tax shall be assessed on the actual profits of the non-resident and charged to the resident as if the resident is the business agent for the non-resident.



## Tax credits and incentives

In accordance with the Iraqi Investment Law, approved industrial projects are given certain custom duty and tax incentives; however, oil and gas is not one of the sectors that is normally granted investment promotion exemptions incentives.

The tax incentives may include corporate tax, individual tax, and others; however, the tax incentives vary from one project to another.

The Board of Investment Promotion has the authority to add any sector or specific project to the list of sectors or projects that benefit from the investment promotion law incentives.

### Foreign tax credit

Income tax paid to a foreign country on income earned in that country may be credited against tax paid to Iraq. The amount of the credit may not exceed the amount of tax assessed in Iraq.

## Withholding taxes

Under the tax law, the amount due from any residing taxpayers to a non-resident, whether the payment is made in cash or credited to the account, is subject to WHT at the rate of 15% if such amounts are related to interest on debentures, mortgages, loans, deposits and advances, as well as annual allowances, pension salaries, or other yearly payments.

## Tax administration

### Returns

The statutory time line for filing tax returns is the first day of June of the year of assessment. If the self assessment of tax is not accepted by the tax authorities, tax is assessed on the income of the taxpayer based on the information available to the tax authorities.

Failure to file a tax return may lead to an estimate of income and assessment of tax by the tax authorities; however, such an assessment does not relieve the taxpayer from responsibility for non-submission of the return within the statutory time line stipulated by law.

### Payment of taxes

Payment of the tax liability has to be paid within 21 days from the assessment date by the tax authority. There is no requirement of quarterly payments during the taxable year.

### Iraqi GAAP

The Iraqi tax law requires all taxpayers to maintain books and records in accordance with Iraq's local unified accounting system (Iraqi GAAP).

These books shall constitute tax books/accounts. This accounting treatment will determine when income is accrued and costs are incurred for computing taxable profits.

# Ireland

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## Significant developments

### Section 110 company

Finance Act 2011 made a number of amendments to the Section 110 regime. The Section 110 regime is a favourable tax regime for Irish resident special purpose companies which hold and/or manage 'qualifying assets' which provides for an onshore investment platform (with access to Ireland's treaty network) in an environment of increased international focus on tax havens and transparency.

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These changes have significantly expanded the range of assets that a Section 110 company can invest in, whilst also seeking to restrict the use of Section 110 in specific targeted circumstances.

Prior to the publication of the Finance Act 2011, Section 110 companies were limited to investing in financial assets. The range of investments in which a Section 110 company can invest has been significantly extended to include investments in commodities and plant and machinery.

Greenhouse gas emissions allowance has been redefined as a qualifying asset to include 'carbon offsets' and has been broadened significantly. These are very welcome changes, particularly in the context of recent market interest in commodity transactions and the launch of the Irish Government's 'Green International Financial Services Centre (IFSC)' initiative. In addition, the extension of the Section 110 regime to include plant and machinery will benefit Ireland's position as the preferred destination for aircraft financing and leasing activities and will give an added boost to Ireland's position as the centre of excellence for aircraft financing transactions *(see the Tax credits and incentives section for further details)*.

### Exemption for start-up companies

Finance Act 2011 confirms that the exemption for start-up companies from corporation tax is to be extended to companies which commence a new trade in 2011. The relief available is now linked to the amount of employer's social insurance (PRSI) paid by a company in an accounting period and is intended to target the relief at companies generating employment.

### Energy efficient equipment

The scheme of 100% upfront capital allowances (tax depreciation) for energy efficient equipment has been extended by Finance Act 2011 for a further three years to 31 December 2014.

### Stamp duty

In December 2010, the rate of stamp duty on residential property was reduced from 9% to a rate of just 1% (with any excess above 1 million euros (EUR) chargeable at 2%).

### *Value-added tax (VAT)*

From 1 July 2011, a reduced 9% VAT rate will apply to certain services in the tourism sector. These include restaurant and catering services, hotel and holiday accommodation, and various entertainment services such as admissions to cinemas, theatres, museums, fairgrounds, amusement parks, and sporting facilities. Under current legislation, this rate will apply until 31 December 2013.

### *Mandatory disclosure*

In a move to promote transparency between taxpayers, practitioners, and tax authorities, provisions relating to the disclosure of tax schemes are applicable as of January 2011. These require promoters of such schemes to provide information to the tax authorities within a specified time of having made the scheme available. A transaction which comes within the new law and which therefore must be reported to Revenue is not necessarily a tax avoidance transaction for the purposes of existing legislation. The rules are wide reaching and essentially cover all tax heads including corporation tax, income tax, capital gains tax, stamp duty, VAT, customs duties, and excise duties.

## *Taxes on corporate income*

### *Corporation tax*

Corporation tax is chargeable as follows on income and capital gains:

| Standard rate on income 'trading rate' | Higher rate on income 'passive rate' | Capital gains rate |
|---|---|---|
| 12.5% | 25% | 25% |

Resident companies are taxable in Ireland on their worldwide profits (including gains). Non-resident companies are subject to Irish corporation tax only on the trading profits of an Irish branch or agency and to Irish income tax (generally by way of withholding) on certain Irish source income.

Non-trading (passive) income includes dividends from companies resident outside Ireland (with some exceptions), interest, rents, and royalties. Legislation provides that certain dividend income (e.g. income from foreign trades) is taxed at 12.5% *(see the Income determination section)*. The higher rate (i.e. 25%) also applies to income from a business carried on wholly outside Ireland and to income from land dealing, mining, and petroleum extraction operations.

An additional 'profit resource rent' tax applies to certain petroleum activities. Depending on the profit yield of a site, the tax rate applicable can range from 25% to 40%.

Close companies *(see the Income determination section)* may be subject to additional corporate taxes on undistributed investment income (including Irish dividends) and on undistributed income from professional services. Examples of professional services include professions such as solicitor, accountant, doctor, and engineer.

## Corporate residence

A company that is incorporated, or has its place of central management and control, in Ireland will be regarded as resident in Ireland for the purposes of corporation tax and capital gains tax. This is subject to the following two exceptions where a company incorporated in Ireland is not considered a tax resident.

A treaty exception applies if the Irish incorporated company is, by virtue of an Irish double tax treaty (DTT), considered to be tax resident in the treaty partner country and not resident in Ireland.

An active trading exception applies if the Irish incorporated company or its 50% affiliate carries on a trade in Ireland and the company has qualifying ownership. A 50% affiliate is essentially a company where:

- one company is a 50% subsidiary of the other or both companies are 50% subsidiaries of a third company
- there is an entitlement to at least 50% of the profits available for distribution, and
- there is an entitlement to at least 50% of the assets available in the case of a winding up of the other company.



Qualifying ownership requires that the Irish incorporated company or a 50% or more affiliate/parent is listed on a stock exchange in an EU member state or a territory which has a tax treaty with Ireland or, in the absence of such a listing, that the ultimate control (more than 50%) of the Irish incorporated company rests with persons who are tax resident in EU or treaty countries.

### Permanent establishment (PE)

Non-resident companies are subject to Irish corporation tax only on the trading profits attributable to an Irish PE, plus Irish income tax (generally by way of withholding, though this is not the case with Irish source rental profits) on certain Irish source income.

For non-resident companies, the liability to corporation tax depends on the existence of any kind of PE through which a trade is carried on. The meaning of PE for Irish tax purposes is set out in statute; it is largely based on the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention definition, but is not identical in all respects.

Subject to the terms of the relevant double taxation agreement, a non-resident company will have a PE in Ireland if:

- it has a fixed place of business in Ireland through which the business of the company is wholly or partly carried on or
- an agent acting on behalf of the company has and habitually exercises authority to do business on behalf of the company in Ireland.

A fixed place of business includes (but is not limited to) a place of management, a branch, an office, a factory, a workshop, an installation or structure for the exploration of natural resources, a mine, oil or gas well, quarry, or other place of extraction of natural resources, or a building or construction or installation project. A company is not, however, regarded as having an Irish PE if the activities for which the fixed place of business is maintained or which the agent carries on are only of a preparatory or auxiliary nature (also defined in the statute).

## Other taxes

### Value-added tax (VAT)

VAT is charged at 21% on the supply of most goods and services in the course of business.

There are two lower rates. A 13.5% rate applies to most building services, labour intensive services, domestic fuel and power, and other reduced rate supplies. A 4.8% rate applies to livestock and greyhounds.

From 1 July 2011, a reduced 9% VAT rate will apply to certain services in the tourism sector. These include restaurant and catering services, hotel and holiday accommodation, and various entertainment services such as admissions to cinemas, theatres, museums, fairgrounds, amusement parks, and sporting facilities. Under current legislation, this rate will apply until 31 December 2013.

Most exports, food, oral medicine, and children's clothing and footwear are zero-rated.

Some supplies are exempt from VAT. The main exempt categories are most banking services, insurance services, medical services, passenger transport, education, and training.

Zero rating is preferable to exemption because most VAT costs incurred in making a zero-rated supply can be recovered, while those incurred in making an exempt supply generally cannot.

### Customs duties

Many goods imported into Ireland from outside the European Union are subject to customs duties. The rates of duty are provided by the EU's Common Customs Tariff.

### Excise duties

Excise duties are chargeable on most hydrocarbon oil products, electricity supply, alcoholic drinks, and tobacco products imported into or produced in Ireland.

### Local taxes

Local taxes known as 'rates' are not based on income but rather are levied on the occupiers of business property by reference to a deemed rental value of the property concerned. The level of rates levied can depend on the region in which the property is located. Rates are an allowable deduction for corporation tax purposes.

Local authorities are also empowered to levy charges on all occupiers for specific services (e.g. water supply). These charges are also deductible for corporation tax purposes.

### Stamp duty

Stamp duty is a tax on instruments. It is payable on transfers of land and on other assets whose legal title cannot be passed by delivery. It is also chargeable on all instruments of transfer executed in Ireland, and on instruments, wherever executed, which relate to Irish property or activities. The transfer of assets between associated companies may not be liable to stamp duty, provided the following key conditions are met:

- The companies have a 90% relationship (that is, one company is the beneficial owner of at least 90% of the ordinary share capital of the other and is entitled to at least

90% of the profits available for distribution and is entitled to at least 90% of the assets in the case of a winding-up of the other company).
- The companies are in a group 90% relationship as defined above that can be traced as far up the group chain as is necessary to establish the qualifying relationship.
- This relationship is maintained for a period of two years after the transfer of the assets to avoid the relief being clawed back.

There is an exemption for transfers of intellectual property (IP), and the categories of IP qualifying for this exemption are broadly similar to those for which IP capital allowances are available *(see Intellectual property regime in the Deductions section)*.

Stamp duty rates are up to 6% of the value transferring. Rates of 1% to 2% apply for residential property. Stamp duty is levied at 1% on transfers of Irish shares.

A EUR 1 stamp duty applies to a policy of insurance, other than life insurance, relating to risks located in Ireland. The stamp duty is normally collected under the terms of a composition agreement, which provides for regular, usually quarterly, payments of duty.



### *Capital duty on share capital*
Ireland does not levy capital duty on share capital of companies.

### *Capital taxes*
Ireland does not levy tax on the net worth of companies.

### *Social security*
Employed persons are compulsorily insured under a state-administered scheme of pay-related social insurance (PRSI). Contributions are made by both the employer and the employee. The employer is responsible for making PRSI contributions up to a rate of 10.75%, and these are an allowable deduction for corporation tax purposes.

### *Insurance premium tax (IPT)*
A levy of 3% of gross premiums received applies in relation to non-life insurance policies relating to risks located in Ireland. This levy is payable four times per annum, within 30 days of the end of each quarter (i.e. within 30 days from quarters ending 31 March, 30 June, 30 September, and 31 December).

A levy of 1% of gross premiums received applies in relation to certain classes of life insurance policies relating to risks located in Ireland. This levy is payable four times per annum, within 25 days of the end of each quarter (i.e. within 25 days from quarters ending 31 March, 30 June, 30 September, and 31 December).

Pension business and reinsurance business are excluded from the levy.

### *Environmental taxes*
In Ireland, a levy (currently 22 cents per bag) is imposed upon consumers provided with a plastic bag when purchasing goods in supermarkets and other retail outlets. Under the applicable legislation, retailers are obliged to collect 22 cents in respect of every plastic bag or bag containing plastic, regardless of size, unless specifically exempted, that is provided to customers and remit all plastic bag levies collected to Irish Revenue. As a result of the levy, most non-supermarket retailers provide paper carrier bags, and many retailers provide ‘bags for life’, which are made from non-plastic material and, therefore, not subject to the environmental levy.

### Carbon tax

A carbon tax has been introduced on mineral oils (e.g. auto fuels, kerosene) which are supplied in Ireland. The rates of carbon tax on oil and gas broadly equate to EUR 15 per tonne of CO2 emitted. Relief applies where mineral oils are supplied to an Emissions Trading Scheme (ETS) installation or for electricity generation. Pure biofuels are exempt from carbon tax. There is full relief for the biofuel component of the fuel. Where biofuel has been mixed or blended with any other mineral oil, the relief from carbon taxes shall apply to the biofuel content of the mixture or blend, regardless of the percentage.

A carbon tax has also been introduced on natural gas and solid fuel where supplied for combustion. Again, reliefs apply where these fuels are supplied to ETS installations or used in electricity generation, chemical reduction, or in the electrolytical or metallurgical processes.

## Branch income

Irish branches of foreign companies are liable to corporation tax at the rates which apply to Irish resident companies. No tax is withheld on repatriation of branch profits to the head office.

## Income determination

Irish trading profits are computed in accordance with Irish Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), subject to any adjustment required by law. Prior-year adjustments may arise on the first-time adoption of IFRS, which may result in double counting of income or expenses or of income falling out of the charge to tax. Generally speaking, in order to avoid such an outcome, transitional adjustments exist whereby amounts of income or expenses that could be double-counted or that would fall out of the charge to tax are identified and the amounts concerned are taxed or deducted as appropriate over a five year period.

### Inventory valuation

Each item of inventory is valued for tax purposes at cost or market value, whichever is lower, and this will normally accord with the accounting treatment. The method used in arriving at cost or market value of inventory generally must be consistent and must not be in conflict with tax law. The first in first out (FIFO) method is an acceptable method of calculation for tax purposes. The base-stock method has been held to be an inappropriate method for tax purposes, as has the last in first out (LIFO) method.

### Capital gains

Companies are subject to capital gains tax in respect of gains arising on the disposal of capital assets. The taxable gain is arrived at by deducting from the sales proceeds the cost incurred on acquiring the asset (as indexed to reflect inflation only up to 31 December 2002). The resulting gain is taxable at 25%. In cases of disposals of interests in offshore funds and foreign life assurance policies, indexation relief does not apply; while, with effect from 1 January 2011, a tax rate of 30% applies to funds and policies located in EU/European Economic Area (EEA)/DTT countries, and a rate of 27% or 40% applies to funds or policies located in all other jurisdictions. Special rules apply to gains (and losses) from the disposal of development land in Ireland.

Companies that are tax resident in Ireland (that is managed and controlled in Ireland or incorporated in Ireland and not qualifying for exclusion) are taxable on worldwide gains. Non-resident companies are subject to capital gains tax on capital gains arising on the disposal of Irish land, buildings, mineral rights, and exploration rights on the Irish continental shelf, together with shares in unquoted (unlisted) companies, whose value substantially (greater than 50%) is derived from these assets. Non-resident companies also are subject to capital gains tax from the realisation of assets used for the purposes of a business carried on in Ireland.

Losses arising on the disposal of capital assets may be offset against capital gains in the accounting period or carried forward for offset against future capital gains. No carryback of capital losses is permitted. There is no facility to offset capital losses against business income or to surrender capital losses within a tax group.

Irish capital gains tax legislation facilitates corporate reorganisations on a tax-free basis in situations where there is a share for share exchange.

### *Participation exemption from capital gains*



A participation exemption is available to Irish resident companies on the disposal of a shareholding interest if:

- a minimum of 5% of the shares (including the right to profits and assets on winding up) is held for a continuous 12-month period
- the share sale takes place during the period for which the minimum 5% holding is held
- the sale takes place within two years after meeting the holding requirement, to take account of gradual dispositions over time
- the company whose shares are sold is resident in an EU member state (including Ireland) or in a country with which Ireland has a DTT in force at the time of the disposal, and
- a trading condition is met at the time of the disposal whereby either: (i) the business of the company whose shares are disposed of consists wholly or mainly of the carrying on of one or more trades or (ii) taken together, the businesses of the Irish holding company and all companies in which it has a direct or indirect 5% or more ownership interest consist wholly or mainly of the carrying on of one or more trades.

If the Irish holding company is unable to meet the minimum holding requirement but is a member of a group (that is, a parent company and its 51% worldwide subsidiaries), the gain arising on the disposal still will be exempt if the holding requirement can be met by including holdings of other members of the group. Thus, the Irish company may be exempt from capital gains tax on a disposal of shares even if it does not directly hold a significant shareholding. The exemption also applies to a disposal of assets related to shares, such as options and convertible debt. However, it does not apply to a sale of either shares or related assets that derive the greater part of their value (more than 50%) from Irish real property, minerals, mining rights, and exploration and exploitation rights in a designated area. Shares deriving their value from non-Irish real property, minerals, and mining rights qualify for exemption if the other conditions are met.

Capital losses arising on the disposal of a shareholding where a gain on disposal would be exempt under the participation exemption are not deductible.

### *Dividend income*
Dividends from Irish companies are exempt from corporation tax. Dividends paid out of the trading profits of a company resident in a country with which Ireland has a DTT may be taxed at the 12.5% rate, provided a claim is made. The 12.5% corporate tax rate applies to the same type of dividends received from companies resident in non-treaty countries, that is, where the company that paid the dividend is a listed company or is part of a 75% listed group the principal class of the shares of which are substantially and regularly traded on the Irish Stock Exchange, a recognised Stock Exchange in a country with which Ireland has a DTT, or on such other Stock Exchange as is approved by the Minister for Finance for the purposes of this relief from double taxation.

Foreign dividends received by an Irish company where it holds 5% or less of the share capital and voting rights in that foreign company are exempt from corporation tax where the Irish company would otherwise be taxed on this dividend income as trading income.

Dividends from Irish resident companies are not liable to further tax, other than a surcharge on close companies if the dividend is not redistributed. Broadly speaking, a close company is a company which is under the control of five or fewer 'participators'. Participators can include individual shareholders, corporate shareholders, loan creditors, any person with a right to receive distributions from the company, etc. Where not less than 35% of the shares of a company (including the voting power) are listed, a company would not be regarded as a close company.

A close company surcharge of 20% is payable on certain non-trading income (for example, rental income, certain dividend income, and interest income) if it is not distributed to shareholders within 18 months of the accounting period in which the income was earned. Since 31 January 2008, a close company making a distribution and the close company receiving a distribution have the option jointly to elect to have the dividend disregarded for surcharge purposes. This can give close companies the option of moving 'trading income' up to a holding company without incurring a surcharge. Generally speaking, close companies avoid the surcharge through the payment of dividends within the prescribed period.

### *Stock dividends*
Stock dividends taken in lieu of cash are taxed to the shareholder on an amount equivalent to the amount which would have been received if the option to take stock dividends had not been exercised. If the recipient is an Irish resident company and it receives the stock dividend from a quoted (listed) Irish company, then there will be no tax. For a quoted (listed) company paying the stock dividend, dividend WHT with the appropriate exemptions and exclusions applies. Other stock dividends (bonus issues) are generally non-taxable.

### *Foreign income*
Resident companies are liable to Irish tax on worldwide income. Accordingly, in the case of an Irish resident company, foreign income and capital gains are, broadly speaking, subject in full to corporation tax. This applies to income of a foreign branch of an Irish company as well as to dividend income arising abroad.

In general, income of foreign subsidiaries of Irish companies is not taxed until remitted to Ireland, although there are special rules that seek to tax the undistributed capital gains arising from the sale of Irish land and buildings by certain non-resident close companies *(see Dividend income above for further information in relation to close companies)*.

Foreign taxes borne by an Irish resident company (or Irish branch of an EEA resident company), whether imposed directly or by way of withholding, may be creditable in Ireland *(see Foreign tax credit in the Tax credits and incentives section)*.

## Deductions

In general, expenses incurred wholly and exclusively for the purposes of the trade are tax-deductible.

### Accrued expenses

General accruals and provisions are not tax-deductible.

### Depreciation

Book depreciation is not deductible for tax purposes (except in the case of IP assets). Instead, tax depreciation (known as capital allowances) is permitted on a straight-line basis in respect of expenditure incurred on assets which have been put into use by the company. The following rates are applicable:



| Asset type | Tax depreciation rate (%) |
|---|---|
| Plant and machinery | 12.5 |
| Industrial buildings used for manufacturing | 4 |
| Motor vehicles | 12.5 |
| IP assets | Book depreciation or 7 |

The allowances are calculated on the cost after deduction of grants, except for plant and machinery used in the course of the manufacture of processed food for human consumption. In this case, the allowances are calculated on the gross cost. Allowances on cars are restricted to a capital cost of EUR 24,000 and may be restricted further (to 50% or zero) depending on the level of carbon emissions of the vehicle.

### Accelerated capital allowances

A 100% first year capital allowance is available in respect of expenditures incurred on certain approved energy-efficient equipment up to 31 December 2014. The categories of equipment that may be eligible for inclusion are:

- Information and communications technology.
- Heating and electricity provision.
- Electric and alternative fuel vehicles.
- HVAC control systems.
- Lighting.
- Motors and drives.
- Building energy management systems.
- Refrigeration and cooling systems*.
- Electro-mechanical systems*.
- Catering and hospitality equipment*.

*Subject to Commencement Order

### Leasing

Ireland operates an eight-year tax depreciation life on most assets. For short life assets (that is, those with a life of less than eight years), Ireland has allowed lessors to follow the accounting treatment of the transaction in the case of finance leases. This basically allowed finance lessors to write-off their capital for tax purposes in line with the economic recovery on the asset. In 2010, Ireland extended this beneficial tax treatment to operating leases of certain assets. Heretofore, operating lessors of such assets were required to write-off their capital over a period of eight years which created a mismatch with the economic recovery. The change means that operating lessors may now elect to follow the accounting treatment so that they are charged to tax on the rentals received from operating lease (that is, rentals included in P&L account) without addback for depreciation and without a deduction for tax depreciation. The new approach provides a faster write-off of the capital cost of an asset where before they were relying on tax depreciation over eight years. The new provision applies to incremental expenditure incurred in accounting periods commencing on or after 1 January 2010.

### *Interest expenses*
A deduction for interest is allowed only to the extent that borrowings are used for the purpose of a trade or other limited purposes.

### *R&D expenses*
Expenditure on scientific R&D and payments for the acquisition of know-how in general are allowable deductions, as are the costs of obtaining or extending patents and obtaining and renewing trademarks.

### *Charitable contributions*
Companies are entitled to a deduction, as a trading expense, for qualifying donations to approved charities, educational institutions, schools, churches, research foundations, sports bodies, and other approved organisations which satisfy certain conditions.
To qualify for a tax deduction, the donation(s) to an organisation in a 12-month accounting period must amount to at least EUR 250.

### *Meals and entertainment*
Costs incurred for third-party entertainment are not tax-deductible. Entertainment includes the provision of accommodation, food, drink, and any other form of hospitality including the provision of gifts. Expenditure on bona fide staff entertainment is allowable as a deduction provided its provision is not incidental to the provision of entertainment to third parties. Certain promotional costs are tax-deductible if they are incurred wholly and exclusively for the purposes of the trade.

### *Pension expenses*
Contributions to certain employee pension schemes and the cost of setting up such schemes are deductible. Pension contributions are allowable as a deduction for employers in the year in which they are paid.

### *Taxes*
Taxes that are deductible in computing profits for corporation tax include VAT not recovered, the employer's share of PRSI contributions, and local taxes (i.e. rates levied on commercial property and local authority charges).

### *Net operating losses*
Losses are computed for tax purposes in the same way as business profits. Trading losses can be offset against other income of any nature, either in the current or preceding accounting period (of equal length). The amount of losses required to shelter the income is dependent on the tax rate which would have been applied to the income in the absence of the loss relief. Any excess losses can be carried forward indefinitely against future trading income. Certain changes in ownership may prevent the

carryforward of losses to future periods. Terminal losses which arise within 12 months of the date a company ceases to trade may be carried back three years.

### *Payments to foreign affiliates*

Generally, deductions can be claimed for royalties, management service charges, and most interest charges paid to foreign affiliates, provided the amounts do not exceed what would be paid to unrelated entities. Depending on the circumstances, certain elections may be required. Ireland does not have any thin capitalisation rules.

## *Group taxation*

The concept of 'fiscal unity' or consolidated group tax does not exist in Ireland. However, trading losses as computed for tax purposes may be offset on a current period basis against taxable profits of another group company. As with loss relief in a single company, the amount of losses required to shelter the income is dependent on the tax rate which would have been applied to the income in the absence of the loss relief.



A group consists of a parent company and all of its 75% subsidiaries, with all group members being tax resident in Ireland or in another member state of the EEA. Non-Irish members may only surrender losses from activities which would, if profitable, be subject to Irish tax.

Capital losses cannot be surrendered within a group.

Relief from capital gains tax is available on intragroup transfers of capital assets. Where a capital asset is transferred from a resident company to another resident company in a 75% group, no capital gains tax charge arises. A group, for capital gains tax purposes, consists of a principal company and its 75% subsidiary companies. A 75% subsidiary is defined by reference to the beneficial ownership of ordinary share capital, owned either directly or indirectly. A capital gains tax group can include EEA resident companies for the purpose of analysing the beneficial ownership of a company.

It also is possible for an Irish resident company and an Irish branch of an EEA company in the same group to transfer capital assets without crystallising a capital gains charge, provided the asset transferred remains within the scope of the charge to Irish capital gains tax.

Subsequent to an intragroup transfer, a charge to capital gains tax will arise when either:

- the asset is sold outside the group, in which case the tax is calculated by reference to the original cost and acquisition date of the asset when first acquired within the group or
- a company owns an asset which was transferred by a group company and subsequently leaves the group within a ten year period of the intragroup transfer. The gain on this intragroup transfer crystallises and becomes payable at this point.

### *Transfer pricing*

In April 2010, Ireland enacted broad based transfer pricing legislation. The legislation endorses the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and adopts the arm's-length principle. The introduction of general transfer pricing legislation in Ireland was widely anticipated and brings the Irish tax regime into line with international norms in this area. The new regime applies to domestic as well as international related party arrangements and is effective for accounting periods commencing on or after 1 January 2011 in relation to certain arrangements entered into on or after 1 July 2010.

The new transfer pricing rules apply to arrangements entered into between associated persons, involving the supply or acquisition of goods, services, money, or intangible assets and relating to trading activities within the charge to Irish tax at the trading rate of 12.5%. The rules confer a power on the Irish tax authorities to re-compute the taxable profit or loss of a taxpayer where income has been understated or where expenditure has been overstated as a result of certain non-arm's-length arrangements. The adjustment will be made to the Irish taxable profits to reflect the arrangement had it been entered into by independent parties dealing at arm's length.

The legislation also places an obligation on a taxpayer to provide documentation 'as may reasonably be required' to support the arm's-length nature of the related party arrangements and that documentation will need to be prepared 'on a timely basis'. Guidance note issued by the Irish tax authorities on transfer pricing documentation support the legislative basis and indicate that a company is required to have transfer pricing documentation available for inspection if requested by the Irish tax authorities. Notably, the guidance notes state that "it is best practice that the documentation is prepared at the time the terms of the transaction are agreed". Additionally, the guidance notes state that in order "for a company to be in a position to make a correct and complete tax return, appropriate transfer pricing documentation should exist at the time the tax return is filed". It is worth noting that the taxpayer can maintain documentation in the form 'of its choosing'. Additionally, where documentation exists in another territory which supports the Irish arrangement, this will also be sufficient from an Irish transfer pricing perspective, provided that the documentation is in English. The Irish tax authorities have also confirmed that they will accept documentation that has been prepared in accordance with either the OECD Transfer Pricing Guidelines or the code of conduct adopted by the EU Council under the title 'EU Transfer Pricing Documentation'.

Note that arrangements entered into between related parties prior to 1 July 2010 are 'grandfathered' and thereby excluded from the scope of the new transfer pricing rules. There is also an exemption from the new rules for small and medium-sized enterprises. Broadly speaking, small and medium-sized enterprises include enterprises employing less than 250 people and that have either a turnover of less than EUR 50 million or assets of less than EUR 43 million.

### *Thin capitalisation*
Ireland does not have any thin capitalisation rules.

### *Controlled foreign company (CFC) regime*
Ireland does not have CFC rules.

## *Tax credits and incentives*

The main tax incentives in Ireland are:

- 12.5% corporation tax rate on active business income.
- A 25% credit on incremental R&D spending over the base year of 2003; total effective tax deduction of 37.5%.
- Ability to exploit IP at favourable tax rates.

- Accelerated tax depreciation allowances for approved energy efficient equipment.
- Ability to carry out investment management activities for non-Irish investment funds without creating a taxable presence in Ireland for such funds.
- An effective legal, regulatory, and tax framework to allow for the efficient redomiciliation of investment funds from traditional offshore centres to Ireland.

### *R&D credit*

Incremental R&D expenditure (over a base year of 2003) qualifies for a tax credit of 25% in addition to a tax deduction. This means that the total tax deduction on qualifying expenditure is 37.5%. Expenditure on buildings used for R&D now also can qualify for the credit as long as at least 35% of the building is used for R&D activities. This hurdle is measured over the course of four years. This is of particular assistance where R&D is carried on in a manufacturing environment. It should be noted that expenditures incurred on the acquisition of an intangible asset that qualify for capital allowances under the IP regime will not qualify for the R&D credit.

Further enhancements to the R&D regime cater to pre-trading expenditures and other specific circumstances. Where a company incurs R&D expenditures but has not yet commenced to trade, all R&D claims in this regard must be made within 12 months from the end of the accounting period in which the company first commences to trade.



The R&D credit can be used to generate a tax refund through a carryback against prior year profits. In addition, repayment for excess credits is available over the course of a three-year cycle. Repayments are limited to the greater of the corporation tax payable by the company in the preceding ten years or the payroll tax liability for the period in which the relevant R&D expenditure is incurred.

In addition, under Irish GAAP, companies may account for the R&D tax credit through their profit and loss account or income statement in arriving at the pre-tax profit or loss.

### *Intellectual property (IP) regime*

Legislation provides for a tax deduction for capital expenditure on the acquisition of qualifying IP assets. The definition of IP assets is widely drafted and includes the acquisition of, or the licence to use, the following:

- Patents and registered designs.
- Trademarks and brand names.
- Know-how (broadly in line with the OECD model tax treaty definition of know-how).
- Domain name, copyrights, service marks, and publishing titles.
- Authorisation to sell medicines, a product of any design, formula, process, or invention (and rights derived from research into same).
- Applications for legal protection (for example, applications for the grant or registration of brands, trademarks, patents, copyright, etc.).
- Expenditure on computer software acquired for commercial exploitation.
- Goodwill, to the extent that it relates directly to the assets outlined above.

Capital allowances will be available at the same rate as the depreciation/amortisation charge for financial accounting purposes. Alternatively, the company may elect to claim allowances over a period of 15 years.

Tax deductions (e.g. financing costs) are available for offset against income generated from exploiting IP assets, up to a maximum deduction of 80% of the relevant IP profits. The remaining 20% is taxable at the 12.5% corporation tax rate. There is no clawback provided the IP is held for ten years (reduced from 15 years in Finance Act 2010).

There is currently an option to elect to stay within the 'old' regime for know-how and patents for IP acquired up until 7 May 2011. A shorter write off period of eight years has also been retained for acquired software rights under the existing capital allowances regime where the rights are not acquired for commercial exploitation (i.e. were acquired for end use by the company).

### *Exemption for new start-up companies*

A corporation tax holiday applies to certain start-up companies that commence to trade during 2009, 2010, or 2011. The relief applies for three years where the total amount of corporation tax payable does not exceed EUR 40,000 in each year. Marginal relief is available where corporation tax payable is between EUR 40,000 and EUR 60,000. Finance Act 2011 confirms that the exemption for start-up companies from corporation tax is to be extended to companies which commence a new trade in 2011. The relief available is now linked to the amount of employer's PRSI paid by a company in an accounting period and is intended to target the relief at companies generating employment.

### *Section 110 company*

Ireland has a favourable tax regime for entities known as Section 110 companies. A Section 110 company is an Irish resident special purpose company that holds and/or manages 'qualifying assets' which provides for an onshore investment platform (with access to Ireland's treaty network) in an environment of increased international focus on tax havens and transparency. The Section 110 regime has been in existence since 1991 and with appropriate planning effectively allows for corporation tax neutral treatment, provided that certain conditions are met. The regime is widely used by international banks, asset managers, and investment funds in the context of securitisations, investment platforms, CDOs, and capital markets bond issuances.

In this context, Finance Act 2011 made a number of amendments to the Section 110 regime. These changes, arrived at following extensive industry consultation, have significantly expanded the range of assets that a Section 110 company can invest in, whilst also seeking to restrict the use of Section 110 in specific targeted circumstances.

Prior to the publication of Finance Act 2011, Section 110 companies were limited to investing in financial assets. The term 'financial asset' is widely defined and includes both mainstream financial assets such as shares, loans, leases, lease portfolios, bonds, debt, and derivatives, as well as assets such as greenhouse gas emissions allowance, all types of receivables, etc.

The range of investments in which a Section 110 company can invest has been significantly extended to include investments in commodities and plant and machinery. Greenhouse gas emissions allowance has been redefined as a qualifying asset to include 'carbon offsets' and has been broadened significantly. These are very welcome changes, particularly in the context of recent market interest in commodity transactions and the launch of the Irish Government's 'Green International Financial Services Centre (IFSC)' initiative.

In addition, the extension of the Section 110 regime to include plant and machinery will benefit Ireland's position as the preferred destination for aircraft financing and leasing activities and will give an added boost to Ireland's position as the centre of excellence for aircraft financing transactions

### *Grants*
Cash grants may be available for capital expenditures on machinery and equipment and industrial premises, training of employees, creation of employment, rent subsidies, R&D, manufacturing and exporting products, providing services to customers overseas, etc. The level of grant aid depends on a number of factors and is specific to each project. Rates depend on the location of the new industry.

### *Foreign tax credit*
Foreign taxes borne by an Irish resident company (or Irish branch of an EEA resident company), whether imposed directly or by way of withholding, may be creditable in Ireland. The calculation of the credit depends on the nature of the income item, but for income sources other than dividends and some related party interest, the credit is limited to the Irish tax referable to the particular item of income. A system of onshore pooling of excess foreign tax credits applies to dividends from 5% or greater corporate shareholdings, and excess credits in the dividend pool can be carried forward indefinitely. A similar pooling system applies to some related party interest and also to foreign branch income.



An Irish resident company with a branch or branches outside Ireland is generally taxable in Ireland on the foreign branch profits with a credit for foreign taxes paid on those profits. A unilateral form of credit relief for foreign taxes paid by foreign branches operating in countries with which Ireland does not have a tax treaty is available also. To the extent that there were foreign taxes on branch profits that were not utilized in the relevant period (that is, where credit for foreign tax exceeds the Irish tax payable), these unused credits were lost, unless they could be used against Irish corporation tax on other foreign branch profits arising in the same accounting period. For accounting periods ending on or after 1 January 2010, any unused credits can be carried forward indefinitely and credited against corporation tax on foreign branch profits in future accounting periods.

## *Withholding taxes*

Irish resident companies are required to withhold tax on certain types of payments as set out below *(see table at end of this section for rate reductions and exemptions).*

| Recipient | Dividends (%) | Interest (%) | Patents, royalties (%) |
|---|---|---|---|
| Resident companies | 0 | 20 | 20 |
| Resident individuals | 20 | 20 | 20 |
| Non-resident companies and individuals | 20 | 20 | 20 |

### *Dividend withholding tax (WHT)*
Dividend WHT applies at 20% to dividends and other distributions, unless the recipient of the dividend is either an Irish company or a non-Irish company eligible for the Parent-Subsidiary Directive (which in Ireland requires a 5% or greater shareholding).

Exemptions from dividend WHT also are available where the recipient of the distribution falls into one of the categories listed below and provided an appropriate declaration is made to the company paying the distribution in advance of the distribution. In a move to significantly ease the administrative burden in applying for exemption for dividend WHT, this declaration is now self-assessed and valid for up to six years.

- Irish tax resident companies (a declaration is not required for Irish tax resident companies which hold a 51% or greater shareholding of the company).
- Non-resident companies, which are resident in a country with which Ireland has a tax treaty or in another EU member state, where the company is not controlled by Irish residents.
- Non-resident companies which ultimately are controlled by residents of a tax treaty country or another EU member state.
- Non-resident companies whose principal class of shares is traded on a recognised stock exchange in a treaty country or another EU member state or on any other stock exchange approved by the Minster for Finance (or if recipient of the dividend is a 75% subsidiary of such a listed company).
- Non-resident companies that are wholly owned by two or more companies the principal class of shares of each of which is traded on a recognised stock exchange in a treaty country or another EU member state or on any other stock exchange approved by the Minister for Finance.
- Individuals who are resident in a tax treaty country or in another EU member state.
- Certain pension funds, retirement funds, sports bodies, collective investment funds, and employee share ownership trusts.

Companies that make a dividend distribution are required, within 14 days of the end of the month in which the distribution is made, to make a return to the tax authorities containing details of the recipient of the dividend, the reason for any exemption from dividend WHT, and to pay over any tax withheld.

### *WHT on capital gains*

Where any of the following assets is disposed of, the person by whom or through whom the consideration is paid (i.e. the purchaser) must deduct capital gains tax at 15% from the payment:

1. Land or minerals in Ireland or exploration rights in the Irish continental shelf.
2. Unquoted (unlisted) shares deriving their value or the greater part of their value (more than 50%) from assets described in (1).
3. Unquoted (unlisted) shares issued in exchange for shares deriving their value or the greater part of their value from assets as described in (1).
4. Goodwill of a trade carried on in Ireland.

The requirement to withhold tax is not required where the consideration does not exceed EUR 500,000 or where the person disposing of the asset produces a certificate from the Revenue Commissioners authorising payment in full. A clearance certificate may be obtained by making application on Form CG50 to the Revenue Commissioners supported by a copy of the agreement or contract for sale. The certificate may be obtained on the grounds that the vendor is Irish resident or that no capital gains tax is due in respect of the disposal or that the capital gains tax has been paid. WHT is creditable against the capital gains tax liability of the vendor, and any excess is refundable.

To avoid the requirement to withhold, clearance must be obtained before the consideration is paid. There is no exemption from the withholding procedure where the asset is held as trading stock or where the transaction is intragroup and a capital gains tax liability does not arise. Failure to obtain the certificate will lead to the purchaser being assessed to capital gains tax for an amount of 15% of the consideration.

### *Professional services withholding tax (PSWT)*
Individual income tax at the standard rate (currently 20%) is deducted from payments for professional services by government departments, state bodies, and local authorities. Credit is granted for any PSWT withheld against the corporation tax (or income tax for an individual) liability of the accounting period in which tax is withheld.

### *Relevant contracts tax (RCT)*
There are special WHT rules (with exemptions available) relating to payments made by principal contractors to sub-contractors in respect of relevant contracts in the construction, forestry, and meat processing industries. Where relevant operations under a relevant contract are carried out in Ireland, the RCT system applies regardless of whether or not parties to the contract are non-resident in Ireland, parties to the contract are not liable to tax in Ireland in respect of those operations, the contract is executed outside Ireland, or payments under the contract are made outside Ireland.

The principal contractor must deduct tax at a rate of 35% from such payments and remit this to the Revenue unless the sub-contractor produces a certificate (Form C2) authorising the receipt of the amount without deduction of tax and the principal contractor obtains a Relevant Payments Card in relation to the sub-contractor.



Qualification for exemption from WHT is a two-part test, and it is critical that both parts are satisfied before any payment is made gross. The gross amount receivable under the contract is included in the computation of the profit of the sub-contractor, and the sub-contractor is entitled to credit for, or repayment of, the tax suffered.

### *WHT rate reductions and exemptions*
Exemptions and rate reductions apply under domestic law and under tax treaties.

| Recipient | Dividends (%) (1) | Interest (%) (2) | Patents, royalties (%) (3) |
|---|---|---|---|
| Albania ** | 0/5 (4)/10 | 0/7 | 0/7 |
| Australia | 0 | 0/10 | 10 |
| Austria *** | 0 | 0 | 0 |
| Bahrain ** | 0 | 0 | 0 |
| Belarus | 0/5 (4)/10 | 0/5 | 0/5 |
| Belgium*** | 0/20 | 0/15 | 0 |
| Bosnia-Herzegovina** | 0 | 0 | 0 |
| Bulgaria | 0/5 (4)/10 | 0/5 | 10 |
| Canada | 0/5 (7)/15 | 0/10 | 0 |
| Chile | 0/5 (6)/15 | 0/5 (8)/15 | 10 |
| China | 0/5 (4)/10 | 0/10 | 10 |
| Croatia | 0/5 (7)/10 | 0 | 10 |
| Cyprus * | 0 | 0 | 0 |
| Czech Republic | 0/5 (4)/15 | 0 | 10 |
| Denmark | 0 | 0 | 0 |
| Estonia | 0/5 (4)/15 | 0/10 | 10 |
| Finland | 0 | 0 | 0 |
| France * | 0/20 | 0 | 0 |
| Germany ***** | 0/20 | 0 | 0 |
| Georgia | 5 (9)/10 | 0 | 0 |
| Greece | 0/5 (4)/15 | 0/5 | 5 |

| Recipient | Dividends (%) (1) | Interest (%) (2) | Patents, royalties (%) (3) |
|---|---|---|---|
| Hong Kong | 0 (12) | 10 | 3 |
| Hungary | 0/5 (7)/15 | 0 | 0 |
| Iceland | 0/5 (4)/15 | 0 | 10 |
| India | 0/10 | 0/10 | 10 |
| Israel | 0 | 0/5 (8)/10 | 10 |
| Italy * | 0/15 | 10 | 0 |
| Japan | 0/20 | 10 | 10 |
| Korea, Rep. of * | 0 | 0 | 0 |
| Kuwait ** | 0 | 0 | 5 |
| Latvia | 0/5 (4)/15 | 0/10 | 10 |
| Lithuania | 0/5 (4)/15 | 0/10 | 10 |
| Luxembourg | 0/20 | 0 | 0 |
| Macedonia | 5 (6)/10 | 0 | 0 |
| Malaysia *** | 0/10 | 0/10 | 8 |
| Malta | 5 (6)/15 | 0 | 5 |
| Moldova | 0/5 (4)/10 | 0/5 | 0/5 |
| Montenegro ** | 0/5/10 | 0/5/10 | 5/10 |
| Morocco ** | 6/10 | 0/10 | 10 |
| Mexico | 0/5 (4)/10 | 0/5 (8)/10 | 10 |
| Netherlands | 0/15 | 0 | 0 |
| New Zealand | 0 | 10 | 10 |
| Norway | 0/5 (7)/15 | 0 | 0 |
| Pakistan * | 0/20 | (5) | 0 |
| Poland | 0/15 | 0/10 | 10 |
| Portugal | 0/15 | 0/15 | 10 |
| Romania | 0/3 | 0/3 | 3 |
| Russia | 0/10 | 0 | 0 |
| Serbia | 0/5 (4)/10 | 0/10 | 0/5/10 |
| Singapore | 0 | 0/5 | 5 |
| Slovak Republic | 0/10 | 0 | 10 |
| Slovenia | 0/5 (4)/15 | 0/5 | 5 |
| South Africa **** | 0/5 (7)/10 | 0 | 0 |
| Spain | 0 | 0 | 10 |
| Sweden | 0 | 0 | 0 |
| Switzerland *** | 0 | 0 | 0 |
| Turkey | 5/15 | 10/15 | 10 |
| United Arab Emirates ** | 0 | 0 | 0 |
| United Kingdom | 0/5 (6)/15 | 0 | 0 |
| United States | 0/5 (7)/15 | 0 | 0 |
| Vietnam | 5 (10)/10 | 10 | 5/10/15 (11) |
| Zambia | 0 | 0 | 0 |

Legislation recently has been amended to allow for favourable treatment in situations where a DTT has been signed but not yet ratified.

* These treaties are currently under renegotiation.

** Awaiting ratification.

*** Protocols to the DTTs with Belgium, Malaysia, Switzerland, and Austria are awaiting ratification. These protocols do not have any impact upon the exemptions and rate reductions outlined above.

**** A protocol to the DTT with South Africa is awaiting ratification. The above exemptions and rates are as per the pending protocol. Currently the above payments to South African companies are exempt from WHT.

***** Protocol agreed and renegotiated treaty awaits ratification. Under the renegotiated treaty, the following dividend WHT rate will apply: 0/5/15.

Notes

1. Individuals (and most companies) resident in countries with which Ireland has a tax treaty should be able to qualify for exemption from WHT subject to filing appropriate documentation.
2. Financial institutions operating in Ireland are obliged to withhold tax (deposit interest retention tax or DIRT) at 25% out of interest paid or credited on deposit accounts in the beneficial ownership of resident companies, unless the financial institution is authorised to pay the interest gross. There is no DIRT on interest paid to non-residents where a written declaration of non-residence is completed. Certain annual interest payments are subject to WHT at 20%. Interest payments by companies to companies resident in other EU member states or in treaty countries are generally not subject to WHT. The EU Interest and Royalties Directive may also provide an exemption from WHT for payments between associated companies.
3. Royalties, other than patents, are not generally subject to WHT under domestic law. Documentation and reporting may be required to access lower treaty withholding rates in other cases. The EU Interest and Royalties Directive may also provide an exemption from WHT for payments between associated companies. Associated companies, for the purpose of this directive, are companies where one can directly control at least 25% of the voting power of the other or at least 25% of the voting power of both companies is directly controlled by a third company. In all cases, all companies must be resident in a member state of the European Union.
4. Where the beneficial owner of the dividends is a resident of a contracting state and is a company which holds directly at least 25% of the capital of the company paying the dividends.
5. Refer to Ireland/Pakistan DTT.
6. Where the beneficial owner of the dividends is a resident of the contracting state and is a company which controls directly or indirectly 10% or more of the voting power in the company paying the dividends.
7. Where the beneficial owner of the dividends is a resident of the contracting state and is a company which controls directly 10% or more of the voting power in the company paying the dividends.
8. For loans from banks and, in the case of Norway, certain government funds.
9. Where the beneficial owner of the dividends is a resident of the contracting state and controls directly or indirectly at least 10% of the voting power in the company paying the dividend and has invested more than EUR 100,000 in the capital of the company paying the dividend. The above details in general are subject to any special relationship that may exist between the payer and the recipient, and it is assumed that the recipient does not have a permanent establishment (taxable presence) in the other contracting state.
10. Where the beneficial owner of the dividends is a resident of a contracting state and is a company which holds directly at least 70% of the voting power of the company paying the dividends.
11. Refer to Ireland/Vietnam DTT.
12. Treaty comes into effect on 1 January 2012.

## *Ireland is currently negotiating treaties with the following countries*

| | |
|---|---|
| Argentina | Saudi Arabia |
| Armenia | Thailand |
| Azerbaijan | Tunisia |
| Egypt | Ukraine |
| Panama | |

# Ireland

## *Tax administration*

### *Return*
Corporation tax returns must be submitted within nine months (and no later than the 21st day of the ninth month) after the end of the tax accounting period in order to avoid a surcharge (maximum of EUR 63,485) or a restriction of 50% of losses claimed, to a maximum of EUR 158,715. The tax accounting period normally coincides with a company's financial accounting period, except where the latter period exceeds 12 months.

### *Statute of limitations*
A system of self-assessment and Irish Revenue audits is in operation in Ireland. Irish Revenue may undertake a Revenue audit of a company's tax return within a period of four years from the end of the accounting period in which the return is submitted.

### *Payment of tax*
Corporation tax payment dates are different for 'large' and 'small' companies. A small company is one whose corporation tax liability in the preceding period was less than EUR 200,000. Interest on late payments or underpayments is applied at approximately 10% per year.

#### Large companies
The first instalment of preliminary tax totaling 45% of the expected final tax liability, or 50% of the prior period liability, is due six months before the end of the tax accounting period (but no later than the 21st day of the month).

The second instalment of preliminary tax is due 31 days before the end of the tax accounting period (but no later than the 21st day of the month). This payment must bring the total paid up to 90% of the estimated liability for the period.

The balance of tax is due when the corporation tax return for the period is filed (that is, within nine months of the end of the tax accounting period, but no later than the 21st day of the month in which that period of nine months ends).

#### Small companies
Small companies only are required to pay one instalment of preliminary tax. This is due 31 days before the end of the tax accounting period (but no later than the 21st day of the month).

The company can choose to pay an amount of preliminary tax equal to 100% of the corporation tax liability for its immediately preceding period or 90% of the estimated liability for the current period. As is the case for large companies, the final instalment is due when the corporation tax return is filed.

## *Other issues*

### *Asset management*
Irish tax legislation contains provisions aimed at enhancing Ireland as a leading location for the management of both Undertakings for Collective Investment in Transferable Securities (UCITS) and non-UCITS funds. UCITS III and IV brought about fundamental changes to both the management and structuring of UCITS. One of the reforms introduced permits UCITS management companies located in one EU jurisdiction to manage UCITS domiciled in another EU jurisdiction. One of the areas of concern is

whether the activities of the management company could bring a foreign UCITS within the charge to tax in the management company's home jurisdiction (e.g. by creating a branch or agency or causing the fund to be regarded as tax resident there). In the case of an Irish management company managing a non-Irish UCITS, such management company will not be regarded as a branch or agency of the non-Irish UCITS and will not bring the profits of the foreign UCITS within the charge to Irish tax or treat the foreign UCITS as an Irish regulated fund.

Following the US and OECD review of offshore domiciles, which has resulted in increased regulation and tax obligations, fund managers are being forced to consider possible alternative onshore jurisdictions for their investment fund products. Because of its international reputation of its investment funds industry and the favourable corporate tax regime, Ireland is seeing a significant trend in investment managers moving their investment platforms there from the traditional offshore jurisdictions. Recent company law changes also allow corporate funds to migrate to Ireland through a re-registration process, whereby the fund company would benefit from its continued existence, including the ability to retain the fund's performance track record post migration and avoid potential adverse tax consequences and costs that typically arise from a merger of an offshore fund with a new onshore fund. The Irish Financial Regulator has introduced a coordinated authorisation process to facilitate speed to market, which at present is a key advantage in comparison to delays being experienced in other EU domiciles.



### *Islamic finance*
The Irish tax treatment of certain Islamic finance transactions, such as funds, certain ijara (leasing), takaful (insurance), and re-takaful (reinsurance) is accommodated within existing Irish tax legislation. Specific legislation was also introduced to facilitate the issuance of sukuk (i.e. Islamic bonds) in Ireland. Overall, the intention of the legislature is to ensure that Islamic finance transactions are treated in the same favourable manner as conventional financing transactions. The legislation also introduced changes in relation to the taxation (and tax impact) of UCITS management companies. The UCITS structure is one of the commonly used structures for many different types of Islamic funds, such as retail Islamic equity funds, Shariah-compliant money market funds, Shariah-compliant exchange traded funds (ETFs), etc. This demonstrates the Irish government and tax authorities desire to enhance the attractiveness of Ireland as a location for Islamic finance transactions by extending to this form of financing the relieving provisions which currently apply to conventional financing.

### *Islamic insurance*
The Irish Revenue has recently provided guidance in respect of the Irish tax treatment of general takaful (non-life), re-takaful (reinsurance), and family (life) takaful arrangements. Legislative changes are not currently required to facilitate Islamic insurance in Ireland.

### *Exchange control*
Ireland does not have exchange control regulations.

### *Choice of legal entity*
Foreign investors tend to operate either through an Irish legal entity or as a branch of a foreign entity. Both are equally valid means of doing business in Ireland, and the choice would normally depend on the commercial fact pattern and individual circumstances of the investor parent company.

### *Mandatory disclosure*

In a move to promote transparency between taxpayers, practitioners, and tax authorities, provisions relating to the disclosure of tax schemes are applicable as of January 2011. These require promoters of such schemes to provide information to the tax authorities within a specified time of having made the scheme available. A transaction which comes within the new law and which therefore must be reported to Revenue is not necessarily a tax avoidance transaction for the purposes of existing legislation. The rules are wide reaching and essentially cover all tax heads including corporation tax, income tax, capital gains tax, stamp duty, VAT, customs duties, and excise duties.

# Isle of Man

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## Significant developments

### Tax treaties

The Isle of Man has, in January 2011, signed a double tax agreement (DTA) with Bahrain, bringing the total number of treaties to four. The DTA with Belgium which was signed in July 2009 is still awaiting ratification.

The Isle of Man now has a total of 25 tax information exchange agreements (TIEAs), including those signed during 2011with Canada, India, Poland, and, most recently, Mexico.

### Income attributed to shareholders

Legislation currently exists which attributes the profits of an Isle of Man resident company to any Manx resident shareholders as if that profit had been distributed to them. Although any resulting tax charge falls on the shareholder, the legislation places reporting and filing obligations on the Isle of Man resident company in respect of profits realised and distributions made.

This legislation was abolished in the 2011 budget and will no longer apply for accounting periods commencing after 6 April 2012.

## Taxes on corporate income

Companies resident in the Isle of Man are taxed on their worldwide income, and any company with Manx-source income is required to file an annual income tax return reporting taxable profits calculated in line with local legislation and practice.

The majority of companies pay income tax at 0% in the Isle of Man. However, certain profits of licensed banks and companies that receive income from the rental or development of land situated in the Isle of Man pay tax at 10%. The general rules for the calculation of taxable income are the same whether a company is liable to tax at 0%, 10%, or a combination of both rates.

Unilateral relief from double taxation in respect of foreign source income is given by way of tax credit.

## Corporate residence

A company incorporated in the Isle of Man is automatically resident for tax purposes and must therefore file an annual income tax return whether it pays tax at 0% or 10%. A company which is incorporated elsewhere will be considered resident in the Isle of Man if it is 'managed and controlled' in the Isle of Man. 'Managed and controlled' is generally interpreted as being the place where the board of directors meets, although this is not always conclusive. In cases where a company is resident in the Isle of Man and also resident in a country with which the Isle of Man has a tax treaty, then a tie-breaker may operate to determine residence.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is a transaction based tax and is applied on the domestic supply of most goods and services and is currently charged at a standard rate of 20% (increased from 17.5% with effect from 4 January 2011). VAT is designed to be a tax borne by the final consumer and there is a mechanism for businesses to recover VAT incurred in a supply chain, subject to meeting certain conditions.

For VAT purposes, the Isle of Man forms a single VAT jurisdiction with the United Kingdom, and the VAT rules are broadly identical. This means that VAT is charged on supplies between Isle of Man and UK businesses as if they were domestic supplies. The Isle of Man has its own tax authorities who work in conjunction with the UK tax authorities.

Some supplies are charged at 0%, including food, books and publications, and public transport, and there is also a 5% rate applying to domestic property repairs, amongst others. Finally, some supplies are exempt from VAT, including insurance and financial services, betting and gaming, education, and health.

### *Customs and excise duties*

In addition to VAT, the Isle of Man forms a common jurisdiction for customs and excise duties with the United Kingdom, and, again, the rules are broadly identical. Customs duties are levied on most goods imported from outside the European Union into the Isle of Man and there are various rates of duty which apply. Excise duties apply to such things as alcohol, tobacco, and fuels, and there are various rates of duty which apply. There is also a levy on commercial passenger flights known as Air Passenger Duty.

### *Betting duty*

There are no other transaction taxes in the Isle of Man other than betting duty on gaming transactions which is levied at differing rates of up to 15%, depending on the nature of the gaming transaction and whether it is on-line or land based.

## *Branch income*

The income of branches is taxed in the same way as other corporate income in the Isle of Man.

## *Income determination*

The general rules for the calculation of taxable income are the same whether a company is liable to tax at 0%, 10%, or a combination of both rates.

### *Banking income*
Licensed banks are taxed at 10% on income from deposit taking and interest earned from the investment of regulatory reserves only. Income earned on capital and reserves in excess of the regulatory capital, group funded lending, fiduciary deposits, assurance, insurance, custody, trust, and corporate services are taxed at 0%. Expenses are allocated against 0% and 10% income streams on a pro rata basis.

### *Inventory valuation*
Inventories are generally stated at the lower of cost or market value. Any method of valuation that is in accord with sound commercial principles is acceptable for tax purposes, provided it is adopted consistently at the beginning and end of the accounting period and does not conflict with tax law. In practice, inventories are normally valued for tax purposes at the lower of cost or net realisable value. A first in first out (FIFO) basis of determining cost where items cannot be identified is acceptable, but not the base stock method or the last in first out (LIFO) method.

In general, the book and tax methods of inventory valuation must conform.



### *Capital gains*
There is no capital gains tax in the Isle of Man.

### *Foreign income*
Resident corporations are liable to tax on their worldwide income (albeit the relevant rate of tax is often 0%). UK tax is relieved under the treaty with the United Kingdom by way of tax credits. However, the treaty does not cover dividends or debenture interest. Where a liability to tax at 10% arises, the Isle of Man grants unilateral relief from double taxation in respect of all foreign-source income arising outside the United Kingdom by way of tax credit.

## *Deductions*

Relief is given in calculating the taxable profit of a company if the expense is incurred in the normal course of the business and is incurred wholly and exclusively for business purposes. However, certain expenses which are deductible in the computation of profits are not allowable for tax purposes. These include depreciation, unpaid but accrued pension and bonus payments, certain lease payments, and interest paid to non-Manx resident lenders.

### *Depreciation*
Relief for depreciation is given using ‘capital allowances’ based on a reducing-balance method. Plant and machinery, tourist premises, industrial buildings, commercial buildings within a designated area, fish processing buildings, and agricultural buildings and works have an initial allowance of 100%. There are restrictions on allowances for expensive motorcars.

Isle of Man government grants are not taken into account in determining the amount of expenditure on which allowances may be given.

Tax depreciation is not required to conform to book depreciation.

Upon disposal, allowances will be reclaimed on the resale value, restricted to cost.

### *Taxes*
Local income taxes paid are not deductible when calculating net taxable profit.

### *Net operating losses*
Losses can be carried forward indefinitely against future profits from the same trade.

Trading losses incurred may be carried back against preceding year profits. There are additional rules which apply in the opening years of trade. Terminal losses in the last year of trade can be carried back against profits for the previous three years of trading.

## *Group taxation*

Trading losses and excess capital allowances may be surrendered (subject to certain restrictions) between 75% affiliates resident in the Isle of Man. Similar concessions are available to members of a consortium, but only a fraction of the loss or excess may be set-off, that fraction being equal to the members' share in the consortium in the relevant year of assessment.

### *Transfer pricing*
There is no transfer pricing regime in the Isle of Man. If, however, the Assessor of Taxes is of the opinion that the main purpose, or one of the main purposes, of any transaction is the avoidance or reduction of tax liability, assessments may be made to counteract that avoidance or reduction of tax liability.

### *Thin capitalisation*
There is no specific thin capitalisation rule in the Isle of Man.

### *Controlled foreign company (CFC) regime*
There is no CFC regime in the Isle of Man.

## *Tax credits and incentives*

In view of the low rate of income tax in the Isle of Man, there are no special tax incentives available.

### *Foreign tax credit*
*See Foreign income in the Income determination section for a description of foreign tax credits.*

## *Withholding taxes*

Withholding tax (WHT) should be deducted from certain payments made to non-residents by Isle of Man resident companies as follows:

- Rent from Manx land and property: 10% if paid to a company, 20% if paid to an individual.
- Dividends: WHT is not required.
- Loan interest and royalties: WHT is generally not required, but there are certain exceptions which may apply.

- Other: The Assessor of Income Tax in the Isle of Man has the power to require WHT, at a rate determined by the Assessor, on payments of taxable income made to a non-resident (e.g. payments made to non-resident sub contractors).

## Tax administration

### Returns
All companies are required to submit income tax returns on an accounting period basis, whether they are liable to tax at 0% or at 10%. The tax return is due for submission one year and one day following the end of an accounting period. An accounting period for tax filing purposes can be no more than 12 months; and where the financial statements cover more than 12 months, two (or more) returns may be required. Fixed rate penalties apply if returns are filed late.

### Payment of tax
Payment of tax is due within one year and one day of an accounting period end. Interest is charged on tax paid late.



## Other issues

### Tax treaties
The Isle of Man has, in January 2011, signed a double tax agreement (DTA) with Bahrain, bringing the total number of treaties to four. The DTA with Belgium which was signed in July 2009 is still awaiting ratification.

The Isle of Man now has a total of 25 tax information exchange agreements (TIEAs), including those signed during 2011with Canada, India, Poland, and, most recently, Mexico.

### Choice of business entity
There are several different entities through which businesses may operate in the Isle of Man. These include companies, limited liability companies, partnerships, limited partnerships, and protected cell companies.

# Israel

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## Significant developments

The current corporate tax rate of 24% is scheduled to be reduced to 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015, and 18% in 2016 and thereafter.

On 29 December 2010, the Israeli Parliament approved a major reform amendment to The Law for the Encouragement of Capital Investments which is intended to simplify the manner of taxation that applies to income generated from an Approved Enterprise (AE) by applying a uniform tax rate for all AE-generated taxable income (2011 Amended Law) *(see Approved Enterprises in the Tax credits and incentives section)*. Prior to these amendments, the corporate tax rate applicable to an AE depended upon many factors, including the tax route selected, the geographical area in which the industrial site is located, the level of foreign investment ownership, and attribution of taxable income between different tiers of AE plans further to complex formulas.

It should be noted that the 2011 Amended Law may apply by filing an irrevocable election for income generated by an AE during 2011 and thereafter. Important transition rules apply.

As having AE status can provide material tax benefits for a company, a company's specific AE plans and overall corporate tax circumstances should be carefully analyzed in order to determine the optimal legislative alternative to be selected for any AE plans in force prior to the 2011 Amendment.

## Taxes on corporate income

Israel incorporated companies and foreign companies that have a branch presence in Israel are both subject to Israeli corporate tax. An Israeli-resident entity is subject to Israeli corporate tax on worldwide income while a non-resident entity is subject to Israeli corporate tax only on income accrued or derived in Israel. Income sourcing rules determine when income is to be considered from an Israeli source.

As of 2011, the current corporate tax rate is 24% (25% prior to 2011). The corporate tax rate is scheduled to be reduced to 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015, and 18% in 2016 and thereafter.

Approved enterprises are subject to reduced rates of tax depending upon the level of foreign ownership and location *(see the Tax credits and incentives section)*.

Israel does not impose local taxes on corporate income.

## Corporate residence

The following are considered to be resident in Israel:

- A company incorporated in Israel.
- A company whose business is managed and controlled from Israel.

In the absence of a definition of the term 'management and control' either in Israeli legislation or a direct discussion of this term by the Israeli courts, it is difficult to determine whether a company that is incorporated outside of Israel shall be viewed as managed and controlled from Israel. This is a complex subject that needs to be addressed on a case by case basis. When an entity is both an Israeli tax resident and a resident of a foreign jurisdiction which is party to an income tax treaty with Israel, most treaties provide a tiebreaker test in the determination of an entity's tax residency.

### Permanent establishment (PE)

Foreign resident entities might be exempt from corporate tax to the extent that its activities do not constitute a PE under the tax treaty applicable between Israel and the foreign resident's country of residency.



Whether a non-resident has a taxable presence under Israeli domestic tax law is far less clear than the definition of PE under a relevant tax treaty. There is no detailed legislation or Israeli court decisions which directly address this issue.

## Other taxes

### Value-added tax (VAT)

The current rate of VAT is 16%.

Exports of goods and certain services and various other transactions are zero-rated, and certain transactions are exempt. Banks and other financial institutions pay VAT-equivalent taxes at the rate of 16% based on their total payroll and on profits. Not-for-profit organisations pay VAT (wage tax) at the rate of 8% of their total payroll.

### Real estate – capital gains

Capital gains on real estate are subject to the Land Appreciation Tax Law. The law relates to any real estate in Israel, including houses, buildings, and anything permanently fixed to land; real estate rights; and leases for 25 years or more. Tax calculations closely follow the calculation of company tax on capital gains *(see Capital gains in the Income determination section)*.

The tax rate on the real gain is the applicable corporate tax rate (24% in 2011).

A special tax rate may apply with respect to real estate acquired prior to 1960.

### Transfer tax

The purchaser of real estate is generally subject to acquisition tax at rates of 0.5% up to a maximum of 5%.

### Municipal tax

Municipal tax is levied annually on buildings by local municipalities based on the size, location, and purpose of the property.

### *Stamp taxes*
There are no stamp taxes imposed in Israel.

### *Customs duties*
Customs duty is imposed on certain products imported into Israel. The rates of duty depend upon their classification according to the Harmonised Customs Tariff and the country of origin. Israel has concluded free-trade agreements with the United States, Canada, Mexico, the European Union (EU), and the European Free Trade Association (EFTA).

### *Employer's national insurance contributions*
Employers are obliged to pay national insurance contributions based on a percentage of each employee's income on a monthly basis. Employers are responsible for withholding employees' contributions from wages and remitting these together with the employer's own contributions. The employer's contribution rates (current as of April 2011) for Israeli-resident employees are 3.45% up to monthly income of 4,984 Israeli shekels (ILS) and 5.9% on the difference between ILS 4,984 and the maximum monthly income of ILS 73,422.

For non-resident employees, the employer rates are significantly lower and are 0.49% up to monthly income of ILS 4,984 and 1.17% on the difference between ILS 4,984 and the maximum monthly income of ILS 73,422. The minimal National Insurance payments for non-resident employees do not provide any retirement benefit for the non-resident but generally provides a certain element of work accident coverage.

When an irregular salary payment in excess of one quarter of the usual salary is made, special provisions apply to the computation of social charges by which the application of this payment is equally attributed to the current month and to the past 11 months.

Israel has social security totalisation agreements with 14 countries which may allow for an exemption from Israeli National Insurance throughout the employment period of the employee in Israel.

## *Branch income*

A branch is liable for tax at the standard corporate rate on Israel-source income. No tax is withheld on transfers of profits to the foreign head office unless the branch is an approved enterprise *(see the Tax credits and incentives section)*.

## *Income determination*

In general, the annual results (i.e. the excess of income over expenses or vice versa) of an Israeli company or branch, as detailed in the taxpayer's financial statements, form the basis for computing the taxable income of the business.

The base amount is then adjusted pursuant to the provisions of the tax law to arrive at 'taxable income'.

### *Inventory valuation*
Inventories are generally valued at the lower of cost or market value (i.e. net realisable value). Conformity is required between book and tax reporting of inventory. The first in

first out (FIFO) or weighted-average basis of valuation is acceptable; the last in first out (LIFO) method is not accepted.

## *Capital gains*

Capital gains tax is generally payable on capital gains by residents of Israel on the sale of assets (irrespective of the location of the assets) and by non-residents on the sale of the following:

- Assets located in Israel.
- Assets located abroad that are essentially a direct or indirect right to an asset or to inventory, or that are an indirect right to a real estate right or to an asset in a real estate association, located in Israel. Taxation applies only in respect of that part of the consideration that stems from the above property located in Israel.
- Assets that are a share or the right to a share in an Israeli entity.
- Assets that are a right in a foreign resident entity which is essentially a direct or indirect right to property located in Israel. Taxation applies only with respect to that part of the consideration that stems from the property located in Israel.



The cashless transfer of rights and assets arising from certain mergers, spin-offs, and asset transfers may be exempt from tax upon meeting various requirements.

### Determination of the capital gain – Computation of real gain and inflationary components

Company tax on capital gains is imposed on the disposal of fixed and intangible assets where the disposal price is in excess of the depreciated cost.

For tax purposes, the capital gain is generally calculated in local currency, and there are provisions for segregating the taxable gain into its real and inflationary components. The inflationary amount is the original cost of the asset, less depreciation (where applicable), multiplied by the percentage increase in the Israeli consumer price index (CPI) from the date of acquisition of the asset to the date of its sale. The inflationary amount component is exempt to the extent it accrued after 1 January 1994 and is generally subject to tax at the rate of 10% if it accrued before that date.

The real gain component, if any, is taxed at the rates set out further below.

A non-resident that invests in capital assets with foreign currency may elect to calculate the inflationary amount in that foreign currency. Under this option, in the event of a sale of shares in an Israeli company, the inflationary amount attributable to exchange differences on the investment is always exempt from Israeli tax.

### Sale of assets (including publicly and non-publicly traded shares)

The real gain is generally subject to tax at the corporate tax rate applicable in the year of the gain (24% in 2011). Special exemptions may apply for non-residents *(see further below)*.

### Special rule for retained profits upon sale of shares

In the case of a disposal by corporations of: (i) non-traded shares and (ii) traded shares when the seller generally directly or indirectly holds at least 10% of the sold Israeli company during the 12-month period preceding the sale, special provisions apply to such part of the real gain which is attributed to the seller's share of retained profits. The share of retained profits is the amount of gain equal to the proportional part of the retained profits of the company that the seller of the shares would have rights to by virtue of those shares. Detailed rules apply in determining this profit component.

Generally, the seller's proportionate part of the company's retained profits is taxed as if this amount had been received as dividends immediately before the sale (i.e. at a tax rate of 0% in the case of an Israeli-resident corporate shareholder or at a tax rate of 25% when the seller is a non-Israeli resident corporate shareholder that generally holds 10% or more in the rights of the Israeli company, subject to a reduced rate in accordance with the provisions of an applicable tax treaty). The part of the retained profits that is attributed to the period ending on 31 December 2002 is subject to tax at the rate of 10%.

### Special exemptions for non-residents

*Publicly traded Israeli shares*

Non-residents corporations not having a PE in Israel are exempt from tax on capital gains from the sale of shares of an Israeli company traded on the Israeli stock exchange or on a foreign stock exchange.

Where the shares were purchased by the non-resident prior to being publicly traded, capital gains tax applies for the portion of the gain that was generated up to the day of the share's public listing but not to exceed the capital gain actually arising upon the sale of the share and provided that the value on the day of public listing was more than their value on the date of purchase and that the proceeds upon sale exceeded the value on the date of purchase.

*Non-publicly traded shares*

For purchases after 1 January 2009, an exemption exists under domestic law for non-residents, regardless of their percentage holding in an Israeli company, from gains derived from the sale of securities not traded on a stock exchange, provided the following conditions are met:

- The investment is not in a company the majority of whose assets are real estate assets in Israel.
- The capital gains were not derived by the seller's PE in Israel.
- The shares were not purchased from a relative (as defined in the Income Tax Ordinance (ITO)) or by means of a tax-free reorganisation.

For shares purchased between 1 July 2005 and 1 January 2009, more restrictive conditions apply in order to be eligible for the exemption. Detailed rules apply.

### Treaty exemption

Non-residents may qualify for a tax treaty capital gain exemption depending upon the particular circumstances and the provisions of the applicable tax treaty (e.g. in some tax treaties, no capital gains exemption is allowed where the holding in the sold Israeli company exceeds a certain percentage).

When assets are attributable to an Israeli PE or are real estate rights (including rights in a real estate association), a treaty exemption will generally not be available.

The Israel Tax Authority (ITA) is very sensitive to treaty shopping, and it will be necessary to demonstrate to the ITA that the foreign holding entity has business substance in its country of residence and that the structuring of the holding through that entity was not implemented for tax treaty benefit purposes.

## *Capital losses*

Capital losses may offset all capital gains (including gains from Israeli or foreign securities) and gains from the sale of property (whether Israeli or foreign source).

Where the capital loss is from a non-Israeli asset (including when carried forward into future years), the loss must first be offset against foreign source capital gains.

Capital losses derived from the sale of securities may also be offset against interest and dividend income generated from the sold security and also against interest and dividend income received from other securities (where the income was not subject to tax of more than 25%).

Capital losses from the sale of shares are generally reduced by any dividends received by the selling corporation during the 24 months preceding the sale, where tax on the dividends of at least 15% was paid.

Capital losses can generally be carried forward indefinitely and set-off only against capital gains.

### *Exit tax*

When an Israeli tax resident, including a company, ceases to be an Israeli resident for tax purposes, its assets are deemed to have been sold one day before it ceased being an Israeli resident. Although exit tax is primarily applicable to individuals, this might also apply to corporations incorporated outside of Israel whose management and control is transferred from Israel to another jurisdiction at a particular time.



Any gain attributable to the deemed sale of assets may be paid on the day the residency ceased or it may be postponed until the date the assets are actually realised. When the tax event is deferred to the sale date of the assets, the amount of the Israeli capital gain portion is determined by taking the real capital gain at the time of realisation, multiplied by the period of ownership from the day on which it acquired the asset until the day it ceased being an Israeli resident, divided by the entire period from the day of the asset's acquisition until the day of realisation. The Minister of Finance is authorised to prescribe provisions for the implementation of the exit tax including provisions for the prevention of double taxation and the submission of tax reports, but no provisions have yet been issued.

### *Dividend income*

#### Received by an Israeli-resident company

Dividends received by an Israel-resident company from another Israeli-resident company which originate from income accrued or derived in Israel are exempt from corporate tax, except for dividends paid from income of an approved enterprise *(see the Tax credits and incentives section)*. This affords the opportunity to transfer after tax profits within an Israeli group of companies for further investment.

Dividends received by an Israeli-resident company from a non-resident company as well as dividends received from an Israeli company which arise from foreign source income of the distributing company are generally taxable for the receiving company at the rate of 25%. Under certain circumstances, the receiving company may elect to be taxed on such dividends at the corporate tax rate, in which case it would also be entitled to a foreign tax credit with respect to corporate taxes paid by the company distributing the dividend (i.e. an 'underlying' tax credit).

#### Received by a non-resident shareholder

Dividends received by a non-resident shareholder from an Israeli company are generally subject to tax at the rate of 20% (25% if paid to a 10% or more shareholder), subject to a reduced rate of tax under an applicable tax treaty.

Several of Israel's tax treaties have very beneficial withholding tax (WHT) rates for dividends and interest being paid from Israel. The ITA is very sensitive to treaty shopping, and it will be necessary to demonstrate to the ITA that the foreign holding entity has business substance in its country of residence and that the structuring of the holding through that entity was not implemented for tax treaty benefit purposes. Furthermore, many of the treaties contain a beneficial ownership clause as a condition to enjoying the treaty WHT rates.

### *Interest income*

**Received by an Israeli-resident company**

Interest income received by an Israeli-resident company is subject to the regular corporate tax rate (24% in 2011).

**Received by a non-resident**

Interest income received by a non-resident company is generally subject to tax at the rate of 20% or subject to a reduced rate of tax under an applicable tax treaty.

Interest received by a non-resident from deposits of foreign currency with an Israel bank is exempt from tax, subject to certain conditions.

### *Rent/royalties income*

Rent and royalty income, less allowable deductions for tax purposes, is subject to tax at the regular corporate tax rate (24% in 2011).

### *Partnership income*

From an Israeli tax perspective, a partnership is in principle a fiscally transparent vehicle. Accordingly, Israeli tax law does not tax partnerships as such, but generally each partner is taxed in respect of its share of the partnership income, with the taxable income allocated to a corporate partner taxed at the regular company tax rate. Consequently, the actual distribution of partnership income to a partner is a non-taxable event.

### *Foreign income*

An Israeli-resident company is liable for tax on its worldwide income. Double taxation is avoided by way of a foreign tax credit mechanism that also applies unilaterally in the absence of an applicable double taxation treaty (*see the Tax credits and incentives section)*.

Under the CFC regime in Israeli tax law, an Israeli company or individual may be taxed on a proportion of the undistributed profits of certain Israeli-controlled non-resident companies in which the Israeli shareholder has a controlling interest (10% or more of any of the CFC's 'means of control'). *See Controlled foreign companies in the Group taxation section for more information.*

## *Deductions*

Costs incurred by a branch or a company are deductible as a business expense for tax purposes where they are incurred 'wholly and exclusively in the production of income'. The amount of the deduction may be limited or disallowed further to other ITO provisions and income tax regulations.

### *Depreciation*
The ITO and tax regulations prescribe standard annual rates of tax depreciation for assets serving in the production of taxable income. Depreciation is generally on a straight-line basis for industrial and other enterprises based on the specific asset types as set out in the tax regulations.

Accelerated rates of depreciation may be available in regard to certain activities (such as industrial) where there is unusual wear and tear due to additional shifts of equipment use. Detailed rules apply.

Depreciation is not permitted on land.

### *Goodwill*
In general, under Israeli tax regulations, goodwill purchased after 1 July 2003 may be amortisable by the purchaser over a 10-year period (10% annually).

### *Organisational and start-up expenses*
Organisational and start-up expenses are generally not immediately deductible but rather are to be capitalised for tax purposes.



### *Research and development (R&D) costs*
Special tax relief is provided under the ITO for R&D costs incurred *(see the Tax credits and incentives section)*.

### *Accrued expenses*
Payments are generally deductible on an accrual basis for commercially justifiable expenses representing arm's-length consideration. However, when such payments attract WHT, the deduction will generally be allowed provided the payment is effected within the tax year. Alternatively, such payments may be deductible in a tax year if the applicable WHT is deducted within three months after the tax year-end and remitted to the tax authorities within seven days of the deduction, together with index linkage differences and interest accrued since the year-end.

However, accrued expenses for severance pay, vacation pay, recreation pay, holiday allowances, and sick pay are not deductible, even if there is an obligation to make these payments. They are only deductible in the year in which they are actually paid to the beneficiary or to a recognised fund.

### *Contingent liabilities*
Based on Israeli court decisions, contingent liabilities may be deductible for tax purposes upon satisfying the following criterion: (i) according to accepted accounting principles, the taxpayer must include in its balance sheet a suitable provision for the potential liability; otherwise, its income will be considered to have been incorrectly reported; (ii) the circumstances of the case and the technical means according to accepted accounting practice must be provided, enabling an agreed determination of the amount of the liability; and (iii) there is a high probability that the potential debt with respect to which the provision was made will become an absolute debt.

### *Excess (disallowed) expenses*
Israeli tax law disallows the partial deduction of certain employee-related expenses incurred by a company doing business in Israel. These include so-called 'excess expenses'. Examples of these are (i) payments for business, travel, and meals which exceed allowable deductions; (ii) expenses incurred in respect of a benefit granted by an employer to its employees but which cannot be attributed to a particular

employee; and (iii) certain vehicle maintenance expenses (all expenses relating to a company owned vehicle that was also designated for use of an employee are generally tax deductible).

A company is obliged to pay a monthly advance on excess expenses in the amount of 45% of the excess expense. The amount paid as an advance in respect of excess expenses is deemed a payment on account of the regular tax advances and payments that the company must pay for corporate income tax and is offset against them, but it is not refundable (i.e. when a taxpayer's tax liability in a given year is lower than the excess expense advances paid, the unutilised amount shall be carried forward to future tax years). Detailed rules apply.

### *Bad debt*
Provisions for bad debts are deductible in the year in which it is evident that the debt has become irrecoverable. Detailed rules apply for making this determination.

### *Charitable contributions*
Charitable contributions do not constitute a regular business expense. However, a tax credit may be available *(see Tax credit for donations in the Tax credits and incentives section)*.

### *Fines and penalties*
Payment of fines and penalties are generally not deductible.

### *Pension expense*
Pension fund contributions are generally deductible for the employer provided inter alia the contributions do not exceed a prescribed level and are effected on a regular basis.

### *Directors' fees*
Payments for commercially justifiable director fees should generally be deductible.

### *Net operating losses*
Business losses can be offset against income from any source in the same year. Loss carrybacks are not allowed. Losses may be carried forward (generally linked to the CPI) and set-off without time limit against income from any trade or business or capital gains arising in the business, but not against income from any other source.

### *Payments to foreign affiliates*
Payments of interest, royalties, and management fees to foreign affiliates are deductible if based on normal commercial terms and practices and evidenced by an inter-company agreement and transfer pricing documentation. Where such payments attract WHT, the deduction will only be allowed where such tax has been withheld and paid in accordance with certain requirements. All cross-border payments to foreign affiliates for goods and services have to comply with arm's-length pricing standards *(see Transfer pricing in the Group taxation section)*.

## *Group taxation*

As a general rule, a parent company and its subsidiaries may not submit consolidated tax returns. Only groups of industrial companies in the same line of business, as well as parent companies that control industrial companies in the same line of business and have at least 80% of their assets invested in industrial companies, are eligible to file consolidated tax returns.

### Transfer pricing

The ITO and its accompanying regulations contain elaborate transfer pricing provisions, including the arm's-length principle, which apply to any international transaction in which there is a special relationship between the parties to the transaction and for which a price was settled on for property, a right, a service, or credit. In general, the regulations are based upon internationally recognised transfer pricing principles (i.e. United States tax regulations or Organisation for Economic Co-operation and Development (OECD) rules). These regulations generally require the taxpayer to support the pricing of international transactions with a transfer pricing study, inter-company agreements, and other documentation. In accordance to Israeli High Court Rulings, the terms of transaction conducted between related parties should be set in written contracts.

Since transfer pricing is a subject that receives considerable attention from the ITA in its examination of related inter-company transactions, transfer pricing principles and documentation requirements should be carefully adhered to.



A taxpayer is required to include in its annual corporate tax return a special form entitled 'Declaration of International Transactions' providing details for every cross-border transaction conducted with related parties. The taxpayer must sign the form which includes a declaration that the transactions with related parties abroad were in accordance with the arm's-length principle, as defined in the Israeli transfer pricing regulations promulgated under the ITO. As a result of this form and declaration, the importance of appropriate transfer pricing documentation has increased.

### Thin capitalisation

Israel has no statutory or regulatory provisions or other rules concerning thin capitalisation for tax purposes as exist in certain other jurisdictions. Since there are no thin capitalisation rules and Israel has no specific debt-equity ratio requirements, a company may be financed with minimum capital and there is no limit to the amount of debt that may be used. Transfer pricing principles shall apply with regards to interest charges.

### Controlled foreign companies (CFC)

Under the CFC regime in Israeli tax law, an Israeli company or individual may be taxed on a proportion of the undistributed profits of certain Israeli-controlled non-resident companies in which the Israeli shareholder has a controlling interest (10% or more of any of the CFC's 'means of control'). A CFC is a company to which a number of cumulative conditions apply including that most of its income or profits in the tax year were derived from passive sources (e.g. capital gains, interest, rental, dividend, royalties) and such passive income has been subject to an effective tax rate that does not exceed 20%.

## Tax credits and incentives

### Foreign tax credit

Double taxation is avoided by way of a foreign tax credit mechanism that also applies unilaterally in the absence of an applicable double taxation treaty. The foreign tax credit is limited to the Israeli corporate tax payable with respect to the same income. Foreign sourced income is divided into 'baskets' (i.e. categories) on the basis of the income source (e.g. dividends, business income), and a particular credit limitation applies to each basket. Excess uncredited foreign income can be carried forward for the subsequent five tax years.

### *Approved enterprises (AEs)*
AE status, which provides for cash and tax benefits, may be granted under the Law for the Encouragement of Capital Investments (the Law) to enterprises that increase the productive capacity of the economy, improve the balance of payments, or provide new employment opportunities.

The Law differentiates between three geographical regions (A, B, and C). Area A enjoys the most incentives, while Area C (generally the central area of the country) enjoys the least amount of incentives.

New AE programmes and expansion of prior existing AE programmes are governed by the Law which underwent a major amendment on 29 March 2005 (2005 Amended Law) and also on 29 December 2010 (2011 Amended Law), effective for 2011 and thereafter.

AE programmes which commenced their period of benefits generally prior to 2005 are still subject to the Law's provisions prior to these amendments.

The 2011 Amended Law is intended to simplify the manner of taxation that applies to income generated from an AE by applying a uniform tax rate for all AE-generated taxable income. Prior to these amendments, as summarized below, the corporate tax rate applicable to an AE depended upon many factors, including the tax route selected, the geographical area in which the industrial site is located, the level of foreign investment ownership, and attribution of taxable income between different tiers of AE plans further to complex formulas.

It should be noted that the 2011 Amended Law shall apply for income generated by an AE during 2011 and thereafter. Transition rules allow AE owners to elect to continue with the AE tax benefits allowed for under the Law prior to these amendments or to choose, in any tax year, to commence to apply the new provisions of the Law and to waive the remaining benefit period those AE benefits provided under the Law prior to its amendment. It should also be noted that once such an election is made by the taxpayer to implement the new provisions, it may not be altered in future tax years. Moreover, as part of the transition rules, an AE owner is generally allowed to elect until 2012 to apply for a new AE status under the terms of the Law in effect prior to its amendment, so long as part of the relating investment was made during 2010. This election can allow the AE owner to further extend the benefits available under the terms of the Law prior to the legislation.

This general overview will address the Law as applicable prior to the 2011 Amended Law as well as setting forth the material tax law changes under the 2011 Amended Law.

We would caution that our comments in regard to the 2011 Amended Law should be regarded as preliminary in nature and they do not address all of the legislative changes. Further detailed rules apply and certain areas still await further legislation and clarifications as to the Israeli Income Tax Authorities' interpretive positions.

#### Cash grants (applicable also under the 2011 Amended Law)
Approved enterprises located in development areas A and B are eligible for cash investment grants, which vary according to the geographic location of the enterprise. Grant amounts and conditions are subject to governmental change from time to time.

### *AE tax incentives prior to 2011 Amended Law*

#### Reduced tax rates

In addition to financial incentives for the establishment or expansion of an AE, various tax incentives are available once a new AE or expansion thereof is operational.

The reduced tax rates generally apply for a seven-year benefit period (or a ten-year period in certain cases of local companies established in development area A or in the case of a foreign investor company, see below), commencing with the year in which the AE first generates taxable income.

Generally, this seven or ten-year period of benefits is limited to 12 years from the year of implementation. For AE plans governed prior to the 2005 amendment to the Law, the period of benefits cannot extend beyond 12 years from the year the enterprise commenced its operations or beyond 14 years from the year in which approval of status as an AE was granted, whichever is earlier.

#### Locally owned companies

Income derived by a company from an AE during the maximum seven-year period of benefits is generally subject to company tax at a rate of 25%.

A WHT rate of 15% (subject to a possible reduction under a tax treaty) applies to dividends paid from profits of an approved enterprise earned during the benefits period, if distributed either during the benefits period or during the subsequent 12 years. Note that dividends from non-approved enterprise profits that are paid to non-residents are generally subject to a maximum 25% WHT rate that may be further reduced under the terms of a relevant tax treaty.

#### Foreign investors' companies (FIC)

A company that qualifies as a FIC is entitled to enhanced tax benefits on AE income. In general, a FIC is a company having more than 25% of its share capital (in terms of rights to shares, profits, voting, and the appointment of directors) and its combined share capital and investor loan capital owned by foreign residents. To qualify for FIC status, a foreign investor must make an investment in the company of at least ILS 5 million.

A FIC benefits from reduced company tax on the profits of an AE for a period of ten years (instead of seven years) commencing with the first year in which taxable income is generated. The total period of benefits is restricted as discussed above.

A FIC enjoys reduced company tax rates applicable to its AE income as shown below:

| Percentage of foreign ownership | Company tax rate (%) |
|---|---|
| Over 25% but less than 49% | 25 |
| 49% or more but less than 74% | 20 |
| 74% or more but less than 90% | 15 |
| 90% or more | 10 |

The foreign ownership percentage is annually determined as the lowest level retained during the specific tax year.

Dividends paid by a FIC out of the profits of its AE are subject to tax in the hands of the recipient at the rate of 15%, without limitation as to their distribution date, provided the dividends are distributed out of AE profits derived during the benefits period.

## Alternative system of tax benefits for approved enterprises (tax holiday)

Companies with new or expanding AEs may elect to forego all government cash grants and receive instead a total exemption (i.e. tax holiday) from company tax on undistributed profits of the approved enterprise for ten years in development area A, for six years in development area B, and for two years in development area C. The area of incentive being the area in which the company's facilities are located.

The tax holiday provides an Israeli tax exemption so long as the AE profits generated in the exemption period are retained within the company. Should a subsequent distribution of such profits occur, company tax and dividend WHT is imposed on the income distributed, at the rates which would have been applicable if the tax holiday had not been elected (i.e. 25% or at a lower rate if the company is a FIC with a foreign ownership percentage of 49% or more during those years).

Under certain anti-avoidance provisions applicable to tax holidays, amounts paid or credited directly or indirectly by an approved enterprise to a relative, a major shareholder, or to a related entity controlled by either a relative or a major shareholder may be treated as a deemed taxable distribution of profits by the AE.

## Ireland track and strategic investment track

For companies having an AE in development area A that seek to distribute dividends while maintaining a low company and dividend tax burden, there is an 'Ireland track' under which the aggregate Israeli corporate and dividend WHT for a foreign resident shareholder is 15% and for an Israeli resident shareholder is 24.8%. This track is in contrast to the standard alternative benefit track discussed above, which provides a tax holiday provided that profits remain undistributed.

Furthermore, a 'strategic investment track' allows for an exemption during the benefit period from company tax and dividend WHT for a company having (depending on its location within Area A of the country) very significant investment and revenue levels. This means that during the benefits period, a company eligible for benefits from income accrued under this track will have no tax liability whatsoever for its productive activity arising from such investment and for the distribution of profits. Detailed rules apply to these tracks.

## Qualifying for AE status

*Minimal investment amount*

For entitlement of tax benefits under the alternative benefit track, there must be a certain minimal investment amount ('Minimum qualifying investment') towards purchasing productive assets (e.g. machinery and equipment, but not buildings) within three years.

In the case of a new factory, the minimum required investment is ILS 300,000.

For expansion of a factory, the amount of required investment is ILS 300,000 or the amount based on the formula shown below, whichever is higher:

| Value of productive assets in the factory in the tax year prior to the year the minimum qualifying investment commences (in ILS million) | Amount of investment required expressed as a percentage of the value of the productive assets (%) |
|---|---:|
| Up to 140 | 12 |
| 140 to 500 | 7 |
| Above 500 | 5 |

Detailed rules apply in determining how to value the assets for purposes of these tests (including in regards to AEs operated by affiliated companies).

For AE plans governed by the Law prior to its amendment, a general condition for approval is that a minimum of 30% of the investment in fixed assets must be equity-financed.

For investors wanting to expand their current AE, a new requirement has been added to the Law that demands at least a two year waiting period before an investor can obtain AE status for its new investments. Upon completion of these investment conditions, the taxpayer must file the election of the investments implementation year. Such election must generally be filed by the filing date of the relevant annual tax return but no later than 12 months from the end of that tax year.

*Automatic approval*
Where an investment project meets all of the eligibility criterion under one of the alternative tracks (Standard Alternative Track, Ireland Track, or strategic investment Track) as set out in the Law and in regulations to be issued, a project will automatically qualify for the AE taxation benefits under the Law with no need for prior approval from the ITA (i.e. a 'green lane'). The criteria that confer tax benefits in the alternative track of the Law are handled by the ITA. A mechanism is available which enables a company to apply for a pre-ruling from the ITA, where it desires to obtain certainty as to the taxation status of its investment under the Amended Law. The application to the ITA must be submitted no later than six months following the end of the investment's implementation year (first year of potential benefits for the AE).



For AE plans governed by the Law prior to its 2005 amendment, the certification of a new or expanding approved enterprise status required interaction with the Israeli Investment Centre (IC) which had to approve the application for approved enterprise status and was responsible for issuing a final implementation approval following its determination that all requirements relating to investments in assets and minimum capital have been met.

*Interruption of entitlement to benefits*
Unlike the Law prior to its 2005 amendment, where an AE owner was generally required to continue to operate the AE for the entire benefit period, under the Law following its amendment in 2005, the examination as to whether an owner is entitled to enjoy AE benefits for a tax year is determined on a year by year basis. Consequently, if in any tax year during the benefit period a company does not meet any of the conditions required under the Law, then for that tax year it is not entitled to benefits. However, if the company again meets the conditions during the benefit period, the company is entitled to the benefits during the remainder of the benefit period.

*Mixed enterprises*
Special rules govern the allocation of taxable income of 'mixed enterprises'. These are essentially entities that derive only part of their income from an AE or entities which operate under a number of approvals relating to separate investment projects. The company tax payable in respect of income from each part of a mixed enterprise is separately computed and a composite WHT is applicable to dividends distributed by a mixed enterprise.

*Neutralisation of assets*
Assets used in the operation of an enterprise that are not part of an AE are regarded as non-approved assets. Consequently, turnover which is deemed to be generated from the

non-approved assets will result in non-approved enterprise income that should be taxed at the regular Israeli corporate tax rate applicable for the relevant year.

For plans operating under the Law prior to its 2005 amendment, in some cases, upon request, the Investment Centre granted neutralisation of assets that were not part of the approved investment plan, so that they would have no negative impact on the tax benefits. Neutralised assets have a 'neutral' effect, as they are not considered part of the approved investment plan or part of a non-approved plan. For certain industrial equipment, neutralisation is not available. Assets that are of a non-productive nature may receive neutralisation.

In accordance with the 2005 Amended Law, this issue arises only in connection to assets purchased which had previous use in Israel.

### *AE 2011 Amended Law overview*

The various reduced tax routes described above are cancelled and replaced with a new uniform tax rate based on the corporate tax rate applicable during the relevant year, as follows:

| Year | Area A | Rest of country | Scheduled regular corporate tax rate |
|---|---|---|---|
| 2011 – 2012 | 10% | 15% | 24% (2011), 23% (2012) |
| 2012 – 2014 | 7% | 12.5% | 22% (2013), 21% (2014) |
| 2014 and thereafter | 6% | 12% | 20% (2015) and 18% in 2016 and thereafter |

A modified Strategic Investment Track has been introduced, but it appears that its qualifying terms and conditions should make this track not particularly relevant for most investors.

The WHT rate applicable to dividends distributed to foreign shareholders remains 15% (subject to being reduced under the terms of an applicable tax treaty). Distributions to Israeli corporations shall not be subject to tax while distributions to Israeli individuals shall be subject to tax at a rate of 15%.

This is a major change in policy from the pre-2011 Amendment FIC route discussed above, which encouraged foreign investment in Israeli companies having AE programs by providing for increasingly reduced rates (e.g. 10% rate where 90% foreign owned). Further to the amendments, there will no longer be available any additional AE tax benefits specifically linked to foreign investment. Notwithstanding the cancellation of the tax holiday route, a distribution or deemed distribution of profits that were tax-exempted under the tax holiday route before the legislative change had taken effect shall continue to be subject to company tax at the applicable AE reduced rates in addition to the dividend WHT that will be imposed on the income distributed.

Although it would appear that the 2011 Amendments may result in an increased Israeli tax liability for many investors, depending on the particular circumstances, some investors may still benefit from the new changes. Consequently, each investor should examine the impact of such changes upon its financial results and prepare its action steps accordingly.

**Transition rules**
It should be noted that the 2011 Amended Law shall apply for income generated by an AE during 2011 and thereafter. Transition rules allow AE owners to elect to continue with the AE tax benefits allowed for under the Law prior to these amendments or to choose in any tax year to commence to apply the new provisions of the Law and to waive the remaining benefit period those AE benefits provided under the Law prior to its amendment. Once such an election is made by the taxpayer to implement the new provisions, it may not be altered in future tax years. Moreover, as part of the transition rules, an AE owner is generally allowed to elect until 2012 to apply for a new AE status under the terms of the Law in effect prior to its amendment, so long as part of the relating investment was made during 2010. This election can allow the AE owner to further extend the benefits available under the terms of the Law prior to the legislation.

### *Research and development (R&D) incentives*
Under special relief provided under the ITO which was enacted for the purpose of encouraging taxpayers to invest in R&D activities, R&D costs can generally be deductible for tax purposes even when they represent capital costs.



The ITO provision generally distinguishes between two types of investors in R&D projects:

- The R&D project is conducted or sponsored by the owner of an enterprise in the fields of industry, agriculture, transportation, and energy, and it is intended to develop this enterprise.
- The R&D costs are borne by a taxpayer that is not the owner of an enterprise in the above mentioned fields or the taxpayer participates in R&D costs of another developer in consideration for a reasonable return, when such R&D projects also enjoy government grants.

In regard to the first group of taxpayers, the R&D expenses shall be deducted in the tax year incurred when such expense has been approved as an R&D expense by the relevant government department (the approval in regard to industrial related projects is generally granted by the Office of the Chief Scientist (OCS)). When such OCS approval is not obtained, the expense shall be deducted over three tax years.

The R&D expenses incurred by the second group of taxpayers shall generally be deducted over two tax years. The deductible expenses allowed to a participant in R&D costs of another developer generally may not exceed 40% of the taxable income of the investor in the year in which the expenses had been incurred.

For acquisitions between 1 January 2011 and 31 December 2015, an Israeli tax resident company that acquires a controlling interest in a private Israeli company that meets certain R&D activity levels shall be entitled to amortize its acquisition amount (i.e. consideration paid for shares less the purchased company's positive equity capital if any) from its taxable income equally over five years beginning with the tax year following the acquisition. Entitlement to this deduction is subject to the fulfillment of detailed qualifying conditions which include inter alia that both companies have AE plans in the year of acquisition, meet certain R&D investment levels, employ a certain prescribed percentage of employees having academic degrees in certain qualifying fields, and for the first three years of the amortization period the R&D expenses of the acquired company are incurred for its own company or that of the purchasing company and at least 75% of such expenses are incurred in Israel. Detailed rules apply.

### *Tax credit for donations*
A tax credit is granted in respect of donations to approved state and charitable institutions aggregating at least ILS 310 (for 2010) in a tax year. The donor is allowed a tax credit equal to the amount of the contribution times the corporate tax rate applicable during the year, provided the donations do not exceed the lower of the following: (i) 30% of the corporation's taxable income in that year or (ii) ILS 7,636,000 (in 2010). The above figures are adjusted each year according to the CPI. Excess unused tax credits may be carried forward for three years subject to detailed rules.

### *Incentive to promote foreign investment in Israeli corporate bonds*
In order to promote foreign investment in the Israeli corporate bonds market, there is an exemption from tax with respect to interest income received by foreign investors on or after 1 January 2009 on their commercial investments in Israeli corporate bonds traded on the Tel Aviv stock exchange (TASE). The exemption is not granted to a foreign investor that has a PE in Israel or is related to, or holds 10% more of the means of control in, the investee company. In addition, in order for the exemption to apply to a foreign investor that has 'special relations' with the investee company, regularly sells products to or provides services to the investee company, or is employed by the investee company, the investor must prove that the interest rate on the corporate bond was determined in good faith.

## *Withholding taxes*

Under Israeli domestic tax law, a 25% WHT on payments of Israeli-source income is generally deducted by an Israeli paying bank from all income remittances abroad, unless a tax certificate is obtained from the ITA authorising withholding-exempt remittances or a reduced rate of tax pursuant to an applicable tax treaty.

Set out below is a listing of WHT rates for dividends, interest, and royalties under domestic tax law and pursuant to tax treaties in force. Detailed rules apply under certain tax treaties for eligibility to the treaty reduced rates (e.g. beneficial ownership, having no permanent establishment in Israel). The applicable tax treaty should be consulted to determine the relevant WHT rate and to examine detailed conditions that may apply for the specific circumstance.

| Recipient | Dividends (%) | Interest * (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations | 0/25 | 25 | 25 |
| Resident individuals | 20/25 | 15/35 | 30 |
| Non-resident corporations: | | | |
| Non-treaty | 20/25 | 25 | 25 |
| Treaty: | | | |
| Austria | 25 | 15 | 0/10 (49) |
| Belarus | 10 | 5/10 (30) | 5/10 (50) |
| Belgium | 15 | 15 | 0/10 (51) |
| Brazil | 10/15 (1) | 15 | 10/15 (52) |
| Bulgaria | 10/12.5 (2) | 5/10 (31) | 12.5 (53) |
| Canada | 15 | 15 | 0/15 (54) |
| China, P.R. | 10 | 7/10 (32) | 10 (55) |
| Croatia | 5/10/15 (3) | 5/10 (33) | 5 |
| Czech Republic | 5/15 (4) | 10 | 5 |

| Recipient | Dividends (%) | Interest * (%) | Royalties (%) |
|---|---|---|---|
| Denmark | 25 | 25 | 10 |
| Estonia | 0/5 (5) | 5 | 0 |
| Ethiopia | 5/10/15 (6) | 5/10 (34) | 5 |
| Finland | 5/15 (7) | 10 | 10 |
| France | 5/10/15 (8) | 5/10 (35) | 0/10 (56) |
| Germany | 25 | 15 | 0/5 (57) |
| Greece | 20/25 (9) | 10 | 10 |
| Hungary | 5/15 (10) | 0 | 0 |
| India | 10 | 10 | 10 |
| Ireland, Rep. of | 10 | 5/10 (36) | 10 |
| Italy | 10/15 (11) | 10 | 0/10 (58) |
| Jamaica | 15/22.5(12) | 15 | 10 |
| Japan | 5/15 (13) | 10 | 10 |
| Korea, Rep. of | 5/10/15 (14) | 7.5/10 (37) | 2/5 (59) |
| Latvia | 5/10/15 (15) | 5/10 (38) | 5 |
| Lithuania | 5/10/15 (16) | 10 | 5/10 (60) |
| Luxembourg | 5/10/15 (17) | 5/10 (39) | 5 |
| Mexico | 5/10 (18) | 10 | 10 |
| Moldova | 5/10 (19) | 5 | 5 |
| Netherlands | 5/10/15 (20) | 10/15 (40) | 5/10 (61) |
| Norway | 25 | 25 | 10 |
| Philippines | 10/15 (21) | 10 | 15 |
| Poland | 5/10 (22) | 5 | 5/10 (62) |
| Portugal | 5/10/15 (23) | 10 | 10 |
| Romania | 15 | 5/10 (41) | 10 |
| Russia | 10 | 10 | 10 |
| Singapore | 5/10 (24) | 7 | 5 |
| Slovakia | 5/10 (25) | 2/5/10 (42) | 5 |
| Slovenia | 5/10/15 | 5 | 5 |
| South Africa | 25 | 25 | 0 (63) |
| Spain | 10 | 5/10 (43) | 5/7 (64) |
| Sweden | 0 | 25 | 0 (65) |
| Switzerland | 5/10/15 (26) | 5/10 (44) | 5 |
| Taiwan (R.O.C.) | 10 | 7/10 (45) | 10 |
| Thailand | 10/15 (27) | 10/15 (46) | 5/15 (66) |
| Turkey | 10 | 10 | 10 |
| Ukraine | 5/10/15 (28) | 5/10 (47) | 10 |
| United Kingdom | 15 | 15 | 0 (67) |
| United States | 12.5/25 (29) | 10/17.5 (48) | 10/15 (68) |
| Uzbekistan | 10 | 10 | 5/10 (69) |
| Vietnam | 10 | 10 | 5/7.5/15 (70) |

Notes

* Some Israeli tax treaties provide for an exemption from WHT on interest involving governmental and quasi-governmental parties. Such exemptions are not separately indicated in the table above.

1. 10% where beneficial owner holds directly at least 25% of the capital of the company paying the dividends.

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2. At a rate which is 50% of the rate which would have been imposed but for this provision but not to exceed 12.5 % and not less than 7.5%. A 10% rate applies where paid from profits generated by an enterprise entitled to special tax rates under the Encouragement of Investment Law.
3. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends where that latter company is a resident of Israel and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax; 15% rate applies in all other cases.
4. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 15% of the capital of the company paying the dividends; 15% rate in all other cases.
5. 0% if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends; 5% rate in all other cases.
6. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends where that latter company is a resident of Israel and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax; 15% rate in all other cases.
7. 5% if the beneficial owner is a company (other than a partnership) which controls directly at least 10% of the voting power in the company paying the dividends; 15% rate in all other cases.
8. 5% if the beneficial owner is a company which holds directly or indirectly at least 10% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly or indirectly at least 10% of the capital of the company paying the dividends and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax; 15% rate in all other cases.
9. At the domestic Israeli tax rate.
10. 5% if the recipient holds directly at least 10% of the capital of the company paying the dividends.
11. 10% if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends.
12. 15% if the beneficial owner is a company (other than a partnership) which holds directly or indirectly at least 10% of the voting power of the company paying the dividends.
13. 5% if the beneficial owner is a company which owns at least 25%of the voting shares of the company paying the dividends during the period of six months immediately before the end of the accounting period for which the distribution of profits takes place.
14. 5% if the beneficial owner is a company which holds directly or indirectly at least 10% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds 10% of the capital of the company paying the dividends and the dividends are paid out of profits which are subject to tax at a rate which is lower than the normal rate of the corporation tax; 15% rate in all other cases.
15. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends where the dividends are paid out of profits which by virtue of provisions in the Israeli Law of Encouragement of Investments in Israel are exempt from tax or subject to tax at a rate that is lower than the normal rate of Israeli company tax; 15% rate in all other cases.
16. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 10 % of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends where the dividends are paid out of profits which by virtue of provisions in the Israeli Law of Encouragement of Investments in Israel are exempted from tax or subject to tax at a rate that is lower than the normal rate of Israeli company tax; 15% rate in all other cases.
17. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax; 15% rate in all other cases.
18. 5% if the beneficial owner is a company which holds directly or indirectly at least 10% of the capital of the company paying the dividends.
19. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends.
20. With respect to dividends paid to a company which holds directly at least 25%of the capital of the company paying the dividends: (i) 10% where the dividends are paid out of profits which, by virtue of provisions in Israeli law for the encouragement of investment in Israel, are exempted from tax or subject to tax at a rate that is lower than the standard rate levied on the profits of a company resident in Israel; (ii) 5% where paid out of regularly taxed profits. A 15% rate applies in all other cases.
21. 10% if the beneficial owner is a company (excluding partnership) which holds directly at least 10% of the capital of the paying company.
22. 5% if the recipient holds directly at least 15% of the capital of the company paying dividends.
23. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends where that latter

company is a resident of Israel and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax; 15 % rate in all other cases.
24. 5% if the beneficial owner holds directly at least 10% of the capital of the company paying the dividends.
25. 5% if the recipient holds directly or indirectly at least 10% of the capital of the company paying the dividends.
26. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends where that latter company is a resident of Israel and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax; 15% rate in all other cases.
27. 10% if the dividends if the recipient holds at least 25% of the capital of the company paying the dividends.
28. 5% if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends; 10% if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends where that latter company is a resident of Israel and the dividends are paid out of profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israeli company tax.
29. 12.5% but only if (i) during the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10% of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation, and (ii) not more than 25% of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, 50% or more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received). A 15% rate applies for payments from income derived during any period for which the paying corporation is entitled to the reduced tax rate applicable to an approved enterprise under Israel's Encouragement of Capital Investments Law (1959). A 25% rate applies in all other cases.
30. 5 %for interest in connection with the sale on credit of any industrial, commercial, or scientific equipment or on any loan of whatever kind granted by a bank.
31. 5% for interest in the case of a bank or other financial institution.
32. 7% for interest received by any bank or financial institution.
33. 5% for interest paid on a loan granted by a bank.
34. 5% for interest paid on any loan of whatever kind granted by a bank.
35. 5% where in connection with the sale on credit of any industrial, commercial, or scientific equipment, or sale on credit of any merchandise by one enterprise to another enterprise, or on any loan of whatever kind granted by a bank loans made by banks; 10% in all other cases. An election can be made to be taxed on the net amount of the interest as if such interest were business profits.
36. 5% for interest paid in connection with the sale on credit of any industrial, commercial, or scientific equipment, sale on credit of any merchandise by one enterprise to another enterprise, or on any loan of whatever kind granted by a bank.
37. 7.5 % for interest if received by any bank or financial institution.
38. 5 % where paid on any loan of whatever kind granted by a bank.
39. 5% where paid on any loan of whatever kind granted by a bank.
40. 10% where paid to a bank or a financial institution.
41. 5% where paid in connection with the sale on credit of any industrial, commercial, or scientific equipment, or sale on credit of any merchandise by one enterprise to another enterprise, or on any loan of whatever kind granted by a bank.
42. 2% rate applies to government debt or government-assisted debt; 5% rate applies when paid to a financial institution; 10% rate applies in all other cases.
43. 5% rate in connection with the sale on credit of any industrial, commercial, or scientific equipment, or in connection with the sale on credit of any merchandise by one enterprise to another enterprise, or on any loan granted by a financial institution.
44. 5% rate for interest paid on any loan of whatever kind granted by a bank.
45. 7% rate for interest paid on any loan of whatever kind granted by a bank.
46. 10% rate for interest received by any financial institution (including an insurance company).
47. 5% rate for interest paid on any loan of whatever kind granted by a bank.
48. 10% for interest derived from a loan of whatever kind granted by a bank, savings institution, or insurance company or the like. 17.5% rate for other interest. An election may be made to be taxed on interest income as if that income were industrial and commercial profits.
49. 0% for literary, dramatic, musical, or artistic work copyright royalties (excluding in respect of motion picture films or films for use in connection with television).
50. 5% for copyright royalties for literary, artistic, or scientific work (excluding cinematograph films) or for the use of, or the right to use, industrial, commercial, or scientific equipment or road-transport vehicles.
51. 0% for copyright royalties for literary, dramatic, musical, artistic, or scientific work (excluding in respect of films for cinema or television).
52. 15% for trademark royalties.
53. The rate is 50% of the rate which would have been imposed but for the treaty provision but not to exceed 12.5% and not to be less than 7.5%.

54. 0% for copyright royalties for the production or reproduction of any literary, dramatic, musical, or artistic work (but not including royalties in respect of motion pictures).
55. For industrial, commercial, and scientific equipment royalties, the 10% rate applies to the adjusted amount of the royalties (70% of the gross amount of the royalties).
56. 0% for copyright royalties for literary, artistic or scientific work (excluding cinematograph films).
57. 0% for copyright royalties for literary, dramatic, musical, or artistic works.
58. 0% for copyright royalties for literary, artistic, or scientific work (excluding cinematograph films or tapes for television or broadcasting).
59. 2% for industrial, commercial, and scientific equipment royalties.
60. 5% for industrial, commercial, and scientific equipment royalties.
61. 10% for royalties for cinematograph films and films or video-tapes for radio or television broadcasting.
62. 5% for industrial, commercial, or scientific equipment royalties.
63. For royalties in respect of cinematograph or television films, the WHT rate shall not exceed tax at the rate applicable to companies on 15% of the gross amount of the royalty.
64. 5% for royalties for copyrights of literary, dramatic, musical, artistic work, or for the use of, or the right to use, industrial, commercial, or scientific equipment.
65. The definition of royalties does not include any royalty or other amount paid in respect of (i) the operation of a mine or quarry or of any other extraction of natural resources or (ii) in respect of cinematograph including television films.
66. 5% for royalties for literary, artistic or scientific work, excluding cinematograph films or films or tapes used for radio, or television broadcasting
67. For royalties in respect of cinematograph or television films, tax may be imposed in Israel, but not to exceed tax at the rate applicable to companies on 15% of the gross amount of the royalty.
68. 10% for copyright or film royalties.
69. 5% of the gross amount of the royalties where such royalties consist of payments of any kind received as a consideration for the use or the right to use any copyright of literary, artistic, or scientific work (excluding cinematograph films).
70. 5% for royalties for any patent, design or model, plan, secret formula or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience; 7.5% for technical fees; 15% for all other royalties.

## *Tax administration*

### *Returns*

The tax year is generally the calendar year. Certain entities may apply to have their tax year-end on different dates, specifically, mutual funds, government companies, quoted companies, and subsidiaries of foreign publicly listed companies.

The Israeli system is based on a combined form of assessment and self-assessment.

The statutory filing date is five months following the end of the tax year, which for a calendar year taxpayer would be 31 May. It is possible, however, to secure extensions of the filing date.

### *Payment of tax*

Generally, 12 monthly advance payments are levied at a fixed ratio of the company's turnover. Alternatively, a company may be required to make ten monthly payments beginning in the second month of its tax year, each payment being a fixed percentage of the previous year's tax assessment.

Penalties are imposed on overdue advance payments and on delays in the submission of tax returns. The balance of any taxes due is payable from the beginning of the following tax year and is linked to the CPI; it bears interest of 4% until paid.

### *Statute of limitations*

The statute of limitation period for corporate tax is three years from the end of the tax year in which the relevant tax return is filed. The Commissioner of the Tax Authorities has the authority to extend this period to four years.

## Other issues

### Choice of business entities

Investments and business operations in Israel may be structured in a variety of ways. The following are the common types of business entities in Israel: (i) Israeli public or private company; (ii) foreign company in Israel (i.e. a branch); (iii) Israeli general or limited partnership; (iv) foreign general or limited partnership; (v) other entities such as cooperative societies; and (vi) other arrangements (e.g. contractual joint ventures).

### Mergers and acquisitions

Israeli tax law allows for non-taxable reorganisations in situations in which the ownership and business enterprise of the original parties is continued after the reorganisation takes place, allowing for the deferral of the tax liability until the shares or assets transferred in such reorganisations are actually sold. Different qualifying requirements and conditions apply (e.g. obtaining a ruling from the ITA in certain cases), depending upon the tax residency of the parties and the type of transfer.

# Italy

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## Significant developments

The major recent changes in the Italian tax rules enacted in 2010/2011 are as follows:

- Penalty protection regime with transfer pricing documentation support.
- Changes to the controlled foreign companies (CFC) rules.
- Offsetting of taxes.
- Changes to value-added tax (VAT).
- New tax incentives.

Please note that Italy tax updates are generally expected from June to September in connection with the finance bill and related laws approval. In this respect, we suggest visiting the Worldwide Tax Summaries website at www.pwc.com/taxsummaries after September each year in order to check whether or not relevant changes affect your business.

### Penalty protection regime with transfer pricing documentation support

Transfer pricing adjustments will no longer be subject to administrative penalties if proper documentation is drawn up and kept available in order to be provided during a tax audit.

Documentation content guidelines have been issued by tax authorities.

Starting from fiscal year 2010, the possession of the documentation must be notified with the tax authorities by filing the annual corporate income tax return. A notification mechanism is provided for previous fiscal years.

### CFC rules modification

Conditions for the applicability of CFC rules have been modified. In addition, CFC rules may also be applicable to certain controlled companies that are not resident in tax havens.

### Offsetting of taxes

As of 1 January 2011, there is a new prohibition of tax credits' offsetting tax debts amounting to more than 1,500 euros (EUR) which have been definitively assessed by the tax authorities and not paid by the taxpayer on time.

### VAT changes

As of 1 April 2011, the supply of mobile telephones and micro processors within the Italian Territory are subjected to the reverse charge mechanism.

As of 1 January 2011, changes regarding the VAT treatment of cultural, artistic, sporting, scientific, educational, recreational, and similar activities and their access, comprised herein of fairs and exhibitions, provision of services of organisers of said activities, and provision of services incidental to the foregoing have entered into force.

As of July 2010, transactions carried out with subjects resident in 'black list' countries must be disclosed in periodical communications to be electronically filed with the tax authorities. An electronic communication to the tax authorities has been introduced for VAT transactions exceeding EUR 3,000.

### *New tax incentives*

#### Tax credits for research and development (R&D) investments

A tax credit for financing R&D projects carried out by universities and other qualified organisations may be obtained for 2011 and 2012.

#### Tax credits for new permanent employment in the south regions

A tax credit is available in the case of new employment of specific categories of workers in the south Italian regions (i.e. Abruzzo, Basilicata, Calabria, Campania, Puglia, Molise, Sardegna, Sicilia).



## *Taxes on corporate income*

Italian corporate entities are subject to a 27.5% corporate income tax, known as Imposta sul REddito delle Società (IRES) and to a 3.9% regional production tax, known as Imposta Regionale sulle Attività Produttive (IRAP).

A 6.5% increase (surtax) to the IRES rate is applied to companies operating in the areas of oil and gas refining, production, or trade and in electrical energy (production or trade) whose turnover exceeded EUR 25 million in the prior fiscal year.

IRES taxable base is determined according to the worldwide taxation principle, providing that, regardless of the location/jurisdiction where the income is produced, to the extent that the income is legally attributable to an Italian resident entity, the income is taxed in Italy. IRES is charged on the total net income reported in the financial statements of the company as adjusted for specific tax rules. Non-resident companies are taxed only on Italian-source income.

There are different methods of computation for the IRAP taxable base, depending on the nature of the business carried out by the taxpayer. Labour costs (with limited exceptions), provisions for liabilities and risks, and extraordinary items cannot be taken into account in determining the IRAP taxable base.

For sales and manufacturing companies, the IRAP taxable base is broadly represented by the company's gross margin in its financial statements. In addition to the non-deductible items mentioned above, interest income and expense and provisions for bad debts are excluded for the purposes of the IRAP taxable base.

For banks, the IRAP taxable base is broadly defined as follows:

- Intermediation margin reduced by 50% of dividends.
- 90% of amortisation costs relating to fixed tangible and intangible assets.
- 90% of other administrative expenses.

Special rules apply to financial institutions, other than banks.

IRAP is levied on a regional basis, and regions are allowed to increase or decrease the standard IRAP rate up to 0.9176%. Companies with facilities in different regions must allocate their overall taxable base to the different regions on the basis of the employment costs of personnel located at the various sites. Facilities become relevant to the calculation of IRAP if they have been established for more than three months. Italian companies with permanent establishments (PEs) abroad, as well as shipping companies qualifying for the tonnage tax regime *(see Tonnage tax below)*, are not subject to IRAP on the income earned through these PEs.

Some Italian regions (Abruzzo, Basilicata, Calabria, Campania, Molise, Puglia, Sardegna, and Sicilia) may reduce/set the rates of IRAP to zero. Terms and conditions for the applicability of IRAP will be set out in a specific Decree to be issued by the President of Council of Ministers in agreement with each region.

Note that for 2010, there was a 0.15% increase in the IRAP rates for the regions of Lazio, Campania, Molise, and Calabria.

### *Substitutive tax on reorganizations (mergers, demergers, contribution in kind)*

Corporate restructurings such as contributions in kind, (assets vs shares transactions) mergers, and demergers are, in principle, tax neutral even if, for financial accounting purposes, the transaction results in the recognition of higher values of the assets or of a goodwill. Companies may elect to obtain partial or full recognition for tax purposes of the step-up in the financial accounting values of assets or of the goodwill arising from the corporate restructurings provided they pay a substitutive tax.

The substitutive tax is calculated on the step-up in tax basis and is based on progressive rates of 12% to 16%. The first EUR 5 million is taxed at 12%, the tranche above EUR 5 million but less than EUR 10 million is taxed at 14%, and the amount in excess of EUR 10 million is taxed at 16%. The substitutive tax may also be paid in three annual instalments of 30% in the year of election, 40% in year two, and 30% in year three plus interest at the rate of 2.5% per year on the deferred amounts. The substitutive tax is not deductible for the purposes of IRES or IRAP.

In addition, stepped-up values of goodwill and trademarks may be depreciated for tax purposes over ten tax years instead of the normally allowed 18 years by paying a substitutive tax of 16%. The higher tax depreciation arising from this election is effective from the tax period subsequent to the one in which the substitutive tax is paid. For example, if a merger transaction occurred in year one and the substitutive tax was paid in year two, the increased tax depreciation would begin in year three.

### *Tonnage tax*

Italian tax resident shipping companies, as well as non-resident shipping companies operating in Italy through a PE, can qualify for and then elect to be subject to the Italian tonnage tax regime. The regime basically allows for the determination of presumptive income based on the net tonnage of the qualifying ships apportioned to the effective shipping days (tonnage income). The tonnage income is subject to IRES only.

To qualify for the tonnage tax, ships must: (i) have a net tonnage of more than 100 net tons (NT); (ii) be used for goods transportation, passenger transportation, salvage, towing, and other services; and (iii) operate in international shipping as defined by the rules disciplining Italian International Registry. Ships chartered out on a bare boat charter are excluded. Chartered in ships with crew are included in the tonnage tax regime if their global net tonnage is less than 50% of the total net tonnage.

Tonnage income is calculated on the basis of the ship's net tonnage. The daily income is determined according to the following rate system:

| Ship's net tonnage (NT) | Daily income in EUR per NT |
|---|---|
| 0 to 1,000 | 0.0090 |
| 1,001 to 10,000 | 0.0070 |
| 10,001 to 25,000 | 0.0040 |
| above 25,001 | 0.0020 |

No deductions are allowed from tonnage tax income.

Income and expenses from the following activities are all deemed to be covered by the tonnage income determined as previously discussed:

- Transport of goods.
- Transport of passengers.
- Salvage and towing.
- Other services that need to be performed on the high seas.
- Charges related to the above mentioned activities (e.g. administrative and commercial expenses, insurances fees).
- Other operations performed in close connection with the transportation operations (e.g. loading and unloading).
- Other minor activities.

Capital gains or losses arising from the transfer of ships that have been acquired by a company, while under the tonnage tax regime, are also deemed to be included in tonnage tax income. Conversely, for capital gains arising from the transfer of a ship acquired prior to election for the tonnage tax regime, the difference between the sale price and the net tax cost as of the last tax period prior to the election for the tonnage tax regime is subject to the ordinary tax regime. Tax losses, in this latter case, are tax deductible.

An election for the tonnage tax regime should be made for all of a company's or group's qualifying vessels. So called 'cherry picking' is not allowed. Election for the tonnage tax regime is on a voluntary basis, but, once elected, it remains in effect for ten years. The election is renewable.

## *Corporate residence*

### *Corporate residence of companies*

Companies having their legal or administrative headquarters or their principal business activity within the Italian territory are considered to be resident companies and are taxable in Italy on their worldwide income.

A foreign company holding one or more Italian subsidiaries is deemed to be resident of Italy for tax purposes if at least one of the following conditions exists:

- The foreign company is, either directly or indirectly, held by Italian tax resident persons.
- The board of directors of the foreign company is made up mainly of Italian resident individuals.

Non-resident companies are subject to IRES and IRAP only on their Italian-source income. Specifically, Italian non-resident companies having a PE in Italy are subject to IRES and IRAP with respect of the taxable income generated from the PE in Italy.

### *Permanent establishment (PE)*
The domestic definition of PE is substantially aligned with the OECD model.

### *Corporate residence of a trust*
Trusts are considered as persons subject to corporate taxation.

Residence is defined on the basis of the location of the place of management and of the main object of the trust. In the first instance, trusts that operate through an appropriate structure are deemed to be tax resident in Italy, if the said structure is located in Italy. In the absence of any such structure, trusts managed by a trustee will be deemed as tax resident in Italy, if the trustee is tax resident in Italy. In addition, trusts that have the largest part of their assets located in Italy are deemed a tax resident in Italy.

Note that there are anti-avoidance rules for Italian non-resident trusts, setting out the specific conditions on which these trusts can become Italian tax resident.

## *Other taxes*

### *Value-added tax (VAT)*
Italian VAT (Imposta sul Valore Aggiunto) applies to the supply of goods and services carried out in Italy by entrepreneurs, professionals, or artists and on importations carried out by anyone. Intra-community acquisitions are also subject to VAT taxation under certain situations.

The Italian standard VAT rate is 20%. Reduced rates are provided for specifically listed supplies of goods and services, such as 4% for listed food, drinks, and agricultural products and 10% for electric power supplies for listed uses and listed drugs. Intra-community supplies and exports are exempt from VAT.

Specific supplies of goods and services expressly listed in the law are exempt from VAT (e.g. public postal services, hospital and medical care, education, insurance services, specific financial services, supply, leasing of particular immovable property). Other specifically listed transactions are also out of the VAT application scope (e.g. transfer of money, transfer of business parts).

Input VAT on purchases of goods and services related to business activity generally is allowed for recovery. Special limitations apply in relation to specific items (e.g. cars, entertainment expenses).

The filing deadline for VAT returns is 30 September.

#### Service supply rules
Services supplied by a taxable person to another taxable person (business to business or B2B) are in the scope of the Italian VAT if the services are supplied to Italian taxable persons or to PEs of an Italian non-resident entity.

The general rules are as follows:

- For services related to immovable property, reference must be made to the place in which the immovable property is located.
- For the transportation of passengers, the place in which the transportation takes place must be identified including the proportion of the distance covered.
- For catering and restaurant services, the place in which the activity will be physically carried out must be identified.
- For short term hiring, leasing, and similar of means of obtaining transport services, the place in which the vehicle is used must be identified (use and enjoyment rule has been implemented on these services).

The general rule for services supplied by a taxable person to a non-taxable person (business to consumer or B2C) identifies the place of taxation with the country of residence of the supplier.

Several rules, in addition to the B2B general rules, exist for the following:

- Brokerage services.
- Goods transport services.
- Services related to movable goods and ancillary activities related to transports.
- Long term hiring/leasing of means of transport services.
- Electronic services supplied by extra-European Union (EU) suppliers.
- Telecommunications and television/radio broadcast services.

In addition, special rules are provided for intangible services provided to final customers established outside the European Union.

In relation to the VAT treatment of cultural, artistic, sporting, scientific, educational, recreational, and similar services, the follow rules apply:

- Before 31 December 2010, these activities were subject to VAT in the country where they were physically carried out (same treatment for B2B and B2C, including the admission to the events).
- After 1 January 2011, the VAT treatment for B2C activities remains unchanged. For B2B activities other than admission, however, VAT is due in the country of the recipient. For B2B services in respect of admission, the place of supply is where the events take place.

### Reporting obligation
As of July 2010, transactions carried out with subjects resident in 'black list' countries (i.e. tax haven jurisdictions) must be disclosed in periodical communications to be electronically filed with the tax authorities.

An electronic communication to the tax authorities has been introduced for VAT transactions exceeding EUR 3,000. Specific transactions are excluded from the communication, regardless of their amount (e.g. importations, exportations, and other transactions which have already been communicated to the Tax Authorities, such as black list, insurance, electricity supply, and telephone services contracts).

### Reverse charge mechanism extension
According to the reverse charge mechanism, the obligations related to supply of goods and provision of services carried out in Italy by non-resident taxable persons towards taxable persons established in Italy are fulfilled by the latter. From a practical point of

view, the recipient of goods and/or services has to issue a self-invoice and record it in the VAT sales register and VAT purchase register.

The reverse charge mechanism obligation has been extended to the supply of all goods and services in the scope of the Italian VAT carried out by non-resident entities to taxable persons resident in Italy. Non-resident entities (including those having an Italian VAT number through indirect or direct registration) cannot charge Italian VAT to an Italian established VAT person.

Note that sales within the Italian territory of:

- mobile telephones, being devices made or adapted for use in connection with a licensed network and operated on specified frequencies, whether or not they have any other use, and
- integrated circuit devices, such as microprocessors and central processing units, in a state prior to integration into end-user products

are subject to the reverse charge in case the recipient of the above goods is a taxable person in Italy. This mechanism is not applicable to retail sales and when the supply of the handset is ancillary to the airtime.

### VAT credit offset with other taxes

From 2010, to offset a VAT credit against other taxes for an amount higher than EUR 10,000, it will be necessary to wait until the 16th day of the month following the filing of the yearly VAT return on which the credit is shown.

Furthermore, in order to avoid abuse, taxpayers intending to offset a VAT credit for an amount greater than EUR 15,000 are required to ask their tax advisors or auditors to affix their signature to the VAT return, which is known as the 'conformity mark'.

## *Registration tax*

Specific deeds and contracts must be filed with the local registration tax office either upon signature or if specific circumstances occur, and the relevant tax must be paid.

Depending on the nature of the contract and on the assets that are the object of the contract, as well as on the form of the contract, registration tax is levied as a fixed amount or as a percentage of the value of the goods and/or rights that are the object of the contract. As a general rule, no proportional registration tax is due in the case of transactions subject to VAT.

## *VAT and registration tax on lease of immovable properties*

Leases, including financial leases, of residential and commercial buildings, or portion thereof, generally are VAT exempt and subject to the registration tax at 2% or 1% rate.

Please refer to the table below for an overview of the tax regime applicable to the leases, including financial leases, of both residential and commercial buildings.

| Type of building | Lessor (VAT status) | Lessee (VAT status) | VAT (%) | Registration tax (%) |
|---|---|---|---|---|
| Residential buildings | Individual or entities not acting in the course of business (not subject to VAT) | Any | Out of scope | 2 |

| Type of building | Lessor (VAT status) | Lessee (VAT status) | VAT (%) | Registration tax (%) |
|---|---|---|---|---|
| Commercial buildings | Individual or entities not acting in the course of business (not subject to VAT) | Any | Out of scope | 2 |
| Residential buildings | Taxable persons acting in the course of business | Any | Exempt (with no right to deduction)* | 2 |
| Commercial buildings | Taxable persons acting in the course of business | Individual or entities not acting in the course of business (not subject to VAT) | 20 | 1 |
| | | VAT taxable persons with a VAT recoverable pro-rata not higher than 25% | 20 | 1 |
| | | Other cases | Exempt (with non-right to deduction) with the possibility for the lessor to opt for the VAT regime (20% rate) | 1 |

* In some specific cases of subsidized housing, VAT is applicable at a 10% reduced rate.

### *Stamp duty taxes*

Stamp duty taxes (Imposta di Bollo) apply on a certain list of deeds or documents provided for by the relevant law provision (e.g. checks, bills of exchange, statements of account, certificates, books of account, deeds of transfer of quotas, and, in some cases, invoices).

According to the kind of deed, stamp duty tax is due at the moment of the deeds' origin or in case of use and can be a fixed amount or an amount proportional to the value of the deed or document.

Stamp duty tax can be paid:

- ordinarily, through a physical stamp attached on the document, or
- virtually, through electronic means (in this case a specific authorization from the Italian Tax Authorities and a specific process are needed).

Stamp duty tax is usually alternative to VAT; however, in case of considerations partially subject to VAT and partially not subject to VAT, the invoice is subject to stamp duty tax if the total amount of the considerations not subject to VAT exceeds EUR 77.46. Moreover, some transactions are stamp duty tax exempted (e.g. inter-community supply of goods). For transactions which are exempted from VAT (with restriction on VAT credit) and for transactions out of scope of VAT, an amount of EUR 1.81 is due as stamp duty tax for every invoice issued.

### *Customs duty*

At the moment of the importation of goods into the EU territory, customs duties are applied. The amount of customs duties to pay depends on the value and nature of the goods imported. In particular, for each kind of good, the Common Customs Tariff provides a tax-rate to be applied to the value of the goods imported.

The correct classification of the goods is one of the most important issues to consider when an economic operator introduces goods in Italy. A wrong classification can give rise to the application of higher customs duties, and the operator could face a tax burden not due, or to the application of lower customs duties, and this situation could lead to a Tax Assessment by Italian Customs Authority.

The value of the goods is represented by the transaction value, hence, the price actually paid or payable for the goods when sold for exportation to the customs territory of the EU, provided that:

- there are no restrictions as to the disposal or use of the goods by the buyer
- the sale or price is not subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued
- part of the profits of any subsequent resale, disposal, or use of the goods by the buyer will not be accrued, directly or indirectly, to the seller, and
- the buyer and seller are not related, or, where the buyer and seller are related, that the transaction value is acceptable for customs purposes.

In determining whether the transaction value is acceptable, the fact that the buyer and the seller are related is not, in itself, sufficient for considering the transaction value as non-acceptable. Where necessary, the circumstances surrounding the sale are examined, and the transaction value is accepted provided that the relationship did not influence the price.

The price actually paid or payable is the total transaction amount paid for the imported goods and includes all payments made as a condition of sale of the imported goods by the buyer to the seller or by the buyer to a third party to satisfy an obligation of the seller.

In determining the customs value, the following items shall be added to the price, to the extent that they are incurred by the buyer and are not included in the price (list not exhaustive):

- Commissions and brokerage.
- Royalties and license fees related to the goods under assessment.
- The cost of transport and insurance of the imported goods.

At the same time, provided that they are shown separately from the price actually paid or payable, the following items shall not be included in to the customs value (list not exhaustive):

- Charges for the transport of goods after their arrival at the place of introduction into the customs territory of the European Community (EC).
- Charges for construction, erection, assembly, maintenance, or technical assistance, undertaken after importation of imported goods such as industrial plant, machinery, or equipment.
- Buying commissions.

A reduced tax-rate at importation can be applied when the goods imported have a preferential origin. The preferential origin depends on the existence of commercial agreements between the European Community and other non-EC states or by facilities provided by European Community to non-EC states unilaterally.

The application of a reduced tax-rate can even depend on the existence of preferential tariff treatment or on the existence of a particular exemption provided by law for some kind of goods.

Any person may appoint a representative in one's dealings with the Customs Authority to perform the activities and formalities laid down by customs rules. Such representation may be direct, in which case the representative shall act in the name and on behalf of another person, or indirect, in which case the representatives shall act in one's own name but on behalf of another person.

For direct representation, a forwarding agent, holder of a particular license, must be appointed.

The representative must be established within the European Community.

### *Excise duty*

The following goods are subject to excise duties:

- Energetic products (e.g. petrol, gas oil, natural gas, coal).
- Alcohol and alcoholic drinks (e.g. wine, beer, ethylic alcohol).
- Processed tobaccos (e.g. cigars, cigarettes, tobacco).
- Electric power.

The subjection of a product to excise duties has to be verified on the basis of its customs combined nomenclature code.

The tax liability, depending on the products, arises:

- at the moment of importation or production (and the excise duties must be paid at the moment in which they are released for consumption in Italy)
- when the excisable goods are used for heating or as fuel, and
- when the excisable goods are released for consumption or used for own use.

As a general rule (with exception from natural gas and coal, coke, and lignite), with reference to excise goods released for consumption during a month, the payment of the relative excise duties has to be done within the 16th day of the following month.

With reference to excise goods imported, customs rules are applied as far as the procedure and terms of payment concern.

The production, processing, and holding of 'excise goods', except from natural gas, coal, coke, lignite, and electric power, are subject to a suspensive regime performed through a fiscal warehouse.

In order to manage a fiscal warehouse, it is necessary to acquire a license issued by the Italian Customs Authority, and there are specific obligations for the owner of a fiscal warehouse (e.g. provide for a particular guarantee, keep a particular accounting system for the goods stored, be subject to controls performed by Italian Customs Authority, where requested).

The Italian legislation provides for many exemptions with regards to the use of 'excise goods'.

Furthermore, under certain circumstances, a tax refund is granted to the operator who released for consumption, if, afterwards, the products are not consumed in Italy.

### *Imposta Comunale sugli Immobili (ICI)*

ICI is the municipal tax on real estate. It is levied either on the owner or on the financial lessee of real estate (i.e. buildings, development land, and agricultural land). The tax rate ranges between 0.4% and 0.7%, depending on the rate set by the municipality where the property is located.

The taxable basis generally is determined on the basis of the so called 'cadastral value' (i.e. capitalisation of the income derived from the real estate).

## *Branch income*

The tax regime for PEs is the same as for corporate Italian entities (e.g. joint-stock companies). Accordingly, a branch is subject to IRES as well as IRAP. Both taxes are determined on the basis of the relevant financial statements related to the business activities carried out by the PE.

Transfer pricing principles apply to transactions between a head office and its Italian tax resident PE.

## *Income determination*

In principle, positive and negative components of a company's income statement are, respectively, taxed or deducted on an accruals basis (under the accrual principle) for tax purposes. Additionally, in order to be taxed/deducted, income items have to be certain under a legal standpoint and either objectively determined or capable of objective determination as to their amount (under the certain and objective determination principle). Income statement items accrued in the statutory accounts not meeting the above criteria are not allowed for tax deduction nor taxed as income in the tax period. Deduction or taxation of income is correspondingly deferred to future tax periods when the criteria are met.

Expenses generally are deductible if they relate to activities generating revenues concurring to the company's taxable income (under the inherence to business principle) and provided they are included in the relevant statutory accounts (under the imputation principle). An exception to this general rule is made for those income statement items accrued in the statutory accounts relating to a tax period different from that in which they become relevant for tax purposes in accordance with the principles of certainty and objective determination as described above. These items are taken into account in determining taxable income in the tax period when the latter conditions are met.

For IRAP purposes, relevant income and expense are those reported in the financial statements.

Specific rules have been released for entities which have adopted International Financial Reporting Standards (IFRS) for Italian statutory financial reporting purposes. These provisions are aimed to align income determination rules with IFRS.

### Inventory valuation

Italian tax law allows the application of all the most commonly used inventory valuation methods: last in first out (LIFO), first in first out (FIFO), average cost. For IRES only, the reference prices used to calculate the written down value of the inventory items cannot be lower than their market prices during the final month of the tax period.

Companies operating in the oil and gas sector are required to adopt either average cost or FIFO for tax purposes.

### Capital gains

Capital gains are taxable in the tax period in which they are realised, as follows:

- Fixed assets: the gain realised on the sale of fixed assets is taxable for both IRES and IRAP purposes. Additionally, for IRES purposes, tax on capital gains can be spread over a maximum of five years. This treatment is allowed provided that the company owns the fixed assets for not less than three years.
- Financial Investments: a specific participation exemption regime (PEX) is applicable. Under this regime, capital gains realized by Italian companies on sales of shareholdings are 95% exempt from IRES.



PEX applies if all of the following conditions are met:

- The shareholding was held uninterruptedly for at least 12 months prior to the sale.
- The investment was classified under financial fixed assets in the financial statements relating to the first tax period of uninterrupted ownership.
- The subsidiary is actually carrying on a commercial activity (e.g. investments in companies mainly performing management of their own real estate are not entitled to the PEX benefits).
- The majority of the subsidiary's income is not generated in a tax haven country or one with a privileged tax regime.

The third and fourth conditions must be met both at the time of the sale of the investment and in the three preceding years. If these conditions are not met, the capital gain realized by the company is ordinarily taxed. Capital losses arising from the sale or write-down of shareholdings meeting PEX conditions are basically not tax deductible. Likewise, the capital losses realized on sales of non-PEX investments are tax deductible. Specific exemptions are provided for those entities adopting IFRS for Italian statutory accounts reporting purposes.

Specific anti-dividend washing rules provide that where capital losses arise from the disposal of shareholdings which are not eligible for PEX, such losses are deductible only for the part exceeding the tax exempt amount of dividends *(see Dividend income discussion below)* received from the shares in question in the 36 months prior to the disposal.

Capital gains on financial investments generally are excluded from the IRAP taxable base.

### Dividend income

Dividends received by Italian resident companies from Italian companies or from companies resident in countries other than tax havens (i.e. not included in the 'black list') are excluded from the IRES taxable base for 95% of their amount. Conversely, no exemption applies to dividends paid by entities that are resident in tax haven jurisdictions (unless those dividends derive from profits that were already taxed under the Italian CFC rules). There are specific rules for entities adopting IFRS for Italian statutory financial reporting purposes. For such entities, dividends from investments in shares and other financial instruments held for trading are fully taxable.

Dividends generally are excluded from the IRAP taxable base.

### *Foreign income*

An Italian resident corporation is taxable on all income whether produced in Italy or abroad. Profits earned by subsidiaries that are resident or located in countries or territories other than tax havens are taxed only on distribution of the relevant profits. Double taxation is, in principle, avoided by means of foreign tax credits.

### *Shell companies*

Resident companies and PEs of non-resident companies can be qualified as non-operating entities if certain tests are not passed. In such a case, these entities will be assessed as having a minimum taxable income for both IRES and IRAP purposes.

For IRES purposes, the average revenues recorded in the current fiscal year and in the prior two must be compared with the amount resulting by applying certain 'deemed return' percentages to the average balance sheet value of specific assets in the current fiscal year and the two previous years.

The main assets to be taken into consideration are shares and shareholdings, financial receivables, owned or leased real estate, and owned or leased tangible and intangible assets. The value of assets acquired or sold during the fiscal year must be adjusted according to the period of ownership.

An entity is deemed to be non-operative if the expected revenues determined on the above basis are higher than the average of actual revenues. As a consequence, the entity is obliged to declare minimum taxable income for IRES, calculated by multiplying fixed percentages of 'deemed return' to the value of the above-mentioned assets.

This condition must be checked every year. Therefore, it is possible for an entity to be 'non-operative' in one year and operative in the following year.

Tax losses generated in a tax period when the company was deemed to be non-operating cannot be carried forward.

For IRAP purposes, labour costs and other non-deductible items have to be added back to the deemed minimum IRES income as outlined above.

These rules are not applicable in the first year of a company's incorporation. Exemptions from these rules can be achieved:

- by means of an advance ruling from the Italian tax authorities aimed at assessing the specific circumstances that caused the company not to earn the minimum amount of income or
- by specific objective situations provided for by Italian law (e.g. company directly or indirectly held by quoted companies).

Shell companies are also subject to limitations in their ability to recover VAT credits.

## Deductions

*The principles outlined in the section on Income determination also apply for deductible costs.*

### Interest expense

Generally, interest expense is fully tax deductible up to the amount of interest income. Thereafter, excess interest expense is deductible up to 30% of the gross operating margin (interest deduction capacity) as reported in the financial statements. Gross operating margin is defined as the difference between operating revenues and expenses excluding depreciation of tangible and intangible assets and charges for leased assets as stated in the profit and loss account for the year.

Net interest expense in excess of the yearly limitation is carried forward indefinitely. Hence, net interest expense not deducted in previous years can be deducted in any future fiscal year as long as total interest in that year does not exceed 30% of gross operating margin. If net interest expense is lower than the annual limit (i.e. 30% of gross operating margin), this difference can be carried over to increase the company's interest deduction capacity in future years. However, this latter rule is only applicable from 2010 onwards.

Where an election is made for the domestic tax consolidation regime, *(as discussed in Group taxation)*, the net interest expense limitation applies to the consolidated tax group. As a consequence, if a company participating in a tax group has an excess interest deduction capacity, this excess may be used against the interest deduction deficit in another company belonging to the same tax consolidation group. Under specific conditions, non-resident subsidiaries can also be 'virtually' included in the tax consolidation for the sole purpose of transferring their excess capacity over 30% of gross operating margin in order to increase the overall interest deduction capacity of the Italian group.

The above-mentioned rules are not applicable for financial institutions, such as banks and insurance companies, where the deductibility of interest expense (for both IRES and IRAP purposes) is limited to a fixed amount of 96% of the interest expense shown in the income statement of these entities.

### Depreciation and amortisation

All fixed assets which are used in the business of the company, except land, are depreciable for tax purposes (for both IRES and IRAP).

For IRES, the maximum depreciation rates for fixed tangible assets are set forth in a ministerial decree. In the event that financial accounting depreciation exceeds the amounts allowed for tax purposes, temporary differences arise. Tax depreciation of fixed tangible assets is allowed from the tax period in which the asset is first used. In the first tax depreciation period, the depreciation rate cannot exceed one-half of the normal rates.

Land is not a depreciable asset. Amortisation of goodwill derived from an acquisition and amortisation of trademarks are deductible for an amount not exceeding one-eighteenth of the cost of the goodwill in any year.

Patents, know-how, and other intellectual property may be amortised over a two-year period.

Concession rights may be depreciated with reference to the utilisation period as determined either by law or in the relevant agreement.

For IRAP purposes only, depreciation and amortisation (other than as related to goodwill and trademarks) are deductible in accordance with the amounts reported in the financial statements, regardless of the limits outlined above.

### *Entertainment expenses*
For IRES purposes, expenses for gifts and entertainment which meet the requirements (both qualitative and quantitative) contained in the specific Ministerial Decree are fully deductible in the tax period in which they are incurred. Entertainment expenses which do not meet these requirements cannot be deducted.

Expenses related to gifts with a value of EUR 50 or less are entirely deductible.

### *Automobile expenses*
For IRES purposes, deduction of the cost of company automobiles is limited to 40% of the total amount of the costs for the automobile. If automobiles are assigned to employees, the company may deduct 90% of the costs associated with the automobile.

Automobile costs may be deducted in their entirety if (i) automobiles are necessary for the company's business or (ii) automobiles are an essential element in the company's activity (i.e. vehicles owned by a car rental company).

### *Telephone expenses*
For IRES purposes, up to 80% of the total expenses related to both mobile and landline telephones are deductible.

### *Travel expenses*
For IRES purposes, the deduction for travel expenses incurred within the municipality is limited to 75% of the amount incurred. However, the VAT related to such costs is fully recoverable.

### *Taxes*
When calculating the IRES base, 10% of IRAP paid is deductible.

ICI, municipal tax on real estate, is not deductible for either IRES or IRAP.

### *Net operating losses (NOLs)*
For IRES purposes, tax losses can be carried forward and used to offset income in future tax periods. The carryforward is limited to the five tax periods following the period in which the loss is incurred. Losses arising in the first three years of activity of the enterprise can be carried forward indefinitely.

For IRAP purposes, tax losses may not be carried forward.

Specific (tax anti-avoidance) rules limit the carryforward of tax losses in the event of:

- change of control and
- an effective change of the main activity (performed by the company carrying forward the losses).

The aforementioned changes must occur together in order for the limitations to be applicable. The change of the main activity is relevant for these purposes if it takes place in the tax period in which the change of control occurs or in the two subsequent or preceding periods.

Specific anti-abuse provisions are also applicable to NOLs in cases of merger or demerger.

In Italy, tax losses may not be carried back.

### *Payments to foreign affiliates*

Transactions with foreign affiliated companies should be at 'fair market value' and, generally, as defined by OECD guidelines.

Italian companies transacting business with related non-resident parties may participate in special tax ruling procedures for the transfer pricing procedures used for intra-group transactions. The agreement executed between the tax authorities and the taxpayer is binding for the fiscal year during which the agreement is executed and for the following two fiscal years, unless significant changes in the circumstances relevant for the conclusion of the agreement executed by the taxpayer take place.



### *Purchases from suppliers resident in tax haven jurisdictions*

The costs of goods and services purchased from entities which are resident in tax haven jurisdictions are deductible on the condition that the taxpayer can, upon request of the tax authorities, provide evidence that the foreign companies carry out a real business activity or that the transactions were carried out for good and sound economic reasons (e.g. better economic conditions, the foreign supplier is the sole distributor for specific products).

An official list of tax haven jurisdictions (known as the 'black list') has been issued by the Ministry of Finance. A list of countries which are not considered to have a privileged tax regime (known as the 'white list') is expected, and countries not on this white list will be deemed tax havens. Specific disclosure is required in a company's income tax return for the expenses arising in tax haven jurisdictions.

## *Group taxation*

### *Domestic tax consolidation*

Companies belonging to the same group can elect domestic tax consolidation. This allows the determination of a single IRES taxable base comprised of the taxable income and losses of each of the participating entities. The tax consolidation does not operate for IRAP purposes.

Where an overall tax loss position arises, this can be carried forward and used against future consolidated taxable income. Conversely, tax losses arising in fiscal years preceding the domestic tax consolidation election can be carried forward and used only by the company to which these losses belong.

The taxable basis determined by each company participating in the tax consolidation arrangement is included in its entirety. No apportionment is made in relation to the percentage of control.

In order to validly elect the Italian domestic tax consolidation regime, the following conditions must be met:

- The consolidating entity must be an Italian tax resident company, and it must hold, directly or indirectly, more than the 50% of the share capital of the consolidated entities (so called 'legal control').
- This control must be in place from the beginning of the tax period for which the tax consolidation is applied for.
- All of the companies participating in the group must have the same year end.

Provided that specific requirements are met, Italian PEs of foreign companies can also participate as controlling entities in a tax consolidation.

The consolidation arrangement operates on an elective basis. Taxpayers may select whether to be included or not, and it is not necessary for all the Italian group/sub-group companies to jointly elect for the tax consolidation.

Once the election is made, it cannot be revoked for three fiscal years.

### *Worldwide tax consolidation group*
A worldwide tax consolidation group is available, allowing the consolidation of foreign subsidiaries.

In addition to the requirements set out for domestic tax group system, the following conditions apply:

- The ultimate parent company must be either owned by individuals who are tax residents of Italy or listed on the Italian Stock Exchange.
- The option must be exercised for all foreign companies (under the 'all in, all out' principle).

Income for each company is apportioned in the tax consolidation based on the actual percentage of control exercised by the ultimate parent company that is an Italian tax resident.

A number of additional requirements need to be fulfilled in order for a worldwide tax consolidation to be operative, including a mandatory audit of the financial statements of all the foreign subsidiaries.

Once the election is made, it cannot be rescinded for five fiscal years.

### *Transfer pricing*
Income derived from operations with non-resident corporations which directly or indirectly control the Italian entity, are controlled by the Italian entity, or are controlled by the same corporation controlling the Italian entity have to be valued on the basis of the normal value of the goods transferred, services rendered, and services and good received, if an increase in taxable income is derived there from. Possible reductions in taxable income as a result of the normal value rule are allowed only on the basis of mutual agreement procedures or the EU Arbitration Convention.

The normal value is the average price or consideration paid for goods and services of the same or similar type, carried on at free market conditions and at the same level of commerce, at the time and place in which the goods and services were purchased or performed. For the determination of the normal value reference should be made, to the extent possible, to the price list of the provider of goods or services, and, in their absence, to the price lists issued by the chamber of commerce and to professional tariffs, taking into account usual discounts.

**Penalty protection regime with transfer pricing documentation support**

New transfer pricing rules has been issued by Italian Tax Authorities in 2010 providing for a penalty protection regime in case of transfer pricing audit provided that the tax payer has prepared proper documentation detailing the compliance of inter-company transaction to the arm's-length principle.

The new regulation applies to transactions incurred between Italian entities and non-resident entities belonging to the same group (transfer pricing rule are not applicable to domestic transactions). No specific methods have been introduced to test the arm's length of transactions; reference is made to the OECD Guidelines.

On the base of new transfer pricing regulation, taxpayers can obtain penalty protection if they provide the Italian tax authorities with:

- documentation to support the inter-company transactions drawn up in the specific format detailed in the Regulation issued by the Italian tax authorities and in Italian language. Tax authority confirmed that information in annexes (inter-company contracts and transactions diagram) can be in the English language.
- notification that documentation has been prepared and available by checking the box in the annual corporate income tax return.

The information required is based on the EU Code of Conduct for Transfer Pricing documentation.

Based on the group structure, Master File and/or Country File have to be prepared.

Italian based groups and Italian sub-groups owning non-Italian subsidiaries must produce both a Master File and a Country File. Italian subsidiaries of multinational groups need to produce a Country File only.

The sub group provisions are onerous, especially so where they relate to branches. Where a foreign entity has an Italian branch but the company itself is also a holding company, a Master File is required for the foreign entity's subgroup, even if there is no holding directly attributed to the branch.

Sub-holding companies based in Italy with at least one non-Italian subsidiary, which need to produce a Master File, may instead produce the Master File for the entire group in English. If it does not contain all the information in the Italian Regulation, they will need to supplement it.

Documentation must be signed by the Legal representative of the company and provided to the authority upon request within ten days. Also, an electronic copy must be provided at authority request.

Small and medium companies (defined as those with an annual turnover of less than EUR 50 million) need to update the economic analysis only every three years, provided that no significant change in the business occurred. Otherwise, it is necessary to update the economic analysis each year.

As the documentation provisions provide a potential benefit for Italian taxpayers (by waiving the automatic tax geared penalties that would otherwise apply to a transfer pricing adjustment), taxpayers have been given the opportunity to take advantage of this penalty protection for all open years if they file a communication that they possess documentation in the required format before they receive notification of any tax audit.

### *Thin capitalisation*

Italy no longer has thin capitalisation rules per se. Instead, net interest expense is deductible only up to an amount equal to 30% of gross operating margin *(see Interest expense in the Deductions section for more information)*.

### *Controlled foreign company (CFC) rules*

An Italian company that controls, either directly or indirectly, an entity located in a tax haven jurisdiction is required to consolidate the taxable income arising in proportion to the percentage of shareholding held, irrespective of whether the profits have been distributed or not.

Income from CFCs is taxed separately from the other taxable income of the business at the standard IRES rate (i.e. other tax losses cannot be used to offset CFC income). Foreign taxes paid by the CFCs are recoverable by way of a corresponding tax credit.

Dividends received by an Italian shareholder from a CFC are excluded from taxable income up to the amount of the taxable income attributed under the above CFC provisions. The excess of any dividends over income already included through the CFC regime is fully taxable in the hands of the shareholder.

Where companies are located in a tax haven, the CFC rules also apply for companies holding not less than the 20% of the company's share capital or entitled to not less than 20% share of the company's profits. In such instances, there are specific rules to determine the taxable income attributable to the Italian resident shareholder. The taxable income is determined by applying specific income ratios to the business assets of the CFC as they appear in the relevant accounts.

Exemption from these CFC rules can be achieved by means of an advance ruling from the Italian tax authorities. To obtain such a ruling, adequate evidence must be provided to demonstrate at least one of the following:

- The foreign company is mainly and effectively engaged in sales and/or industrial activities in the 'market' of the foreign host state or territory. Banks, other financial entities, and insurance companies must demonstrate that most of the financial resources and related proceeds are made in or the result of yields, respectively, from the market of the foreign host state or territory. However, this exemption cannot be requested where more than 50% of the income of the foreign subsidiaries is derived from 'passive income' (e.g. holding or investment in securities, receivables, or other financial assets, transfer or licence of intangible rights) or from intra-group services.
- No less than 75% of all the proceeds of the CFC have been taxed in jurisdictions that are not tax privileged countries (e.g. a company resident in Hong Kong has all of its operations in China mainland and it is subject to ordinary taxation there).

The CFC rules also extend to controlled companies that are located in a jurisdiction with a privileged tax regime that is not a tax haven, if the following conditions exist:

- The effective tax is less than 50% of the tax that would have been charged had the company been resident in Italy.

- More than 50% of revenue is derived from so-called 'passive income' or from intra-group services.

By means of an advance ruling, the Italian parent company is able to obtain an exemption from these rules if it is able to provide proper evidence that the establishment of the company in the privileged tax jurisdiction is not for tax avoidance purposes (unfair tax advantage).

## *Tax credits and incentives*

### *Foreign tax credit*

Where foreign-source income definitively is taxed abroad, a tax credit can be claimed for use against a company's IRES liability. The amount of the tax credit that can be claimed is the lower of the foreign tax incurred and the proportion of the IRES liability related to the foreign-source income. For partially exempt income (e.g. dividends), the foreign tax credit is reduced in proportion to the amount of the income taxable in Italy.



If an Italian company receives foreign income from more than one country, this limitation is applied separately to each country.

Foreign taxes borne by the foreign PE of an Italian resident company are allowed to be offset against the overall consolidated tax liability (IRES).

Any excess of foreign tax credit over the maximum amount allowed for recovery in the same tax period can be carried back or carried forward for eight years and recovered if specific conditions are met (e.g. same source country of the income, occurring because of an excess of the IRES liability related to the foreign-source income).

### *Inward investment, capital investment, and R&D investment incentives*

A number of incentives have been established to attract new industry to southern Italy and certain depressed mountain areas in central and northern Italy.

Tax credits are given to companies that increase the number of their employees and that invest in research and development.

The possibility of taking advantage of these rules, however, depends on the taxpayer fulfilling specific conditions and on the actual availability of financial resources by the Italian state. These financial resources generally are set in the annual state budget.

### *New tax regime for EU investments in Italy*

A special incentive has been introduced for the companies resident in other EU countries starting new economic activities in Italy and for their employees and staff. The possibility is to apply for three years the tax regime of EU countries in alternative to the Italian one.

The new activities need to be carried out starting from 31 May 2010 and need to be effectively performed in Italy.

The possibility to benefit from the new incentive needs to be agreed by means of an international ruling procedure with the Italian tax authorities.

Ministry of Finance shall issue a decree regulating the relevant fulfilments to the application of this new rule.

# Italy

## *Withholding taxes*

### *Withholding tax chart*

Domestic corporations paying certain types of income are required to withhold as shown on the following chart. The numbers in parentheses refer to the notes below.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations | 0 | 0/12.5/27 (1) | 0 |
| Resident individuals | 0/12.5 (2) | 12.5/27 (1) | 20 (3) |
| EU resident corporations | 0/1.375 (4, 5) | 0 (4) | 0 (4) |
| Swiss resident corporations | 0 (6) | 0 (6) | 0 (6) |
| Non-resident corporations and individuals: | | | |
| Non-treaty countries | 27 (7) | 0/12.5/27 (1) | 30 (3) |
| Treaty countries (8): | | | |
| Albania | 10 | 0/5 (9) | 5 |
| Algeria | 15 | 0/15 (9) | 5/15 (10) |
| Argentina | 15 | 0/20 (9) | 10/18 (11) |
| Armenia | 5/10 (12) | 0/10 (9) | 7 |
| Australia | 15 | 0/10 (9) | 10 |
| Austria | 15 | 0/10 (9) | 0/10 (13) |
| Bangladesh | 10/15 (14) | 0/10/15 (15) | 10 |
| Belgium | 15 | 0/15 (9) | 5 |
| Bosnia and Herzegovina (Jugoslavia Ex) | 10 | 10 | 10 |
| Brazil | 15 | 0/15 (9) | 15/25 (16) |
| Bulgaria | 10 | 0 | 5 |
| Byelorussia | 5/15 (17) | 0/8 (9) | 6 |
| Canada | 15 | 0/15 (9) | 0/10 (18) |
| China, People's Rep. | 10 | 0/10 (9) | 10 |
| Croatia (19) | 15 | 10 | 5 |
| Côte d' Ivoire | 15/18 (20) | 0/15 (9) | 10 |
| Cyprus | 15 | 10 | 0 |
| Czech Republic | 15 | 0 | 0/5 (21) |
| Denmark | 0/15 (22) | 0/10 (9) | 0/5 (18) |
| Ecuador | 15 | 0/10 (9) | 5 |
| Egypt | 27 (23) | 0/25 (9) | 15 |
| Estonia | 5/15 (24) | 0/10 (9) | 5/10 (25) |
| Ethiopia | 10 | 0/10 (9) | 20 |
| Finland | 10/15 (26) | 0/15 (9) | 0/5 (18) |
| France | 5/15 (27) | 0/10 (28) | 0/5 (18) |
| Georgia | 5/10 (29) | 0 | 0 |
| Germany | 10/15 (30) | 0/10 (28) | 0/5 (21) |
| Ghana | 5/15 (31) | 10 | 10 |
| Greece | 15 | 0/10 (9) | 0/5 (21) |
| Hungary | 10 | 0 | 0 |
| Iceland | 5/15 (32) | 0 | 5 |
| India | 15/25 (33) | 0/15 (9) | 20 |
| Indonesia | 10/15 (30) | 0/10 (9) | 10/15 (34) |
| Ireland, Rep. of | 15 | 10 | 0 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Israel | 10/15 (30) | 10 | 0/10 (18) |
| Japan | 10/15 (35) | 10 | 10 |
| Jordan (19) | 10 | 10 | 10 |
| Kazakhstan | 5/15 (36) | 0/10 (9) | 10 |
| Kuwait | 0/5 (37) | 0 | 10 |
| Latvia | 5/15 (31) | 0/10 (9) | 5/10 (38) |
| Lithuania | 5/15 (31) | 0/10 (9) | 5/10 (38) |
| Luxembourg (39) | 15 | 0/10 (9) | 10 |
| Macedonia | 5/15 (17) | 0/10 (9) | 0 |
| Malaysia | 10 | 0,15 (9) | 15 |
| Malta | 15 | 0/10 (9) | 0/10 (21) |
| Mauritius | 5/15 (17) | 27 (23) | 15 |
| Mexico | 15 | 0/15 (9) | 0/15 (18) |
| Montenegro (Jugoslavia Ex) | 10 | 10 | 10 |
| Morocco | 10/15 (30) | 0/10 (9) | 5/10 (18) |
| Mozambique | 15 | 0/10 (9) | 10 |
| Netherlands | 5/10/15 (40) | 0/10 (9) | 5 |
| New Zealand | 15 | 0/10 (9) | 10 |
| Norway | 15 | 0/15 (9) | 5 |
| Oman | 5/10 (41) | 0/5 (9) | 10 |
| Pakistan | 15/25 (42) | 0/30 (9) | 30 |
| Philippines | 15 | 0/10/15 (43) | 25 |
| Poland | 10 | 0/10 (9) | 10 |
| Portugal | 15 | 0/15 (9) | 12 |
| Qatar | 5/15 (44) | 5 | 5 |
| Romania | 10 | 0/10 (9) | 10 |
| Russia | 5/10 (12) | 10 | 0 |
| Saudi Arabia (19) | 5/10 (45) | 5 | 10 |
| Senegal | 15 | 0/15 (9) | 15 |
| Serbia (Jugoslavia Ex) | 10 | 10 | 10 |
| Singapore | 10 | 0/12.5 (9) | 15/20 (18) |
| Slovak republic | 15 | 0 | 0/5 (21) |
| Slovenia (19) | 5/15 (17) | 10 | 5 |
| South Africa | 5/15 (17) | 0/10 (9) | 6 |
| South Korea | 10/15 (30) | 0/10 (9) | 10 |
| Soviet Union Ex (46) | 15 | 0 | 0 |
| Spain | 15 | 0/12 (9) | 4/8 (18) |
| Sri Lanka | 15 | 0/10 (9) | 10/15 (21) |
| Sweden | 10/15 (47) | 0/15 (9) | 5 |
| Switzerland | 15 | 12.5 | 5 |
| Syria | 5/10 (29) | 0/10 (9, 48) | 18 |
| Tanzania | 10 | 15 | 15 |
| Thailand | 15/20 (49) | 0/10 (50) | 5/15 (18) |
| Trinidad and Tobago | 10/20 (51) | 10 | 0/5 (21) |
| Tunisia | 15 | 0/12 (9) | 5/12/16 (52) |
| Turkey | 15 | 15 | 10 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Uganda | 15 | 0/15 (9) | 10 |
| Ukraine | 5/15 (53) | 0/10 (9) | 7 |
| United Arab Emirates | 5/15 (18) | 0 | 10 |
| United Kingdom | 5/15 (54) | 0/10 (9, 28) | 8 |
| United States | 0/5/15 (55) | 0/10 (56) | 0/5/8 (57) |
| Uzbekistan | 10 | 0/5 (9) | 5 |
| Venezuela | 10 | 0/10 (9) | 7/10 (21) |
| Vietnam | 5/10/15 (58) | 0/10 (9) | 7.5/10 (59) |
| Zambia | 5/15 (18) | 0/10 (60) | 10 |

Notes

1. Rates depend on the nature of the interest and/or of the recipient. The rates on debenture loans depend on the legal instruments adopted and the redemption period, mainly:
   - 0% applies on loan agreements and ordinary notes.
   - 12.5% on bonds if the term of the bond issue is longer than 18 months.
   - 27% if the bond issue period is shorter than 18 months.
2. 0% is applicable on dividends received by shareholders holding no less than the 20% of the sharecapital (2% in the case of listed entities), so called 'qualified investments'.
3. The rate is applicable on 75% of the gross amount of the royalty paid.
4. Pursuant to the EU Directives and provided that the requirements set forth therein are met, payments of dividends, interest, and royalties made by an Italian company to an EU resident group company can be WHT exempt. Specifically for the dividends, the minimum shareholding requirement (to benefit from this exemption) is currently equal to 10%.
5. Should the full WHT exemption not apply, 1.375% is applicable on dividends paid to EU tax residents.
6. Pursuant to the 2004 Swiss EU tax agreement and provided that the requirements contained therein are met, payments of dividends, interest, and royalties made by an Italian company to a Swiss tax resident group company can be WHT exempt.
7. Non-residents persons have the right to obtain reimbursement for up to four-ninths of the withholding effected, upon proof of the actual taxation of the dividends in the foreign country where the recipient is a resident.
8. Provided that all conditions are met, domestic tax legislation is applicable if more favourable for the taxpayer.
9. The 0% rate applies to interest paid to public bodies or any agency or instrumentality (including a financial institution) in relation to loans made in application of an agreement concluded between the governments of the contracting states.
10. The 5% rate applies to royalties arising from the use of any copyright from literary, artistic, or scientific work. The 15% rate applies in all other cases.
11. The 10% rate applies to royalties arising from the use of any copyright of literary, artistic, or scientific work. The 18% rate applies in all other cases.
12. WHT is 5% if the foreign company holds at least 10% of the capital of the Italian company (this share should be at least USD 100,000 or its equivalent in any other currency); otherwise, the rate is 10%.
13. The higher rate applies if the Austrian company directly owns more than 50% of the capital in the Italian company.
14. WHT is 10% if the foreign company holds at least 10% of the capital in the Italian company; otherwise, it is 15%.
15. The 0% rate applies to interest on public bonds. WHT is 10% if the interest is derived by a bank or any other financial institution. The 15% rate applies in all other cases.
16. WHT is 25% on royalties arising from use or the right to use trademarks. The 15% rate applies in all other cases.
17. The 5 % rate applies if the foreign company holds directly at least 25% of the capital of the company paying the dividends. Withholding is 15% in all other cases.
18. The lower rate applies to copyright royalties, excluding films.
19. In force from 1 January 2010.
20. Withholding is 18% on dividends paid by a company which is a resident of the Republic of the Ivory Coast and which is exempt from tax on its income or which is not subject to that tax at the normal rate. The 15% rate in all other cases.
21. The lower rate applies to copyright royalties, including films.
22. The 0% rate applies if the Danish company has owned directly at least 25% of the capital of the company paying the dividends for a 12 month period prior to the date the dividends are declared. Withholding is 15% in all other cases.
23. The Italian domestic rates apply as no reduction is provided under the treaty.
24. The 5% rate applies if the foreign company holds directly at least 10% of the capital of the company paying the dividends. Withholding is 15% in all other cases.

25. The 5% rate applies on royalties paid for the use of industrial, commercial, or scientific equipment. Withholding is 10% in all other cases.
26. 10% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly more than 50% of the capital of the company paying the dividends. Withholding is 15% in all other cases.
27. Non-resident shareholding companies with more (less) than 10% of the capital of the company subject to 5% (15%) WHT.
28. The lower rate applies to interest on public bonds and trade credits, and to interest arising from the sale of equipment.
29. WHT is 5% if the company holds at least 25% of the capital of the Italian company; otherwise, it is 10%.
30. WHT is 10% if the company holds at least 25% of the capital of the Italian company; otherwise, it is 15%.
31. WHT is 5% if the company holds at least 10% of the capital of the Italian company; otherwise, it is 15%.
32. The 5% rate applies to dividends if the beneficial owner is a company which owns at least 10% of the capital of the company paying the dividends for a 12-month period ending on the date the dividend is declared. The 15% rate applies in all other cases.
33. WHT is 15% if the company holds at least 10% of the shares of the Italian company; otherwise, it is 25%.
34. The 10% rate applies on royalties in respect of payments of any kind received as a consideration for the use of, or the right to use industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience. Withholding is 15% in all other cases.
35. WHT is 10% if the foreign company holds at least 25% of the entire voting shares in the Italian company; otherwise, it is 15%.
36. WHT is 5% if the foreign company holds directly at least 10% of the capital in the Italian company; otherwise, it is 15%.
37. The higher rate applies if the Kuwaiti resident holds 75% or more of the capital in the Italian company.
38. The 5% rate applies to royalties paid for the use of industrial, commercial, or scientific equipment. Withholding is 10% in all other cases.
39. Applicable only to companies that are not considered holding companies in Luxembourg.
40. The 5% rate applies if the Netherlands company has owned more than 50% of the voting shares in the Italian company for at least 12 months. The 10% rate applies if it has so owned more than 10%; the 15% rate applies in all other cases.
41. WHT is 5% if the foreign company holds directly at least 15% of the capital in the Italian company; otherwise, it is 10%.
42. WHT is 15% if the company holds at least 25% of the capital of the Italian company; otherwise, it is 25%.
43. The 0% rate applies to interest on public bonds. The 10% rate applies to interest on other bonds. WHT is 15% in all other cases.
44. WHT is 5% if the beneficial owner is a company that owns at least 25 % of the capital of the payer company for a period of at least 12 months preceding the date the dividends were declared; otherwise, it is 15%.
45. The 5% rate applies to dividends in the country of residence of the beneficial owner if the beneficial owner is a (joint stock) company that owned at least 25% of the capital of the distributing company for at least 12 months before the distribution. The 10% rate applies in all other cases.
46. Is applied until new double tax treaties (DTTs) with the following countries are ratified: Azerbaijan, Moldova, Kirghizstan, Tajikistan, and Turkmenistan.
47. Withholding cannot exceed 10% if the Swedish company holds at least 51% of the entire voting rights in the Italian company.
48. The lower rate applies to interest on any loan granted by a bank.
49. WHT is 15% if the company in Thailand holds at least 25% of the entire voting rights of the Italian company; otherwise, it is 20%.
50. The 0% rate applies to interest on public bonds and to interest received by an administrative subdivision or a local authority. The 10% rate applies if the interest is received by a financial institution (including an insurance company) and the enterprise paying the interest engages in an industrial undertaking. In case of a special relationship between the parties, the treaty is not applicable to the part which exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship. The excess part of the payments shall remain taxable according to the law of each Contracting State.
51. WHT is 10% if the company in Trinidad and Tobago holds at least 25% of the capital of the company paying the dividends; otherwise, it is 20%.
52. The 5% rate applies to copyright royalties on literary, artistic, or scientific work. The 16% rate applies to a trademark, to cinematograph and television films, to industrial, commercial or scientific equipment. The 12% rate applies in other cases.
53. WHT is 5% if the foreign company holds at least 20% of the capital in the Italian company; otherwise, it is 15%.
54. Non-resident shareholding companies with more than 10% of the voting power are subject to 5%WHT. The 15% rate applies in all other cases.
55. The 0% rate applies if the beneficial owner of the dividends is a qualified governmental entity that holds, directly or indirectly, less than 25 % of the voting stock of the company paying the dividends.

The 5% rate applies to dividends if the beneficial owner is a company which owns at least 25% of the voting rights of the company paying the dividends for a 12-month period ending on the date the dividend is declared. The 15% rate applies in all other cases.

56. The 0% rate applies on certain categories of interest that are exempt from taxation in the source state:
    - The beneficial owner is a qualified governmental entity that holds, directly or indirectly, less than 25 % of the capital of the entity paying the interest.
    - Interest is paid with respect to debt obligations guaranteed or insured by a qualified governmental entity of either contracting state, and the recipient is the beneficial owner of the interest.
    - Interest is paid or accrued with respect to outstanding balances between enterprises for the sale of goods, merchandise, or services.
    - Interest is paid or accrued in connection with the sale on credit of industrial, commercial, or scientific equipment.

    The 10% rate is applied in all other cases.
57. The 0% WHT applies for the use of, or right to use, a copyright of literary, artistic, or scientific work (excluding royalties for computer software, motion pictures, films, tapes, or other means of reproduction used for radio or television broadcasting). The 5% rate applies for the use of, or the right to use, computer software or industrial, commercial, or scientific equipment. The 8 % rate applies in all other cases.
58. WHT is 5% if the company holds at least 70% of the capital of the Italian company. It is 10% if the company holds at least 25% of the capital of the Italian company; otherwise, it is 15%.
59. WHT is 7.5% on royalties for technical services.
60. The 0% rate applies to interest paid to the Zambian government or local authority thereof or any agency or instrumentality (including a financial institution) wholly owned by that government or local authority.

The Italian Parliament is expected to ratify tax treaties with Azerbaijan, Belgium, Canada, Cuba, Gabon, Iran, Lebanon, Moldova, Mongolia, and San Marino.

The treaties with Congo and Kenya have been ratified but have not entered into force.

Negotiations and re-negotiations have been initiated with Austria, Jamaica, India, Ireland, Liberia, Mexico, United Kingdom, and Trinidad and Tobago.

## *Tax administration*

### *Returns*

IRES and IRAP returns must be filed by the end of the ninth month following the tax year-end.

The ordinary filing deadline for WHT agent returns is 31 July for both the simplified WHT return and the ordinary WHT return.

### *Payment of taxes*

For IRES and IRAP purposes, the tax law provides for both advance payments and settlement payments. The advance payments are equal to the net tax payable for the previous tax period and are due during the tax period to which they refer. Advance payments are split into two instalments:

- 40% by the 16th day of the sixth month following the tax year-end.
- 60% by the end of the 11th month following the tax year-end.

Settlement payments are due by the 16th day of the sixth month following the tax year-end to which they refer.

Tax payments should be performed through a specific form to be electronically filed to the Tax Authorities (i.e. F24 form).

### *Offsetting of taxes*
Payables and receivables (not claimed for refund) resulting from a return regarding different taxes are allowed for off-setting within a yearly limit of EUR 516,457.90.

Starting as of 1 January 2011, the mentioned offsetting is no longer allowed if taxes definitively assessed by the Tax Authorities and not paid within the deadlines by the taxpayer are higher than EUR 1,500. In case of breach of the above limit, the law provides for a penalty of up to 50% of the undue settled amount.

### *Administrative penalties*
Failure to file a tax return results in a penalty ranging from 120% to 240% of the taxes due. Minimum penalties (ranging from EUR 258 to EUR 1,032) are applicable if no tax liability emerged in the return.

A tax return showing either a taxable income lower than the one assessed or a tax credit higher than those owed to the taxpayer (i.e. an untrue tax return) results in a penalty ranging from 100% to 200% of the higher taxes ultimately due.

Omitted and/or late payments of taxes of whichever kind and nature result in a penalty equal to 30% of the unpaid/late paid tax.

Special rules apply where similar violations are repeated over various years.

### *Software based tax controls (so-called 'Studi di settore')*
The Italian Tax law provides for special tax control procedures for those enterprises whose total turnover does not exceed EUR 7.5m (EUR 5.16m up to fiscal year 2006). The controls, so-called 'Studi di Settore', are based on standardized economic models of the different business fields and are aimed at assessing whether or not a specific subject's taxable income is in line with its own standard model (on statistical basis).

A higher possibility of undergoing tax audit should be considered for entities not meeting such standard model.

### *Statute of limitations*
The Italian tax authorities are entitled to make an assessment in relation to direct taxes (IRES and IRAP), VAT, and WHT returns up to the end of the fourth calendar year following the year in which the tax return was filed. Under certain circumstances (e.g. no return filed or fraud giving rise to criminal law penalties) the above deadlines may be extended.

Tax disputes can be settled by accepting all the issues raised in the tax auditor's report without any challenge and by paying the related tax and reduced penalties. A number of other options to avoid tax litigation are provided for by law.

Administrative checks on tax returns may be carried out within the year following that in which the tax return has been filed for larger companies having a yearly turnover in excess of EUR 300 million (turnover to be progressively decreased to EUR 100 million).

With limited exceptions, corporations that usually are repeatedly in tax loss position should be subject to specific controls.

## Other issues

### Adoption of IFRS and taxation

The Italian tax law provides for two basic principles and some specific rules for taxation of a company adopting International Accounting Standards (IAS)/IFRS in the statutory financial statements:

- Derivation principle ('Principio della Derivazione'): the taxable base of companies is determined starting from the net income arising from the profit and loss, increased or decreased by items directly booked to equity pursuant to the application of IAS/IFRS. To such 'rectified' income the general tax adjustments set forth by the Corporate Income Tax Law apply. In this respect, as exception to the general tax criteria, the accrual principle, and the qualification and classification criteria stated by the IFRS are relevant for the calculation of the taxable base.
- Neutrality principle ('Principio della Neutralità'): such principle aims to neutralise the effects deriving from the movement to IAS/IFRS (First Time Adoption – FTA). Conversely, such principle does not grant an equal treatment for companies adopting or not IAS/IFRS (in fact, specific rules are applicable only to IAS/IFRS adopters, e.g. taxation of dividend on held for trading securities, derivatives).

The following specific rules applicable to IAS adopters must be considered:

- Adjustments or recognitions of transactions made in equity are relevant for tax purposes, to the extent that such items are in compliance with general tax principles.
- For equity instruments, the legal classification is prevailing over the accounting one (debt vs. equity classification).
- Under certain conditions, unrealised profits and losses recognised in the profit and loss become taxable and deductible (e.g. fair value on securities other than available for sale, held to maturity, and participations; on derivatives transactions not concluded for hedging reasons);
- The tax treatment of the transactions between IFRS adopters and non-IFRS adopters, in relation to operations concluded between an IFRS adopter and a non-IFRS adopter, is based on the accounting principle adopted by each company (e.g. financial leasing).
- Depreciation and amortisation are permitted within the rates provided by the tax rules, independently by the amounts booked. In this respect, the abolition of the imperative systematic depreciation of the goodwill and its substitution by the goodwill's review for impairment does not affect the tax deduction of the goodwill amortisation that should be made solely for tax purposes.

# Ivory Coast (Côte d'Ivoire)

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## Significant developments

There have been no significant corporate tax developments in the Ivory Coast (Côte d'Ivoire) during the past year.



## Taxes on corporate income

Tax on industrial and commercial profits in Côte d'Ivoire is levied at 25%, subject to a minimum tax. The minimum tax is based on total turnover and is calculated at the rate of 0.5% (banking activities, 0.15%; oil companies, 0.10%), with a minimum of 2 million Communaute Financiere Africaine francs (XOF) and a maximum of XOF 30 million.

## Corporate residence

In Côte d'Ivoire, companies are considered resident in tax jurisdictions where they have a registered fixed establishment.

## Other taxes

### Value-added tax (VAT)

VAT is a non-cumulative tax levied on the sale of goods and services at the rate of 18%. Subject to certain restrictions, VAT is recoverable. The rate is reduced to 9% for milk and pasta products which contain 100% durum wheat semolina.

### Real estate tax

A real estate tax is imposed at the following rates:

- 1.5% for the undeveloped lands.
- 4% on land revenue.
- 11% on the developed land or 15% when the built property is used by the company itself. The rate is reduced to 4% for unoccupied buildings.

In the case of the transfer of property through a direct sale, taxes are assessed at the following rates:

- 10% for lease transfers.
- 10% or 7.5% for the sale of real estate.
- 10% for the sale of businesses.

### Advance payment of property tax
Property owners are required to withhold 15% of rentals, payable on the 15th day of each month to the tax authorities. This is an advance payment on the annual real estate tax by the owner of the estate property.

### Stamp duty
A direct tax is paid for any document subject to a registration procedure, for an acknowledgment of a cash payment, and for bills of exchange.

### Tax on banking operations
A cumulative tax of 10% is levied on bank services rendered.

### Special tax for equipment
A tax of 0.08% is calculated on the total turnover and is paid monthly.

### Business franchise tax
The business franchise tax includes a turnover tax and a proportional tax. The turnover tax is calculated on the turnover at the rate of 0.5% with a maximum of XOF 3 million and a minimum of XOF 300,000. The proportional tax is based on the rental value of the professional office location (based on general office rents). The rate is 18.5%.

### Payroll tax
Taxes are levied at the rates of 2.8% for local employees and 12% for expatriate employees on the total taxable remuneration, including salaries, benefits, and benefits in-kind.

### Registration taxes
Registration of capital contributions is taxed, whether the capital or increase in capital is made in cash or in-kind. The rate is 0.6% for contributions up to XOF 5 billion and 0.2% for contributions over XOF 5 billion, with a minimum of XOF 18,000. Increases in capital by incorporation of reserves are taxed at 6%.

In the event of a capital increase through a merger, the increase in the share capital of the acquiring company is taxed at half the rate, 0.3% for amounts up to XOF 5 billion and 0.1% for amounts over XOF 5 billion.

### Tax on insurance premiums
Insurance premiums are subject to tax as follows:

| Policy type | Rate (%) |
|---|---|
| Marine policies | 7.0 |
| Life policies | Exempted when contract's duration is more than three years |
| Fire policies | 25.0 |
| Health policies | 8.0 |
| Export credit insurance | 0.1 |
| Other (e.g. personal liability, transportation) | 14.5 |

Premiums paid under commercial shipping insurance policies for maritime risks are exempt. The tax may be paid by the insurance company, its agent, or the subscriber, in cases where the subscriber had to pay the premium to a foreign insurance company.

### *Social security contributions*
Employers must contribute to the social security system (CNPS) at the following rates:

| Contribution | Rate (%) | Monthly ceiling (XOF) |
|---|---|---|
| Family allowance | 5.75 | 70,000 |
| Work injury | 2.0 to 5.0 | 70,000 |
| Retirement pension | 4.8 | 1,647,315 |

### *Tax for national reconstruction*
The tax for national reconstruction was eliminated in May 2009.

### *Withholding tax (WHT) on public contracts*
Any payment made by government bodies or public institutions for a contract for goods or services is subject to a 10% WHT, except the companies registered at the Directorate of Large Companies (Direction des Grandes Entreprises), with a minimum turnover over XOF 1 billion. The tax is recoverable and may be applied to VAT and to income taxes due and withheld by employers. Contractors who do not have a permanent establishment in Côte d'Ivoire are not subject to this tax. Surplus tax payments and tax credits are refundable.



### *WHT on small size businesses*
The FY2010 financial law has created a 5% WHT on the remunerations paid to individual service providers registered under the standard tax regimes for small size companies.

### *Contributions for the end of the crisis*
This is a tax enforced by FY2010 fiscal law. It is calculated at a rate of 3% on some expenses of entities which have XOF 1 billion or more in turnover. The annual amount of the tax due is capped at XOF 150 million, as per discussions with the government.

This tax was not renewed.

## *Branch income*

The tax rate for branch income is the same as that for corporate income. After-tax branch earnings are subject to a 12% tax (Impôt sur le revenu des valeurs mobilières or IRVM) calculated on 50% of the taxable profit. This is analogous to the WHT on dividends.

## *Income determination*

### *Inventory valuation*
Inventory is generally stated at the lower of cost or market value. Last in first out (LIFO) and first in first out (FIFO) are permitted. Book and tax conformity is required.

### *Capital gains*
Capital gains are normally taxed at full corporate rates. However, the tax on capital gains, exclusive of recaptured depreciation, can be deferred if the gain is reinvested within three years.

### *Inter-company dividends*
Inter-company dividends are included in taxable income at 50% of the net amount received (after 12% WHT). The exemption is increased to 95% for dividends received from a subsidiary if a parent company domiciled in Côte d'Ivoire owns 10% of the subsidiary.

### *Stock dividends*
Stock dividends are unusual, but in the event they are declared, they are not taxable to the recipient.

### *Other significant items*
Interest from loans and dividends is brought into taxable income at 50% of the net amount earned by the company. Dividends derived from subsidiaries are brought into taxable income at 5% of the net income earned.

### *Foreign income*
Resident corporations are taxed on their worldwide income, except for profits derived from business conducted through a permanent establishment (PE) outside Côte d'Ivoire. Since income derived from business conducted outside Côte d'Ivoire is not taxable, no tax credit is allowed. Interest and dividends from foreign sources are entitled to certain deductions to alleviate instances of double taxation. Subject to provisions of tax treaties, no deductions or tax credits are allowed for revenue from royalties and services.

## *Deductions*

### *Depreciation and depletion*
Depreciation is generally computed on a straight-line basis over the useful life of the asset (buildings, 20 years; automobiles, three years). Accelerated depreciation is sometimes permitted for machinery. The following depreciation rates are generally accepted for tax purposes:

| Assets | Rate (%) |
|---|---|
| Buildings | 5 |
| Machinery, equipment (rate depending on equipment) | 20, 10, 8 |
| Office furniture | 10 |
| Office equipment | 20 |
| Vehicles | 33.3 |
| Computing equipment | 20 to 50 |

A time coefficient is applied to the rate of depreciation to obtain the declining balance. Depreciation rates may be amended, but only after agreement with the tax authorities.

New plants and equipment may be depreciated at twice the normal rate in the first year of use, provided they are depreciated over at least six years. Under certain circumstances, buildings used for staff housing may be depreciated at 40% of cost in the first year. Annual depreciation must be booked to preserve tax deductibility. The whole or any part of the annual charge can then be deferred in annual accounts for fiscal years showing a tax loss. Recaptured depreciation is taxed at full rates. Tax and book conformity is obligatory.

Depletion allowances as such do not exist, but tax incentives are available for exploration to replace depleted natural reserves.

### *Other significant items*
In respect to legal reserves, 10% of net profit must be transferred to a reserve for legal fees until the reserve equals 5% of the paid-up share capital.

To be tax deductible, provisions must relate to existing liability or loss. General reserves are not deductible.

Interest paid to shareholders may be deducted. The maximum interest rate allowed is related to the Banque Central des Etats de l'Afrique de l'Ouest (BCEAO) rate plus three points. The reimbursement of the loan must take place in the five years following the loan.

Fines and third party taxes borne by corporations are not tax deductible.

### *Net operating losses*
Losses may be carried forward five years. Losses derived from depreciation can be carried forward indefinitely.

### *Payments to foreign affiliates*
Reasonable royalties, interest, and management and service fees paid to foreign parent companies are tax deductible. However, the deductions should not exceed 5% of the turnover and 20% of the overhead. Otherwise, the portion exceeding the ceiling is not tax deductible. The onus is on the taxpayer to prove that expenses are justified and reflect real transactions.

## *Group taxation*

Group taxation is not permitted.

## *Tax credits and incentives*

### *Inward investment*
Investment Law No. 95-620 of 3 August 1995 divides the country into two investment zones, offering incentives for up to five or eight years in each area.

The Investment Code provides for 100% tax exemption during the first three or six years (depending on the nature of the activity and the zone), then 50% and 25% progressively for the last two years of exemption. Exemption periods may be extended to complete a scheduled investment program.

Incentives are divided into two programs: 'prior declaration' for investments of less than XOF 500 million that create new activity and 'prior agreement' for investments of XOF 500 million or more that create new activity or develop an existing activity. Both programs are handled by the Centre de Promotion des Investissements en Côte d'Ivoire (CEPICI) and are open to all sectors except trade, public works, building construction, transportation, banking, and insurance.

Prior declaration investments may be exempt from tax on corporate income and the business franchise tax. Prior agreement investments benefit from exemptions varying with the size and nature of the project as follows:

- Creating a new enterprise or a new activity in an existing enterprise:
  - Investments of XOF 500 million to XOF 2 billion may be exempt from tax on corporate income, business franchise tax, import duties, and taxes (with the exception of a 5% tax on machinery, equipment, and spare parts).
  - Investments of more than XOF 2 billion may be exempt from property tax, in addition to the above.
- Developing an existing activity:
  - Investments of at least XOF 500 million may be exempt from import duties and taxes (with the exception of a 5% tax on machinery, equipment, and spare parts).

These incentives may not be combined with sector-specific investment programs, such as those for mining and hydrocarbons.

***Capital investment***
With prior approval of the tax authorities and varying with geographical location, 35% to 40% of the total investment in fixed assets related to commercial, industrial, or agricultural activity may be deducted from taxable income. The deduction is limited to 50% of taxable profits. The balance of deduction of the first year may be carried forward over the three following years.

***Export incentives***
No VAT is levied on export sales.

Sales and provisions of services made to export companies, which process certain farm products (i.e. cocoa, coffee, banana, hevea, and palm tree oil) and realise at least 70% of their turnover from exports, are free from VAT. The exemption is granted for the purpose of avoiding new cases of VAT credits in this line of business.

***Export incentives - mining industry***
During the exploration phase, investments may be exempt from payroll tax, VAT on goods and services, additional tax (on the sale of goods) on imports and purchases, all import taxes and duties including VAT on materials, machines, and equipment used in research activities, and half of the registration duties applicable to in-kind or cash share-capital contributions.

During the production phase, mining activities may have a five-year exemption from corporate income tax and relief from all import duties, including VAT on recovered investments required for exploitation. In addition, they may be granted temporary admission of machines and equipment that facilitate research and exploitation. A tax on profit is levied as soon as investment funds are recovered. Mining enterprises may not combine these incentives with those of the Investment Code.

***Export incentives - petroleum service contractors***
A special and optional tax treatment applies to petroleum service contractors that meet established criteria. Corporate tax, distribution tax, payroll tax, income tax on salaries, and the tax on insurance premiums are calculated on the turnover of the contractor. The total taxes represent 5.636% of turnover. Standard rates apply for business franchise tax and social security contributions for local personnel. The exemption from customs duties and VAT for oil companies is extended to petroleum service contractors.

## *Withholding taxes*

Withholding taxes (WHT) are levied as follows.

- Impôt sur le revenu des valeurs mobilières (IRVM): 12% or 18% on dividends and directors' fees.
- Impôt sur le revenue des créances (IRC): 18% on interest payments, reduced to 13.5% (individuals) and 16.5% (businesses) on bank deposit interest. Foreign banks are subject to 18% tax on loan interest or 9% on equipment loans with minimum three-year terms.
- Impôt sur les benefices non commerciaux (BNC): 25% of 80% of revenues on royalties, license fees, and management and service fees paid by Ivorian companies to foreign companies (effective rate: 20% of net amount paid). Treaties with Belgium, Canada, France, Germany, Italy, Norway, Switzerland, and the United Kingdom provide a maximum BNC rate of 10% on royalties and management fees. The tax treaty between the member states of West African Economic and Monetary Union (UEMOA) provides a maximum BNC rate of 15%.
- Interest on certificates of deposit (bons de caisse): 25%.



## *Tax administration*

### *Returns*

Companies are required by law to have a 31 December fiscal year-end. The corporate income tax due is returned together with annual financial statements according to local generally accepted accounting principles. The deadline for the filing is 30 April for entities with more than XOF 1 billion turnover, 30 May for entities with less than XOF 1 billion turnover, and 30 June for the entities under the Synthetic tax regime.

### *Payment of tax*

Tax withheld must be rendered to the tax authorities by the 15th day of each month. Other taxes are rendered on varying dates.

# Jamaica

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## Significant developments

### Dividends

Major changes were made to the rules governing the taxation of ordinary and preference dividends. Historically, persons in receipt of dividends (whether ordinary or preference) derived from a company listed on the Jamaica Stock Exchange (JSE) were subject to tax at the rate of 0% on such dividend income. As of 1 January 2009, ordinary dividends paid to Jamaican tax residents from resident companies (whether or not they are listed on the JSE) are also taxed at a zero rate. However, preference dividends that qualify as tax deductible expenses of the paying company *(see below)* are taxable in the hands of the recipient, whether or not the shares on which they are paid are listed on the JSE. This tax-free treatment does not extend to non-resident shareholders in receipt of dividends from resident companies, and, accordingly, all dividends paid to non-resident shareholders are now subject to income tax thereon at the default rate of 33 1/3% in the case of a company and 25% in the case of an individual (subject to any treaty protection or incentive relief available).

Subject to certain conditions being met, a company may claim an income tax deduction in respect of preference dividends paid during the year of assessment. However, to the extent that these preference dividends do not qualify for this income tax deduction, they will be treated in a similar manner to ordinary dividends, as indicated above.

### Increase in special capital allowances

As part of a stimulus package, Jamaica increased the special capital allowances available for capital expenditure on certain machinery procured by the owner/operator of a 'qualifying business' from 50% to 100% of the capital expenditure. This new rate became effective on 1 January 2009, and the operator should secure approval in order to claim allowances at this rate.

### Increase in the general consumption tax (GCT) rate

The GCT rate was increased from 16.5% to 17.5% as of 1 January 2010. This new rate applies generally to all goods and services taxable at the standard rate. The rate of 25% applies to the provision of telephone services and handsets.

### Imposition of GCT on electricity consumption

Prior to 2010, the supply of electricity to the public was exempt from GCT. The following measures now apply to the consumption of electricity both by residential and commercial users:

- Supplies of electricity to residential customers up to 200 KwH per month are zero-rated for GCT purposes.
- Supplies of electricity to residential customers (in excess of 200 KwH per month) and to commercial or industrial consumers are subject to GCT at the rate of 10%.

### *Enhanced benefits under the Urban Renewal (Tax Relief) Act*

Amendments were made to the Urban Renewal (Tax Relief) Act in December 2010, which provide improved benefits to persons approved under the Act. The changes include an increased tax credit of 33 1/3% (up from 25%) of expenditure on capital improvement works in a designated special development area (e.g. Downtown Kingston). In addition, lessees of the improved properties who satisfy certain criteria are now able to claim a tax deduction of double the rental paid.

### *Recent tax policy reform measures*

The following measures were announced by the Minister of Finance & Planning in the 2011/2012 budget speech and became effective in May 2011:

#### Recovery of GCT on capital equipment

GCT registered taxpayers who incur GCT on the acquisition of machinery or equipment costing more than 100,000 Jamaican dollars (JMD) for the purpose of their taxable activity are now able to claim this GCT by way of input tax credit over a three month period instead of over a 24 month period.

#### Carryforward of contractors levy

Previously, contractors who suffered the 2% contractors levy on receipts could claim a credit against their income tax liability only in the year of assessment in which the levy is deducted. As of the financial year 2011/2012, where the levy is deducted from the contract sum and remitted to the Collector of Taxes, any amount not utilised as a credit against income tax for that year of assessment may be carried forward to subsequent years of assessment, not exceeding five years. Previously, there was no provision to carry forward any levy credit not utilized.

#### Revision of import duty structure on motor vehicles

The rates of Common External Tariff applicable to several types of motor vehicles were reduced as of 2 May 2011. This includes sports utility vehicles, vehicles referred to as pick-ups, certain motor cycles, and all-terrain vehicles.

#### Tax administration

A series of administrative reforms aimed at enhancing the efficiency and effectiveness of Jamaica's tax regime have been implemented. As of 1 May 2011, the Inland Revenue Department, the Taxpayer Audit & Assessment Department, and the Tax Administration Services Department were merged into a single department called Tax Administration Jamaica. Jamaica Customs was separated and is being transitioned into an Executive Agency. Additionally, the Taxpayer Appeals Department has become a Revenue Appeals Division of the Ministry of Finance, the objective being to ensure that the reporting structure in relation to assessments and appeals is separated.

#### Other reform measures

Other reform measures included the removal of transfer tax and stamp duty on securities and a reduction in stamp duty on the refinancing and transfer of mortgages.

## *Taxes on corporate income*

Income tax at a rate of 33 1/3% is payable by most corporations, including Jamaican branches of foreign corporations.

Building societies (similar to savings and loans) are taxed at the rate of 30% on their profits.

Life insurance companies are taxed at 15% on their 'investment income' net of 'management expenses' both terms of which are defined by the Income Tax Act. Additionally, 'regionalised' life insurance companies pay income tax on gross premiums at the rate of 3% while others pay at the rate of 4%.

The income of certain organisations is specifically exempt from income tax. These include pension and superannuation funds and charitable organisations approved by the Commissioner General of Tax Administration Jamaica.

There are no other local taxes on corporate income.

## *Corporate residence*

A corporation, wherever incorporated, is resident in Jamaica if the central management and control of its business is exercised in Jamaica. Normally, this is the case if meetings of directors and shareholders are held in Jamaica and major policy decisions of the corporation are made in Jamaica.

## *Other taxes*

### *Consumption taxes, custom duties*

The general consumption tax (GCT) is a value-added tax (VAT). The standard rate is 17.5%. Higher rates are applicable to some goods and services (tobacco products, liquor, motor vehicles, fuels, and telephone charges).

The list of items and services exempt from GCT includes a wide range of basic food items, medical supplies, and other items. Certain specified drugs, as well as other items and services, are zero-rated.

GCT is also charged on imported services. Where a taxable activity consists of imported services from a person who is not resident in Jamaica, the recipient of those services is deemed to be the registered taxpayer and pays the tax chargeable on the service. This may be available as a credit in some cases against the tax payable by the recipient of the service.

Lower rates are applicable to hotels and other businesses in the tourism sector, which are taxed at an effective rate of approximately 10% as of 1 April 2010, rather than the standard rate of 17.5%.

In addition to normal customs duties, a user fee of 2% and an environmental levy of 0.5% are imposed on the value of imports. Also, effective 1 January 2010, an additional 5% GCT is levied on the commercial importation of goods subject to GCT. Certain categories of imports are however excluded from this advance GCT charge.

### *Annual fee*

A fee ranging from JMD 1,000 to JMD 35,000 is payable on or before 1 September, depending on the aggregate value of the company's assets. The minimum fee is payable where the aggregate value of the assets is less than JMD 50,000, and the maximum fee is payable where the aggregate value of the assets is greater than JMD 100 million.

### *Real estate tax*
All land in Jamaica is valued on the 'site value' or 'unimproved value'. Owners of properties valued at JMD 300,000 or less pay a flat rate of JMD 600. Tax is payable at a rate of 0.75% where the property exceeds this value, in addition to the flat rate. These new rates became effective in April 2010.

### *Construction operations levy*
A levy of 2% of the gross amount is payable on contracts relating to construction and tillage operations. The contractors levy is in the nature of tax withheld at source and must be deducted by the taxpayer from the gross payment for the construction or tillage operations and paid to the Collector of Taxes within 14 days of the month in which the gross payments are made.

The levy paid is allowable as a credit against the income tax liability of the contractor.

## *Branch income*

Branch income is taxed at the same rate as that of local corporations and on a similar basis. The transfer of profits to the head office is subject to a withholding tax (WHT) of 33 1/3% or at a lower treaty rate, where applicable.



A branch operation, irrespective of the nature of its business activities, is subject to Jamaican tax on income derived from the island and elsewhere to the extent remitted to the island. In computing the income for tax purposes, expenses incurred outside of Jamaica, wholly and exclusively for the purpose of the branch's trade are deductible, including a reasonable proportion of head office expenses.

Transactions between the branch, its head office, and affiliates should be at arm's-length values.

## *Income determination*

### *Inventory valuation*
Inventories are valued at the lower of cost or market value. The Commissioner General has made no pronouncement, but last in first out (LIFO) is not generally permitted.

Any method of valuation that accords with standard accounting practice is acceptable for tax purposes, provided it is consistently applied at the beginning and end of the accounting period and it is not in contravention of the Income Tax Act.

### *Capital gains*
There is no tax on capital gains. There is, however, a transfer tax of 4% of the market value of the asset transferred (limited to 37.5% of the capital gain payable) on the transfer of land, buildings, securities, and shares. There is also stamp duty of 1% payable on the transfer/disposal of shares, and 3% for real property sold/transferred. Transactions on the Jamaica Stock Exchange are exempt from both transfer tax and stamp duty.

### *Inter-company dividends*
Inter-company (ordinary) dividends paid out of profits of a company resident in Jamaica to a shareholder resident in Jamaica can be paid without further tax.

Income tax is withheld at source on dividends paid to a non-resident shareholder. Such dividends are taxed at the rate of 33 1/3% and 25% if paid to corporations and individuals, respectively. Lower rates of withholding are possible provided that the recipient is resident in a country that has concluded a double taxation agreement with Jamaica.

### *Stock dividends*
Stocks issued by way of the capitalization of retained earnings (referred to as 'bonus issues') do not create a taxable distribution in the hands of the shareholders.

### *Foreign income*
A resident corporation is taxable on its worldwide income. Avoidance of double taxation is achieved by credits under tax treaties or, in the case of most Commonwealth countries, under the general Income Tax Act itself. Where recourse cannot be had to either of these, partial relief is granted by a deduction against income for the foreign tax.

## *Deductions*

### *Depreciation and depletion*
Depreciation is generally computed on the reducing balance basis over the useful life of the asset at specified rates. An election may be made for machinery and equipment to be depreciated at higher rates on the straight-line basis. Provision also exists for increased depreciation on machinery and equipment used for more than one shift in certain qualifying industries.

Capital gains on depreciable property are not taxed. However, a recharge limited to the extent of the depreciation allowed (balancing charge) is taxable.

Machinery and plant acquired by a 'qualifying business' may be depreciated over one year instead of the estimated useful life of the asset. A qualifying business is one so designated by the Ministry of Industry, Investment & Commerce.

Tax depreciation may not conform to book depreciation.

### *Charitable contributions*
Approved donations (not exceeding 5% of taxable income) to certain qualified charities and educational institutions are deductible.

### *Real estate taxes*
Taxes on real estate from which income is derived are deductible.

### *Net operating losses*
Losses incurred may be carried forward indefinitely until fully utilised. There are provisions designed to disallow the deduction of such losses where the company that has accumulated them is sold under certain circumstances.

### *Payments to foreign affiliates*
Royalties, management fees, and interest charges paid to foreign affiliates are deductible to the extent that these payments are made at arm's-length rates. WHT should be paid in respect of such services, normally at 33 1/3% where payment is to a company and 25% in the case of individuals, unless a lower rate is provided for under

a treaty. Furthermore, interest paid to non-residents is not deductible until the WHT is remitted.

## *Group taxation*

Group taxation is not permitted in Jamaica.

## *Tax credits and incentives*

A number of incentive laws grant approved industries relief from taxation for a specified number of years. The capital may be either derived from local or foreign sources. Tax relief is given to resident shareholders on dividends paid out of tax-free profits. Relief to non-resident shareholders is generally limited to the applicable foreign tax rate.

Specific incentives are set out under the following acts:

- The Export Industry (Encouragement) Act.
- The Industrial Incentives Act.
- The Industrial Incentives (Factory Construction) Act.
- The Jamaica Export Free Zones Act.
- The Hotel Incentives Act.
- The Resort Cottages Incentives Act.
- The International Finance Companies (Income Tax Relief) Act.
- The Income Tax Act (Agricultural & Venture Capital Incentives).
- The Urban Renewal (Tax Relief) Act.
- The Motion Picture Encouragement Act.
- The Shipping Act.
- The Factory Construction Act.



The incentives offered under the Industrial Incentives Act, the Export Industry (Encouragement) Act, and those available for the production of goods under the Jamaica Export Free Zones Act are to be phased out, given Jamaica's commitments under the World Trade Organisation (WTO) agreement. This was expected to have been phased out by 1 January 2003. An extension of time has been granted for implementation until the end of 2015, with a two year phase-out period.

The Urban Renewal (Tax Relief) Act provides tax incentives to persons approved under the Act in connection with undertaking programmes of development in areas designated as special development areas, with a view to improving or restoring them. The tax incentive provides certain tax benefits, including relief from income tax on rental income and interest earned by an investor in an Urban Renewal Bond. There is also exemption from stamp duty and transfer tax on the transfers of property.

*See the Deductions section for depreciation incentives available in the Income Tax Act.*
In addition to the aforementioned incentives, certain qualifying industries are able to write off, over a period of time, 120% of the cost of machinery and equipment, excluding private motor vehicles.

Non-residents who place deposits with Jamaican banks can earn interest free of Jamaican tax in certain circumstances. The deposits may be designated in hard currency or Jamaican dollars.

Certain tax benefits accrue to employees and employers in respect of contributions made to an approved Employee Share Ownership Plan (ESOP) as well as the allocation of shares from such plans.

## *Withholding taxes*

The Jamaican Income Tax Act refers to deduction at source and not to withholding. The following references are to deduction at source. If it is proved that this exceeds the tax actually payable, refunds are made.

'Prescribed Persons', primarily financial institutions, are required to withhold tax at source at a rate of 25% on interest income earned on investment instruments (subject to any lower rate as prescribed in a double taxation treaty). The Income Tax Act has been amended to provide a wider definition of the term 'interest'. 'Prescribed persons' as defined, include the Accountant General; banks operating under the Banking Act or the Bank of Jamaica Act; institutions operating under the Financial Institutions Act; building societies; societies registered under the Industrial and Provident Societies Act, unless certain conditions are met; the Ministry of Finance & the Public Service; life insurance companies; companies registered under the Companies Act in which the government or an agency of the government holds more than 50% of the ordinary shares and which issues interest bearing securities; issuers of commercial paper; unit trust management companies; and any person who is connected with any of the persons mentioned above (with the exception of the Accountant General).

Generally, all WHTs, including taxes withheld from dividend, interest, royalties, and fees must be remitted to the Inland Revenue Department within 14 days of the end of the month in which the payment is made.

| | Dividends | | | | |
|---|---|---|---|---|---|
| **Recipient** | **Portfolio (%)** | **Substantial holdings (%)** | **Interest (%) (1)** | **Royalties (%)** | **Management fees (%)** |
| Resident corporations | 0 | 0 | 25 (3) | 0 | 0 |
| Resident individuals | 0 (2) | 0 (2) | 25 (3) | 0 | 0 |
| Non-treaty: | | | | | |
| Non-resident corporations | $33^{1/3}$ | $33^{1/3}$ | $33^{1/3}$ | $33^{1/3}$ | $33^{1/3}$ |
| Non-resident individuals | 25 | 25 | 25 | 25 | 25 |
| Treaty: | | | | | |
| Canada | 15 | 22.5 | 15 | 10 | 12.5 |
| CARICOM countries | 0 (4) | 0 (4) | 15 (4) | 15 (4) | 15 |
| China, P.R | 5 (5) | 5 (5) | 7.5 (5) | 10 | $33^{1/3}$ |
| Denmark | 15 | 10 (6) | 12.5 | 10 | 10 |
| France | 15 | 10 (6) | 10 | 10 | 10 |
| Germany | 15 | 10 (6) | 12.5 (7) | 10 | 10 |
| Israel | 22.5 (8) | 15 | 15 | 10 | $33^{1/3}$ |
| Norway | 15 (5) | 15 (5) | 12.5 | 10 | 10 |
| Spain | 10 (5) | 5 (5) | 10 | 10 | 10 |
| Sweden | 22.5 (5, 8) | 15 (5) | 12.5 | 10 | 10 |
| Switzerland | 15 (5, 6) | 10 (5) | 10 | 10 | 10 |
| United Kingdom | 15 (5, 6) | 22.5 (5) | 12.5 | 10 | 12.5 |

| Recipient | Dividends: Portfolio (%) | Dividends: Substantial holdings (%) | Interest (%) (1) | Royalties (%) | Management fees (%) |
|---|---|---|---|---|---|
| United States | 15 (5, 6) | 10 (5) | 12.5 | 10 | $33^{1/3}$ (9) |

Notes

1. No WHT is applicable where the interest is paid by a local bank or financial institution to an approved overseas organisation, that is, a foreign bank or financial institution to an approved overseas organisation approved by the Ministry of Finance & the Public Service.
2. Tax is withheld at the rate of 0% as of 1 January 2010 where an ordinary dividend is paid by a company resident in Jamaica to a resident shareholder.
3. Tax is deducted from interest paid to Jamaican residents if payment is made by a prescribed person.
4. Rates apply only to specified member states.
5. The lower treaty rates do not apply if the recipient has a permanent establishment in the other territory that is 'effectively connected' with the company paying the dividend.
6. A rate of 15% applies to an individual regardless of shareholding.
7. Reduced to 10% if received by a bank recognised as a banking institution under the laws of that state.
8. A rate of 22.5% applies to an individual regardless of the shareholding.
9. Nil in the absence of a permanent establishment.

A WHT rate of 25% is required to be applied in respect of interest paid or credited by prescribed persons. However, certain categories of interest income earned on long-term savings accounts (LSAs) were made exempt from tax including:

- Interest paid or credited in respect of investments or deposits made by individuals with prescribed persons if:
  - The deposit remains a minimum of five years without any withdrawal from the principal sum invested.
  - The deposit or investment (other than interest accrued or credited) does not exceed JMD 1 million dollars in any year.
  - The account is not transferable, except on the death or bankruptcy of the depositor or investor.
  - Not more than 75% of the interest accrued in any year is withdrawn during the year.
- Benefits derived from investments in certain life insurance policies may also be exempt from income tax if specified criteria are satisfied.

## *Tax administration*

Jamaica has established the following departments to handle tax administration:

- The recently formed Tax Administration Jamaica (TAJ) integrates the functions which were previously undertaken by a number of different departments. These functions include compliance and tax collection, administrative and legal support, audit and assessment of income tax, general consumption tax, stamp duty, and transfer tax. The Commissioner General has responsibility for the direction, supervision, and administration of TAJ and is supported in undertaking this role by several Deputy Commissioners General.
- The former Taxpayer Appeals Department (TAD), which recently became a Revenue Appeals Division of the Ministry of Finance processes appeals to decisions made by TAJ.
- Jamaica Customs administers taxes at the port of entry.

There is also a Financial Investigations Division in the Ministry of Finance which investigates customs breaches and fraudulent acts in respect of tax legislation.

### Returns

A corporation is subject to tax on its income for a calendar year. However, where the Commissioner General of TAJ is satisfied that a corporation normally prepares financial statements to a date other than 31 December, the company may be permitted to use the profits of its own financial year rather than the calendar year as the basis of assessment.

Income tax returns are due for filing by 15 March in the year following the year of assessment.

### Payment of tax

The balance of income tax payable for a taxation year, after deduction of the instalments of estimated tax, is due on 15 March of the following year. It is the corporation's responsibility to determine the liability and settle it with the tax authorities.

Quarterly instalments are based on an estimate of the year's liability or the actual tax payable for the previous year.

## Other issues

### Corporation tax calculation - Calendar year 2011

| **Net profit before taxation** | | **JMD 10,000,000** |
|---|---|---|
| **Add:** | | |
| Depreciation charged in the financial statements | 500,000 | |
| Interest payable, 2011 – accrued (1) | 20,000 | |
| Donations not approved | 15,000 | |
| Subscriptions disallowable | 5,000 | |
| Interest for late payment of income tax | 4,000 | |
| Legal fees re increase in share capital | 21,000 | |
| Bad debts – increase in general provision (2) | 150,000 | |
| Loss on sale of fixed assets | 5,000 | |
| Balancing charge (3) | 7,500 | |
| Capital expenditure charged in the financial statements | 22,500 | 750,000 |
| | | 10,750,000 |
| **Less:** | | |
| Interest payable, 2010 – now paid (1) | 15,000 | |
| Interest receivable, 2011 – accrued (1) | 7,000 | |
| Losses carried forward from year of assessment 2010 | 40,000 | |
| Capital allowances (4) | 455,000 | 517,000 |
| Taxable income | | 10,233,000 |
| Income tax payable at 33 1/3% | | 3,411,000 |
| **Less:** | | |
| Estimated (advance) tax payments | 2,400,000 | |
| Foreign tax credit | 11,000 | |
| Tax deducted from local bank interest | 25,000 | (2,436,000) |
| Net tax payable by 15 March 2012 | | 975,000 |

Notes

1. Interest paid/received is dealt with on the cash basis, hence the adjustments for the amount receivable/payable.
2. Reserve for specific bad debts is allowed.
3. Recapture of excess tax depreciation is allowed.
4. Tax depreciation is granted in lieu of book depreciation.

# Japan

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## Significant developments

The 2011 tax reform bill was submitted to the Lower House of the Diet on 25 January 2011. However, discussion of the bill is currently suspended. Normally, the tax reform bill is passed by both houses of the Diet by the end of March and the amended tax laws become effective from April 1. As the 2011 tax reform bill was not passed by 31 March 2011, the Transitional Tax Reform Laws (to extend the expiration dates of certain concessions granted under the Special Measures Law and the Local Tax Law from 31 March 2011 to 30 June 2011) was passed on 30 March 2011. Pursuant to the Transitional Tax Reform Laws, the applicable period for certain tax concessions, including the reduced corporation tax rate for small and medium enterprises (SMEs) and additional research and development (R&D) tax credits, are extended.

The main changes in the Japanese corporate tax system for 2010 were as follows:

- A new group taxation regime was introduced for domestic companies which are wholly owned by a domestic company, foreign company, or individual ('group companies'). Under this regime, the recognition of capital gains or losses from the transfer of certain assets between group companies is deferred until the asset is transferred to a non-group company (on or after 1 October 2010). A group company that would otherwise qualify as a SME on a stand-alone basis is not eligible for the aforementioned benefits (e.g. reduced corporate tax rate, preferable allowable ratios for deductible portion of bad debt provisions, partial deductibility of entertainment expenses, carry back of tax losses) if the parent company of the group has paid-in capital of 500 million yen (JPY) or more.
- Several consolidated tax rules were amended. The most significant amendment relates to pre-consolidation tax losses of a subsidiary, which can now be carried forward into a consolidated tax group but may only be offset against taxable income of the subsidiary.
- Anti-tax haven (controlled foreign company or CFC) rules were amended as follows:
  - The minimum effective tax rate for applying this rule was lowered from 25% to 20%.
  - The stock ownership threshold which a taxpayer is required to own in a CFC was increased from 5% to 10%.
  - The holding of equity securities is disregarded for the business purpose test for the application of the active business exemption where the CFC qualifies as a Regional Headquarters Corporation.
  - Some types of non-operating income derived by a CFC that qualifies for the active business exemption are included in the calculation of taxable income.

### Tohoku Earthquake and special tax legislation

On 27 April 2011, special national tax laws to help deal with the Tohoku Earthquake, including associated amendments to the local tax laws, were promulgated and immediately became effective ('Tohoku Legislation'). These tax laws are intended to provide special tax relief for affected individuals or corporations. *See the Tax credits and incentives section for more information.*

### Pending legislation

Please note this information is current as of 1 June 2011. Please visit the WWTS website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

## Taxes on corporate income

A domestic corporation in Japan is taxed on its worldwide income. A foreign corporation is taxed only on its Japan-source income.

The total corporate income tax burden (i.e. effective tax rate) is in the range of 40.87% to 42.05%, depending upon the size of a company's paid-in capital. Since enterprise tax is deductible, the effective tax rate is less than the total of the statutory rates of corporation tax, inhabitant's tax, and enterprise tax.



### Corporation tax

The corporation tax rates are as follows:

| Company size and income | Corporation tax rate (%) |
|---|---|
| Paid-in capital of over JPY 100 million. | 30 |
| Paid-in capital of JPY 100 million or less, except for a company wholly owned by a company which has paid-in capital of JPY 500 million or more: | |
| First JPY 8 million per annum during fiscal year ending before 1 July 2011. This is a temporary rate which, if not extended by legislation, would revert to a 22% rate. | 18 |
| Over JPY 8 million per annum. | 30 |

### Standard enterprise tax (and Special Local Corporate Tax)

Enterprise tax is imposed on a corporation's income allocated to each prefecture. This allocation is generally made on the basis of the number of employees.

The standard rates of enterprise tax, including a Special Local Corporate Tax, are shown below.

| Taxable base | Enterprise tax (%) | Special Local Corporate Tax |
|---|---|---|
| First JPY 4 million per annum | 2.7 | 81% of the current enterprise tax *(see the immediate left column)* |
| Next JPY 4 million per annum | 4.0 | |
| Over JPY 8 million per annum | 5.3 | |

If the paid-in capital of a corporation is JPY 10 million or more and the corporation has places of business in more than two prefectures, the graduated rates above are not applicable.

For utilities and insurance companies, the standard tax rate is shown as follows:

| Taxable base | Enterprise tax (%) | Special Local Corporate Tax |
|---|---|---|
| Net revenue (net utility charges or net insurance premiums) | 0.7 | 81% of the current enterprise tax *(see the immediate left column)* |

### *Size-based enterprise tax (and Special Local Corporate Tax)*
Instead of the above general enterprise tax, a 'size-based' enterprise tax (Gaikei Hyojun Kazei) is applied to a company whose paid-in capital is more than JPY 100 million as of the year end.

Factors such as the size of a corporation's personnel costs and its capital (the amount of paid-in capital) will determine the additional amount of tax payable. The existing profit-based enterprise tax will also continue to apply at the tax rates indicated below. Therefore, a loss company in Japan may be required to pay tax based on value-added activities and the corporation's paid-in capital. The applicable standard rates are shown as follows:

| Taxable base | Tax rate (%) | Special Local Corporate Tax |
|---|---|---|
| Profit-based tax: First JPY 4 million per annum | 1.5 | 148% of the current enterprise tax *(see the immediate left column)* |
| Next JPY 4 million per annum | 2.2 | |
| Over JPY 8 million per annum | 2.9 | |
| Additional value-based tax | 0.48 | N/A |
| Capital-based tax | 0.2 | N/A |

### *Inhabitant's tax*
Inhabitant's tax is imposed on a corporation's income allocated to each prefecture and city (municipal borough). The allocation is generally made on the basis of the number of employees, in the same way as enterprise tax.

The standard tax rate is 5% as prefectural tax and 12.3% as municipal tax. However, the tax rate may be increased up to 6% for prefectural tax and 14.7% for municipal tax, depending upon the determination of each local government.

In addition to the above, inhabitant's tax is imposed on a per capita basis, in the range from JPY 70,000 (in the case that the amount of paid-in capital is JPY 10 million or less, and the number of employees in each prefecture and city is 50 or less) to JPY 3,800,000 (in the case that the amount of paid-in capital is over JPY 5 billion and the number of employees in each prefecture and city is over 50). The inhabitant's tax amount is determined by the local government by the factors of paid-in capital and the number of employees.

## *Corporate residence*

### *Domestic and foreign corporation*
A company incorporated under the laws of Japan is a domestic corporation. The nationality of its shareholders or place of central management is not relevant.

A corporation other than a domestic corporation is regarded as a foreign corporation.

### *Permanent establishment (PE)*
Under domestic tax law, the scope of Japan-source income in respect of which a foreign corporation is taxable depends upon the type of taxable presence that it has in Japan. The types of taxable presence that a foreign corporation may have in Japan include the following:

- Branch, factory and other fixed places in which business is conducted in Japan, mine, quarry, building for rent, etc. but exclude a specified place used only for the business of purchasing assets and for keeping them (Direct PE).
- Construction, installation, assembly project, or supervisory services related thereto for a period of greater than one year.
- Certain agents (Agent PE), as follows:
  - A person in Japan who has an authority to conclude contracts for a foreign corporation (excluding contracts to purchase assets) and exercises such authority continuously (Contracting Agent).
  - A person in Japan who keeps for a foreign corporation a certain quantity of assets sufficient to meet ordinary demand from the foreign corporation's customers and delivers the said assets to the customers according to their requirements (Fills Order Agent).
  - A person in Japan who, solely or principally for or on behalf one foreign corporation, habitually performs an important part of solicitation of orders, negotiations, or other acts leading up to the conclusion of contracts with respect to the business of the foreign person (Secure Order Agent).



As a matter of law, the articles of Japan's tax treaties have precedence over domestic tax law. In general, there are no significant differences between the definitions of PE under domestic tax law and Japan's tax treaties. However, once a PE has been established for a foreign corporation under domestic law, all Japan-source income is taxable to the PE (as opposed to just income 'attributable to' the PE, as is the case under most treaties).

## *Other taxes*

### *Consumption tax*
Consumption tax (value-added tax or VAT) is levied when a business enterprise transfers goods, provides services, or imports goods into Japan. The applicable rate is 5%. Exports and certain services to non-residents are taxed at a zero rate. Specified transactions, such as sales or lease of land, sales of securities, and provision of public services, are not subject to taxation.

Consumption tax paid by the business enterprise shall be refundable by filing the consumption tax return to the extent that such transaction is recorded in the accounting book.

### *Customs duty*
A customs duty is levied on imported goods based on the custom tariff table.

### *Fixed assets tax*
The annual fixed assets tax is levied by the local tax authorities on real property and depreciable fixed assets used for business purposes. Real property is taxed at 1.7% (standard rate including city planning tax) of the value appraised by the local tax authorities. The depreciable fixed assets tax is assessed at 1.4% of cost after statutory depreciation.

### *Stamp duty*
A stamp duty is levied on certain documents prepared in Japan. The tax amount is generally determined based on the amount stated in the document.

### *Registration and license tax*
Registration and license tax is levied where certain property is registered, at a rate from 0.2% to 2% of the taxable basis. The taxable basis depends upon the property being registered (e.g. the amount of paid-in capital registered by a company or the value of real estate as assessed by local tax authorities).

### *Family corporation tax*
If an individual shareholder together with their family members own, either directly or indirectly, more than 50% of the total issued shares or voting rights of a Japanese corporation, the corporation is treated as a family corporation (with the exception of corporations with paid in capital of JPY 100 million or less) and is subject to the family corporation tax in addition to corporation tax.

A family corporation is liable for an additional tax at the rates shown below on its undistributed current earnings in excess of specified limits.

| Taxable undistributed current earnings | Family corporation tax rate (%) |
|---|---|
| First JPY 30 million per annum | 10 |
| Next JPY 70 million per annum | 15 |
| Over JPY 100 million per annum | 20 |

### *Business premises tax*
Business premises tax is levied and designated by each city in Japan, such as Tokyo, Osaka, Nagoya, Fukuoka, and other cities with a population of more than 300,000. A company that uses business premises in excess of 1,000 square metres and/or has more than 100 employees in a designated city is responsible to pay this tax based on the usage of the business (JPY 600 per square metre) and gross payroll (0.25% of gross payroll).

## *Branch income*

Branch profits are taxed in the same manner as corporate profits. However, the family corporation tax does not apply to a branch of a foreign corporation. In addition, no withholding tax (WHT) is imposed on the repatriation of branch profits to the home office.

## *Income determination*

The taxable income of a corporation is the aggregate income from all sources. There is no specific requirement to differentiate between the types of income. In principle, accounting for tax purposes follows generally accepted accounting principles in Japan, and income of a corporation is determined on an accrual basis.

### *Inventory valuation*
Inventory cost should be determined by applying one of the following methods accepted for corporate tax purposes: actual individual cost, first in first out (FIFO), weighted

average, moving average, most recent retail, selling price reduction, and lower of cost or market.

### *Capital gains*

Capital gains and losses are classified as ordinary income and losses respectively.

Under certain circumstances (e.g. qualified reinvestment, exchange property), taxes generally levied on capital gains may be deferred (i.e. provided rollover relief) as long as certain requirements are met. A special relief is available in the case of expropriation of real property by either the national or local government.

As of 1 October 2010, the recognition of capital gains or losses from the transfer of certain assets between group companies will be deferred until the asset is transferred to another group company or a non-group company.

### *Dividend income*

Dividends received from a Japanese corporation are excluded from taxable income for corporate income tax purposes, provided that the recipient corporation owns 25% or more of the shares in the dividend-paying corporation. If a corporation owns less than 25% of the shares in the dividend-paying corporation, 50% of the dividends received from the dividend-paying corporation are excluded from taxable income.



Interest expense which is allocable as an investment cost of the shares that generate the dividend income effectively reduces the amount of dividend income. Note that this rule is not applicable to dividends between 100% group companies.

95% of dividends received by a company from a foreign company in which it has held at least 25% of the outstanding shares for a continuous period of six months or more, ending on the date on which the dividend is declared, can be excluded from the company's taxable income.

If the foreign company is resident in a country with which Japan has concluded a tax treaty for the avoidance of double taxation, and such treaty provides for the allowance of an indirect foreign tax credit for taxes paid by the foreign company on the profits out of which the dividend is paid where the company holds a certain percentage of the foreign company's outstanding shares (e.g. 10% based on the tax treaty between the United States and Japan), that percentage will apply for the purpose of determining the availability of the above exemption to the extent that it is lower than 25%.

The WHT for dividends is applicable at a rate of 7% (15% on and after 1 January 2012) or 20% depending on the type of stock from which the dividends were received, and a tax credit may also be available for such WHT.

### *Foreign income*

A Japanese corporation is subject to Japanese corporate income taxes on its worldwide income. However, to avoid double taxation of foreign-source income, Japanese corporations are allowed to claim a tax credit against corporation and inhabitant's taxes for foreign income taxes paid directly. *See Foreign tax credit in the Tax credits and incentives section for more information.*

Undistributed profits of a foreign subsidiary (i.e. CFC) located in a tax haven are included in the Japanese parent company's taxable income under certain conditions. *See Anti-tax haven (CFC) rules in the Group taxation section for more information.*

## Deductions

### Depreciation and amortisation

Depreciation is deductible in the calculation of taxable income for corporation tax purposes. Depreciable assets include tangible property, such as buildings, attachments to buildings, structures, machinery and equipment, etc. Certain intangible assets are also eligible for amortisation, such as goodwill, patents and trademarks, etc.

With regard to depreciation methods, a taxpayer may adopt one of the allowable methods for each of the types of depreciable property. Tangible property is generally depreciated using either the straight-line method or the declining-balance method. Intangible property is generally amortised under the straight-line method.

### Reserves

Reserves recorded in the books of accounts, except for reserves for doubtful receivables and return of goods not sold, are not deductible for corporate tax purposes.

#### Reserve for doubtful receivables

The deductibility of a reserve for doubtful receivables is limited by the following two components: (i) an estimate of irrecoverable amounts from a debtor and (ii) a calculation of the limit in the aggregate based on either the actual historical bad debt percentage or statutory percentage (reduced for large corporations), excluding the irrecoverable amount of receivable in (i) above.

#### Reserve for return of goods not sold

A deductible reserve for return of goods not sold is available to corporations such as publishers, wholesalers of books, and others, provided that the corporation sells the merchandise under an unconditional repurchase agreement.

### Charitable contributions

Except for certain designated donations, the tax deduction for charitable contributions is limited to the sum of 1.25% of certain taxable income plus 0.125% of paid-in capital and capital surplus. Donations subject to this limitation include economic benefits considered to be given as a subsidy. Donations to foreign affiliates are not fully deductible.

In the case that a donation occurs on after 1 October 2010 between group companies (as defined), there will be no tax implications for either the donor or donee (i.e. no deduction for the donor and no taxation for the donee).

### Directors' remuneration

The remuneration paid to directors is deductible only in the following three cases:

- Fixed monthly payments.
- Fixed payments in accordance with an advance notice to the tax office.
- Performance bonuses paid in proportion to the company's earnings to directors who engage in the operation of the company's business, to the extent that certain requirements are met.

If the amount of remuneration is deemed unreasonable by the tax authority, only the reasonable amount is deductible for tax purposes.

### *Entertainment expenses*

In principle, entertainment expenses are not deductible for tax purposes. However, a small or medium-sized enterprise (SME), defined as a company with paid-in capital of JPY 100 million or less (except for a company wholly owned by a company which has paid-in capital of JPY 500 million or more after the group taxation regime is effective) may take a tax deduction up to the smaller of 90% of the actual disbursement for the entertainment expense or JPY 5.4 million (90% of JPY 6 million). With regard to expenses for eating and drinking, a company may deduct such expenses up to JPY 5,000 per person (excluding expenditures for internal purposes) for tax purposes.

### *Taxes*

Enterprise tax and business premises tax are deductible in the calculation of the taxable income for corporation tax purposes on a cash basis. However, corporation tax and inhabitant's tax are not deductible. Fixed assets tax and other taxes are deductible, when assessed. Foreign income taxes also may be deductible if the Japanese corporation does not elect to claim a foreign tax credit.

### *Net operating losses*

For corporate income tax and enterprise tax purposes (indirectly for inhabitant's tax purposes), a tax loss can be carried forward to offset future income for seven years, in the case that a taxpayer files a 'blue form' tax return *(see Returns in the Tax administration section)* or if the tax loss is incurred as a result of certain disaster events.

Where there is a change in ownership of a corporation followed by certain events, such as the cessation of business or a significant change in its business within a five-year period following a business acquisition, the utilisation of its tax loss is restricted.

Carryback of tax losses is generally available for one year for national corporation tax purposes. Currently, this carryback rule is suspended until the fiscal year ending 31 March 2012 (except in specified circumstances, e.g. year of liquidation). However, a SME can apply a tax loss recognized in a fiscal year ending on or after 1 February 2009.

No carryback of losses is allowed for enterprise tax and inhabitant's tax.

### *Payments to foreign affiliates*

In order to support a deduction in Japan for expenses incurred by a foreign affiliate and charged to a Japanese corporation, in general, it should be demonstrated that the service arrangement between the foreign affiliate and the Japanese corporation satisfies arm's-length criteria for purposes of Japan's transfer pricing laws and regulations.

Generally, fees that are paid by a Japanese subsidiary to a foreign affiliate should be deductible for Japanese tax purposes if the following conditions are met:

- The services should have the same character as services which take place between non-related companies or such services are essential to Japan's activities.
- There is a written service agreement.
- The services were requested by the Japanese corporation.
- The rendering of services is documented with evidence (e.g. requests for services from the Japanese subsidiary, regular invoices sent by the foreign affiliate).
- The service charges are reasonable.

## Group taxation

### Consolidated tax regime

Under the consolidated tax regime, a consolidated group can report and pay national corporate income tax on a consolidated basis. A consolidated group may be formed by a Japanese parent company and its 100% owned (directly or indirectly) Japanese subsidiaries. The taxpayer may file an application to elect a consolidated group filing for tax purposes, but the election must include all of the parent's eligible subsidiaries. Once the election is made, the consolidated filing, in principle, cannot be revoked unless there is a specific event, such as an ownership change that causes the qualifying conditions of a consolidated filing to fail, or an application to discontinue the consolidated group has been approved by the Commissioner of the National Tax Agency (NTA).

The taxable income of the consolidated group is computed on a consolidated basis by aggregating the taxable income or losses of each member of the consolidated group followed by the consolidation adjustments. Profits from intra-group transactions, except for transfer of certain assets as defined, should be included in the aggregate taxable income. Gains or losses from the intra-group transfer of certain assets are deferred.

Pre-consolidation tax losses of a subsidiary can be carried forward into a consolidated tax group but may only be offset against taxable income of the subsidiary for the calculation of a consolidation income on or after 1 October 2010.

The consolidated national corporate income tax liability is determined by applying the corporate income tax rate to the consolidated taxable income and adjusted for consolidated tax credits. The total tax liabilities are allocated back to each member company. The parent company files the consolidated return and pays the national corporate income tax for the group; however, each member company remains jointly and severally liable for the consolidated group's total national corporate income tax liability.

Local corporate income taxes levied on member companies are paid on a separate company basis, but the amount of local tax payable may be affected because of the consolidated filing.

### Group taxation regime

As of 1 October 2010, a new group taxation regime became effective. This new regime is applicable to domestic companies that are wholly owned by a domestic company, foreign company, or individual ('group companies'). Unlike the consolidated tax regime, the group taxation regime automatically applies to group companies.

The key points of this regime are summarized as follows:

- The recognition of capital gains or losses from the transfer of certain assets (including the transfer of assets as a result of a non-qualified or taxable merger) between group companies is deferred until the asset is transferred to another group company or a non-group company. The scope of assets is the same as that under the tax consolidation system (i.e. fixed assets, land, securities, monetary receivables, and deferred expenses (excluding securities for trading purposes and assets with a book value of less than JPY 10 million)).
- Where a donation occurs between group companies, there are no tax implications for either the donor or donee (i.e. no deduction for the donor and no taxation for the donee). Note that this treatment is not applied to a group company owned by an

individual. This is consistent with the treatment of a donation between members of a consolidated tax group.
- A dividend received from a group company can be fully excluded from taxable income without any reduction for allocable interest expense. This is consistent with the treatment of dividends between members of a consolidated tax group.

A group company that would otherwise qualify as a SME on a stand-alone basis is not eligible for SME benefits (e.g. reduced corporate tax rate, preferable allowable ratios for deductible portion of bad debt provisions, partial deductibility of entertainment expenses, carry back of tax losses) if the parent company of the group has paid-in capital of JPY 500 million or more.

### *Transfer pricing system*
If a corporation which is subject to corporation tax sells property to or buys property from a foreign-related person, or provides services or conducts other transactions with a foreign-related person, and consideration is received or paid by the corporation, the transaction is required to be carried out at an arm's-length price for corporation tax purposes.

A foreign-related person is a foreign corporation which maintains certain special relationships with the subject corporation, such as parent-subsidiary, brother-sister, or substantial control relationship.



The arm's-length price for the sales or purchase of inventory may be determined using one of the four following methods:

- Comparable uncontrolled price method.
- Resale price method.
- Cost plus method.
- Other method (it may only be used if the first three methods cannot be applied to the case).

An advanced pricing agreement (APA) system is available to confirm the arm's-length pricing system proposed by a taxpayer. In general, corporations entering into an APA are advised to file a request for mutual agreement procedures (MAP) in order to obtain the agreement of the competent authorities of each country.

### *Thin capitalisation*
Interest paid on debt to controlling foreign shareholders is disallowed to the extent the average balance of debt on which that interest is paid is more than three times the equity of controlling foreign shareholders.

### *Anti-tax haven (controlled foreign company or CFC) rules*
Undistributed profits of a foreign subsidiary (i.e. CFC) located in a tax haven are included in the Japanese parent company's taxable income under certain conditions.

Tax havens are defined as certain countries or territories that do not impose corporate income tax or that tax the income of a foreign subsidiary at a rate of 20% or less. A Japanese corporation owning a 10% or more direct or indirect interest in a CFC is required to include its pro-rata share of the taxable retained earnings of the CFC in its gross income under certain circumstances.

A dividend paid by a CFC is not deductible when calculating its undistributed income.

## Tax credits and incentives

### Foreign tax credit

A Japanese corporation is subject to Japanese corporate income taxes on its worldwide income. However, to avoid double taxation of foreign-source income, Japanese corporations are allowed to claim a tax credit against corporation and inhabitant's taxes for foreign income taxes paid directly.

Creditable foreign taxes are defined as taxes that (i) are incurred directly by the taxpayer; (ii) are levied by foreign governments and local authorities in accordance with local tax laws; (iii) are levied on corporate income; and (iv) have the same characteristics as Japanese income tax, corporation tax, and local income-based taxes. A tax for which refund can be claimed optionally by the taxpayer after the tax payment, or a tax whose payment grace period can be decided by the taxpayer, are not regarded as foreign tax.

In order to prevent the credit from reducing corporation tax on Japan-source income, certain limitations are set on the amount of foreign tax that can actually be credited.

A foreign tax credit is not applicable for enterprise tax purposes, although foreign branch income attributable to a business executed outside Japan is exempt from enterprise tax.

Generally speaking, the foreign tax credit system does not apply to the extent the dividend income from the foreign subsidiary is subject to the dividend exemption system.

### Tax credit for research and development (R&D) cost

The tax credit for R&D cost is calculated based on gross R&D cost. Limitation of the credit is determined based on the corporation tax liability as follows:

- For fiscal years ending on or before 31 March 2009: 20% of the corporation tax liability.
- For fiscal years beginning 1 April 2009 to 30 June 2011: 30% of the corporation tax liability.

In the case that the amount of the credit exceeds 30% of the corporation tax liabilities, the excess amount can be carried forward for one year.

In addition to the R&D credit, for tax years beginning during the period 1 April 2008 to 31 March 2012, a taxpayer may claim an additional tax credit based on its incremental R&D expenditure or excess R&D cost over sales, as follows:

- 5% of the excess R&D costs over the annual average of R&D costs for the last three years.
- Excess R&D costs over 10% of the average sales amount times a tax credit ratio equal to ((R&D costs/average sales) –10%) x 0.2).

### Special tax credit for staff training expenses

SMEs that qualify and have elected to file 'blue form' tax returns *(see Returns in the Tax administration section)* are allowed to claim a tax credit against the corporation's income tax liability for certain staff training expenses for fiscal years beginning 1 April 2008 to 30 June 2011.

The amount of tax credit is calculated using the tax credit rate for staff training expenses. The range of the tax credit rate is between 8% and 12%, depending upon the percentage of training expenses over the total labour costs, subject to the limitation of 20% of the corporation tax liability.

### *Special tax treatment for investment in certain equipment*

SMEs filing 'blue form' tax returns may elect, under certain conditions, to claim accelerated depreciation of 30% of the base acquisition cost or a special tax credit equivalent to 7% of the base acquisition cost on designated equipment to the extent that it is acquired by 31 March 2012. The maximum tax credit is limited to 20% of the taxpayers' corporate tax liability.

### *Tohoku Earthquake and special tax legislation*

On 27 April 2011, special national tax laws to help deal with the Tohoku Earthquake, including associated amendments to the local tax laws, were promulgated and immediately became effective ('Tohoku Legislation'). These tax laws are intended to provide special tax relief for affected individuals or corporations.

### Corporate tax refunds for loss carrybacks



Under current law, one year tax loss carrybacks are allowed for small and medium corporations (SMCs). Other corporations are allowed a one year tax loss carryback in the year of liquidation. In the Tohoku Legislation, corporations which incurred a specified disaster loss from the Tohoku Earthquake (the 'Tohoku Earthquake Disaster Loss') may carry back such loss for two years for national tax purposes. Such carryback may be elected either with the annual corporate tax return or an interim tax return based upon a full interim closing of the corporate books. For local tax purposes, the tax loss carryback is not applicable, although carryforward of all losses (including the Tohoku Earthquake Disaster Loss) is allowed over the normal seven year carryforward period.

| Applicable tax year and tax return | Carryback years | Refundable tax amount |
|---|---|---|
| Final tax return for tax year ending between 11 March 2011 and 10 March 2012 | Tax years beginning within two years from the first date of the tax year when the Tohoku Earthquake Disaster Loss is incurred | Tax liability of carryback year X (Tohoku Earthquake Disaster Loss / Taxable income of carryback year) |
| Closing basis interim tax return for interim period ending between 11 March 2011 and 10 September 2011 | Tax years beginning within two years from the first date of the interim period when the Tohoku Earthquake Disaster Loss is incurred | |

### Special depreciation for newly acquired assets relating to the Tohoku Earthquake

A corporation may claim a special depreciation of certain assets in the year of acquisition in addition to normal depreciation. The qualified assets should be acquired and placed in service between 11 March 2011 and 31 March 2016 and satisfy either (i) or (ii) below:

i. Newly acquired assets to replace Tohoku Earthquake destroyed assets, including
   - Buildings, structures, machinery, or equipment.
   - Registered vessels, aircraft, or vehicles.

ii. Newly acquired assets placed in service in a business carried out at the affected area*, including buildings, structures, machinery, or equipment.

* Areas where destroyed buildings or structures were located and surrounding areas where machinery or equipment were installed.

| Assets | Special depreciation rate applicable to the assets acquired and put into service between 11 March 2011 and 31 March 2014 | | Special depreciation rate applicable to the assets acquired and put into service between 1 April 2014 and 31 March 2016 | |
|---|---|---|---|---|
| | SMCs | Other than SMCs | SMCs | Other than SMCs |
| Buildings, structures | 18% | 15% | 12% | 10% |
| Machinery, equipment; registered vessels, aircraft, vehicles | 36% | 30% | 24% | 20% |

**Rollover relief given to newly acquired assets to replace old assets**
Under the current statutes, up to 80% of the capital gain realized when a corporation acquires an asset to replace an old one may be deferred. Under the Tohoku Legislation, for certain assets acquired between 11 March 2011 and 31 March 2016, the entire amount of capital gain may be deferred. Qualified replacement assets include the following:

- Real estate or depreciable assets located in Japan purchased to replace real estate (including buildings or structures fixed to the land) in the affected area that had been acquired prior to 11 March 2011.
- Real estate or depreciable assets purchased in the affected area to replace real estate, buildings, or structures located other than in the affected area.

When applying the rollover relief rules, the due date for acquiring replacement assets is extended for a further two years if it is difficult to acquire the replacement asset by the normal due date as a result of the Tohoku Earthquake.

| | |
|---|---|
| Applicable transaction | • Acquiring replacement assets due to expropriation.<br>• Acquiring certain other replacement assets. |
| Cases where the extension will be approved | • Difficulty in acquiring replacement assets by the normal due date which falls within a tax year which ends between 11 March 2011 and 31 March 2012. |
| Requirements for applying the extension | • A corporation expects to acquire the replacing asset within the designated period (up to two years).<br>• A corporation expects to place the replacing asset in service within one year from acquisition date (excluding replacement assets due to expropriation).<br>• Extension is approved by the chief of the appropriate tax office. |
| Filing of the application form | • The application form should be filed within two months from the beginning of the tax year following the transferring year. |

## *Withholding taxes*

### *Tax treaty network*
As of 31 March 2011, Japan has entered into 48 tax treaties with 59 countries. Companies making certain payments are required to withhold income taxes using the following rates.

| Recipient | Dividends (%) Portfolio (3) | Substantial holdings (1) | Interest (%) | Royalties (%) (2) |
|---|---|---|---|---|
| Japanese corporations | 7/20 (3) | 20 | 0/20 (4) | 0 |
| Resident individuals | 10/20 (3) | 20 | 0/20 (4) | 0 |
| | | | | |
| Foreign corporations, non-resident individuals: | | | | |
| Non-treaty (5): | 7/20 (3) | 20 | 0/15/20 | 20 |
| Treaty (6): | | | | |
| Australia | 10 | 0/5 | 10 | 5 |
| Austria | 20 | 10 | 10 | 10 |
| Bangladesh | 15 | 10 | 10 | 10 |
| Belgium | 15 | 10 | 10 | 10 |
| Bermuda (7) | - | - | - | - |
| Brazil | 12.5 | 12.5 | 12.5 | 12.5/15/25 (8) |
| Brunei | 10 | 5 | 10 | 10 |
| Bulgaria | 15 | 10 | 10 | 10 |
| Canada | 15 | 5 | 10 | 10 |
| China, P.R. | 10 | 10 | 10 | 10 |
| Czechoslovakia (former) (9) | 15 | 10 | 10 | 0/10 (9) |
| Denmark | 15 | 10 | 10 | 10 |
| Egypt (5) | 15 | 15 | 0/15/20 | 15/20 (10) |
| Finland | 15 | 10 | 10 | 10 |
| France | 10 | 0/5 | 10 | 0 |
| Germany | 15 | 10 | 10 | 10 |
| Hungary | 10 | 10 | 10 | 0/10 (11) |
| India | 10 | 10 | 10 | 10 (12) |
| Indonesia | 15 | 10 | 10 | 10 |
| Ireland, Rep. of | 15 | 10 | 10 | 10 |
| Israel | 15 | 5 | 10 | 10 |
| Italy | 15 | 10 | 10 | 10 |
| Kazakhstan | 15 | 5 | 10 | 10 (13) |
| Korea, Rep. of | 15 | 5 | 10 | 10 |
| Luxembourg | 15 | 5 | 10 | 10 |
| Malaysia | 15 | 5 | 10 | 10 |
| Mexico | 15 | 0/5 (14) | 10/15 | 10 |
| Netherlands | 15 | 5 | 10 | 10 |
| New Zealand (5) | 15 | 15 | 0/15/20 | 20 |
| Norway | 15 | 5 | 10 | 10 |
| Pakistan | 10 | 5/7.5 (15) | 10 | 10 |
| Philippines | 15 | 10 | 10 | 10/15 (16) |
| Poland | 10 | 10 | 10 | 0/10 (17) |
| Romania | 10 | 10 | 10 | 10/15 (18) |
| Singapore | 15 | 5 | 10 | 10 |
| South Africa | 15 | 5 | 10 | 10 |
| Spain | 15 | 10 | 10 | 10 |
| Sri Lanka (19) | 20 | 20 | 0/15/20 | 0/10 |
| Sweden | 15 | 0/5 (20) | 10 | 10 |

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| Recipient | Dividends (%) Portfolio (3) | Substantial holdings (1) | Interest (%) | Royalties (%) (2) |
|---|---|---|---|---|
| Switzerland | 15 | 10 | 10 | 10 |
| Thailand | 7/20 | 15/20 (21) | 10/25 (21) | 15 |
| Turkey | 15 | 10 | 10/15 (22) | 10 |
| USSR (former) (23) | 15 | 15 | 10 | 0/10 (23) |
| United Kingdom | 10 | 0/5 | 10 | 0 |
| United States | 10 | 0/5 | 10 | 0 |
| Vietnam | 10 | 10 | 10 | 10 |
| Zambia | 0 | 0 | 10 | 10 |

Notes

The applicable treaty rates are effective as of 31 March 2011.

1. The tax treaty rates apply only to corporate shareholders. The applicable treaty should be checked for conditions required to claim the reduced rate.
2. The applicable treaty should be reviewed because certain tax treaties exclude film royalties and/or gain from copyright transfer from taxable income.
3. For certain dividends received from 1 January 2004 through 31 December 2011, the reduced rate of 7% (for resident individuals, an additional 3% will be levied) is applied instead of 20%. Thus, the WHT rate for resident individuals is either 10% or 20%, whereas, the rate for corporations or resident individuals in non-treaty countries is 7% or 20%. For residents in treaty countries, 7% or the treaty rate will be applied. As of 1 January 2012, 20% will be applied without exception.
4. Interest on bank deposits and/or certain designated financial instruments is subject to a 15% national WHT and 5% local inhabitants WHT (20% combined). Taxation of such interest is fully realized by tax withholding, so resident individuals are not required to aggregate such interest income with other income. Interest on loans made by resident individuals is not subject to withholding tax; instead, it is taxed in the aggregate with other income.
5. Dividends, interest, and royalties earned by non-resident individuals and/or foreign corporations are subject to a 20% national WHT under Japanese domestic tax laws in principle. An exception rate of 7% is applied to dividends from certain listed companies. An exceptional rate of 15% is applied to interest on bank deposits and certain designated financial instruments. Interest on loans, however, is taxed at a 20% rate. A special exemption from WHT applies to certain long-term corporate bonds issued to non-residents in foreign countries.
6. Tax treaties with many countries provide reduced tax rates, as indicated. Some treaties, however, provide higher tax rates (e.g. Brazil, Thailand) or do not provide rates (e.g. Egypt, New Zealand). In these instances, rates specified under Japanese domestic tax laws apply. Each treaty should be consulted to see if a reduced rate for dividends (in the case of substantial holdings) is applicable.
7. The tax treaty with Bermuda was concluded mainly for the purpose of information exchange.
8. The tax treaty with Brazil provides a 25% tax rate for certain royalties (trademark). However, the WHT rate cannot exceed 20% on any royalties to be received by a non-resident taxpayer of Japan under Japanese income tax law. Film royalties are taxed at 15%. Any other royalties are taxed at 12.5%.
9. The treaty with the former Czechoslovakia is applied to the Czech Republic and the Slovak Republic. It stipulates that cultural royalties are tax exempt.
10. Film royalties are taxed at 20%, and other royalties are taxed at 15%.
11. Cultural royalties are tax exempt.
12. The rate of 10% for royalties includes consideration for technical services.
13. The rate for royalties is reduced to 5% by Protocol.
14. Dividends received from subsidiaries, by parent companies that have met certain conditions, are exempt from withholding taxes.
15. A 5% rate is applied to a company which has over 50% shares with direct voting rights, and a rate of 7.5% is applied to a company which has over 25% shares with direct voting rights.
16. Film royalties are taxed at 15%. Any other royalties are taxed at 10%.
17. Cultural royalties are tax exempt.
18. Cultural royalties are taxed at 10%.
19. Interest paid to financial institutions is tax exempt, as well as film and copyright royalties. Patent royalties are subject to a 10% rate.
20. If certain conditions for beneficial owners are met, dividends are taxable only in the contracting state of which the beneficial owner is a resident.
21. Dividends paid by a corporation that is engaged in industrial undertakings are taxed at 15%. Interest paid to financial institutions is taxed at 10%.
22. Interest paid to financial institutions is taxed at 10%.

23. The treaty with the former USSR is applied to Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. It stipulates that cultural royalties are tax exempt.

## Tax administration

### Returns

Corporate income tax returns (i.e. the national corporation tax return, enterprise tax return, and local inhabitants' tax return) are self-assessment tax returns.

The tax year is the corporation's annual accounting period specified in its articles of incorporation. A Japan branch of a foreign corporation must use the same accounting period that is adopted by the corporation in its home country.

If a corporation meets certain conditions, such as keeping certain accounting books, and makes an application for it in advance, it is allowed to file a 'blue form' tax return. A blue form filing corporation may benefit from loss carryforward and other benefits.

A corporation (including a branch) is required to file the final tax return within two months after the end of its annual accounting period. If a corporation cannot file the final return because of specific reasons, the due date of final return may be extended for one month with the tax authority's approval.



### Payment of tax

Income taxes payable on the final corporate income tax return should be paid on or before the filing due date of the final tax returns (usually two months after the end of the corporation's accounting period). If an extension of time for filing is granted, the taxes may be paid on or before the extended due date with interest accrued at a rate of 4.3% (for the year 2011) per annum for the period from the day following the original due date (i.e. two months after the end of an accounting period) to the date of the actual payment.

Provisional tax payments are required for a corporation that has a fiscal period longer than six months. Provisional taxes generally are computed as one-half of the tax liabilities for the previous year, but they may be reduced by the filing of interim tax returns that reflect semi-annual results of the operations.

### Consolidated taxation

The parent company will file the consolidated tax return and pay national corporate income tax for the group. The consolidated tax return and payment due dates are the same as previously discussed; however, the due date of the final return may be extended for two months.

For local corporate income taxes, each member of the consolidated group must separately file the returns and pay the taxes.

### Penalties

If the tax return is filed late, a late filing penalty is imposed at 15% to 20% of the tax balance due. In the case that a corporation voluntarily files the tax return after the due date, this penalty may be reduced to 5%.

An under-payment penalty is imposed at 10% to 15% of additional tax due. In the case that a corporation amends a tax return and tax liabilities voluntarily after the due date, this penalty may not be levied.

In addition, interest for the late payment of tax is levied at 4.3% (for the year 2011) per annum for the first two months and increases to 14.6% per annum thereafter.

# Jersey, Channel Islands

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## Significant developments

Jersey's business tax regime has recently been reviewed by the EU Code of Conduct on Business Taxation Group. The Code Group expressed concerns over Jersey's rules for taxing profits of Jersey companies on Jersey shareholders as deemed dividends or attributed profits. To address these concerns, the Chief Minister announced in February 2011 that these provisions would be removed as of 31 December 2011. Draft legislation removing the deemed dividend and full attribution provisions was lodged in May 2011 and is due to be debated on 5 July 2011.



No changes have been made to corporate income tax rates.

The standard rate of goods and services tax (GST) has been increased to 5% as of 1 June 2011.

## Taxes on corporate income

Companies pay income tax at a rate of 0%, 10%, or 20% on taxable income. The tax rate applies to the company as a whole, the only exception being Jersey-source property income, which is taxed at 20% regardless of the classification of the property holding company.

As of 1 January 2011, certain Collective Investment Funds and Securitisation Vehicles can elect to be exempt from tax on income, other than income from Jersey land or property, for an annual fee of 500 pounds sterling (GBP).

The 20% tax rate applies to Jersey-based utility companies, such as telephone, gas, and electricity companies. Additionally, income from Jersey real estate, including rental and property development, is subject to tax at 20%. From 2011, the 20% rate applies to companies exploiting Jersey land (e.g. quarrying activities), and from 2012, to companies involved in oil importation.

The 10% rate applies to financial services companies. A company is defined as a financial services company if:

- it is registered under the 1998 financial services law to carry out investment business, trust company business, or fund services business as an administrator or custodian in relation to an unclassified or an unregulated fund
- it is registered under the 1991 banking business law, or
- it holds a permit under the collective investment funds law of 1988 as an administrator or custodian.

The 0% rate applies to all entities that are not exempt, financial services entities, or utility companies, including fund managers who do not hold any of the permits mentioned above.

There are provisions in Jersey tax law under which Jersey-resident beneficial owners of Jersey companies are subject to tax on distributed or undistributed profits. These provisions are to be removed as of 31 December 2011.

## Corporate residence

A company is regarded as tax resident in Jersey if it is incorporated in Jersey or if it has its place of central management and control in Jersey. However, a Jersey incorporated company managed and controlled elsewhere will not be regarded as a Jersey resident, provided certain conditions are satisfied.

## Other taxes

### General sales tax (GST)

A 3% GST was introduced in May 2008. This rate has been increased to 5% as of 1 June 2011.

Companies with taxable supplies of more than GBP 300,000 per annum are required to register for GST.

### International service entity (ISE) status

To address the difficulty of irrecoverable input tax in the financial services sector, and to mitigate the administrative cost of GST for exporters in general, Jersey has introduced the concept of an ISE. Where an entity qualifies for this status:

- it will not be required to register for GST
- services to it will be zero-rated (i.e. treated as an export) where the supply exceeds GBP 1,000, and
- input tax on purchases less than GBP 1,000 may be reclaimed.

ISE status will automatically be available to a wide variety of service providers and administered entities based in Jersey, on application and payment of the relevant fee, including licensed banks, licensed trust service providers, licensed fund administrators, fund managers, and managed managers.

Other entities not automatically eligible under one of the categories above, including companies, partnerships, trusts, unrecognised funds, and special purpose vehicles, may still obtain ISE status if they fulfil certain criteria.

The ISE must be included on a list maintained by the comptroller of income tax. The list will refer either to the entity itself or (e.g. for administered entities) a class of entities as submitted by the administrator.

## Branch income

Branch income is taxed at the rate applicable to the company. No further tax is withheld on the transfer of profits abroad.

## Income determination

### Inventory valuation
Inventory is valued at the lower of historical cost or net realisable value. The last in first out (LIFO) method is not permitted. Generally, there are no material differences between accounts prepared on a normal accounting basis and those prepared on a tax basis.

### Capital gains
Capital gains are not subject to tax.

### Dividend income
There is no requirement to withhold tax at source when paying dividends. If a dividend is paid out of profits that have suffered tax at either a 10% or 20% rate, the net dividend will be accompanied by a tax credit at the applicable rate. Repayment of the tax credit can be claimed by Jersey investment companies and financial services companies receiving the dividends, subject to certain restrictions. However, trading companies subject to tax at 0% are not entitled to claim a repayment of any of the tax credit.



### Stock dividends
Stock dividends are taxed as income.

### Foreign income
Income tax is levied on foreign branch income when earned and on foreign dividends, interest, rents, and royalties. Double taxation is mitigated by either the granting of unilateral relief to the extent of taxing foreign income net of foreign taxes or by treaty relief, which gives credit for foreign tax. Concessional credit relief might be granted in certain limited circumstances upon application.

In addition to the long standing Double Tax Arrangements with the United Kingdom and Guernsey, the Island now has Double Tax Arrangements with Australia, Denmark, Estonia, Faroes, Finland, France, Germany, Greenland, Iceland, Malta, New Zealand, Norway, and Sweden. The scope varies from agreement to agreement but most are of limited scope.

Jersey has also signed Tax Information Exchange Agreements with 20 countries.

## Deductions

### Capital allowances
Capital allowances are available using the diminishing-balance method on machinery and equipment, including vehicles, at a rate of 25%. For this purpose, all such assets are pooled, and the allowance is calculated by reference to the value of the pool.

On disposal of an asset, the lower of cost and sale proceeds of the asset is deducted from the pool. A balancing charge is levied if the proceeds exceed the balance of the pool.

Motor vehicles costing more than GBP 21,000 and greenhouses are subject to special rules and are not pooled with other assets.

By concession, an alternative is to claim the full cost of replacement in the year of replacement.

Capital allowances are not applicable to buildings or the depletion of natural resources.

### *Taxes*
Local income tax paid is not deductible in computing taxable income. ISE fees paid are a tax-deductible expense.

### *Other significant items*
Normally, business deductions are allowed if they are incurred wholly and exclusively for the purpose of the trade.

### *Net operating losses*
Under zero/ten legislation, no distinction is drawn between different types of income or losses arising from different trades or sources, apart from Jersey property income which is separately streamed. These should be aggregated in order to arrive at the company's net relevant profits (0% companies) or tax-adjusted profits (financial services companies).

Unrelieved net relevant losses or tax-adjusted losses may be carried forward and used to offset the net relevant profits or tax-adjusted profits in future accounting periods. Alternatively, net relevant losses or tax-adjusted losses can be group relieved to group companies in the same income tax rate band.

There are now only very limited circumstances where a company can obtain relief for carrying back losses under the new zero/ten regime.

### *Payments to foreign affiliates*
Patent royalties are generally subject to taxation at source, and relief is obtained by retention of the tax deducted.

## *Group taxation*

Group taxation is not permitted.

The zero/ten legislation contains provisions for group relief between group companies subject to the same rate of tax. It is not possible to relieve losses between two companies taxed at different rates.

## *Tax credits and incentives*

There are generally no special incentives for locally owned businesses in view of the low rate of tax.

## *Withholding taxes*

Interest and patent royalties paid by Jersey companies to non-residents are exempt from Jersey tax.

## *Tax administration*

### *Returns*

The tax year is the calendar year. Companies are assessed on income earned in respect of the financial year that ends within the applicable calendar year of assessment. The system relies on the filing of a return of information with the Island tax authority, which then raises an assessment (in the case of companies taxed at 10% or 20% on all or part of their income). Companies taxed at 0% are required to submit a tax return but are not required to submit accounts and tax computations.

As of 1 January 2011, there is a filing deadline for the corporate return of 6pm on the last Friday in July and a late filing penalty of GBP 250.

### *Payment of tax*

Tax is payable in arrears during the calendar year following the year of assessment. Tax paid after a prescribed date (usually the first Friday in the December following the year of assessment) incurs a 10% surcharge.

# Jordan

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## Significant developments

The Jordanian tax regime was previously based on the application of the Jordanian Income Tax Law No. 57 of 1985 ('Old' Tax Law). The Old Tax Law was repealed and replaced by a temporary income tax law, which became effective as of 1 January 2010. This temporary income tax law was introduced by the newly appointed Jordanian government in the absence of a Parliament (after a royal edict ordering its dissolution). When the new government was sworn in during December 2009, the introduction of a new income tax law was identified on the agenda of items to be addressed. On this basis, the temporary income tax law was introduced by the new government and will be in force until the elected Parliament enacts the final income tax law; however, an exact date for enactment is not yet known. Part of Parliament's tasks will be to review these temporary laws, make amendments, if appropriate, and then pass the laws as final.

## Taxes on corporate income

The corporate tax rates in Jordan are applied based on the industry/business activities from which the taxpayer generates income. The corporate tax rates are as follows:

- 30% for banks.
- 24% for telecommunication, insurance, financial intermediation companies (including exchange and finance leasing companies).
- 14% for other companies.

Jordanian resident corporations are not subjected to income tax on their worldwide income, except for foreign branches of Jordanian resident corporations, whereby 20% of the branch net income after taxes is subject to Jordanian corporate tax.

Non-resident corporations are taxed through withholding tax (WHT*) (see the Withholding taxes section)*.

## Corporate residence

An entity will be deemed to be resident in Jordan if it has been established and registered in accordance with the provisions of the Jordanian legislation in force and (i) has an office or branch practicing management and supervision of its work in Jordan, (ii) whose management head office or actual office is located in Jordan, or (iii) which the government or any official or public institutions own more than 50% of its capital.

## Other taxes

### Sales tax
A general sales tax similar in operation to a value-added tax (VAT) is imposed at the rate of 16% on the following transactions:

- Sales of goods or services or both.
- Importing any service or goods from outside Jordan or from the free zone areas and markets inside Jordan.

Special tax rates are applied on certain items (e.g. tobacco, fuel, alcoholic drinks, and certain cars).

A zero rate is applied to the export sales of goods and services outside Jordan or to the free zone areas and markets. A zero rate is also applied to sales inside Jordan of certain food items, books, magazines, manure, farm tractors, other agricultural tools, and salt.

Goods exempt from sales tax include fish, eggs , animals, bread, water packed in less than 5 litres, trees and plants, fruits, vegetable oils, honey, tea, sugar, gold, money, potash, emergency and fire vehicles, electricity, and pharmaceutical products.



Services exempt from sales tax include the following:

- Air transport.
- Education.
- Disposal of sewage and waste.
- Public health and similar activities.
- Activities of religious organisations.
- Activities of social organisations.

### Property taxes
There is a property tax in Jordan that is paid annually, and the tax rate is determined by the Municipality depending on the location and size of the property and, in case of buildings, depending on annual rental value.

### Transfer property taxes
Transfer of property is subject to tax at a rate of 5%.

### Stamp duty
An *ad valorem* stamp duty of 0.3% or 0.6% is levied.

### Payroll tax
A company should withhold payroll tax from monthly salaries and benefits at rates ranging from 7% to 14%.

### Social security tax
A social security tax is imposed on the employer and the employee by rates of 11% and 5.5% respectively on the monthly salaries and certain allowances in kind. The employer should report and withhold these contributions on a monthly basis.

## *Branch income*

Operating branches of non-resident companies registered in Jordan are taxed based on their activities/business being carried out in Jordan at the prevailing corporate income tax rates. Non-operating branches of non-resident companies registered in Jordan are generally prohibited from carrying on any commercial activity in Jordan.

## *Income determination*

Any income incurred in or from Jordan, regardless of the place of payment even if it was from illegal sources, shall be subject to tax. This includes, but is not limited to, income from:

- Professional services or activities.
- Interest, commissions, discounts, currency differences, deposit profits, and profits from banks and other legal resident persons.
- Royalties.
- Selling goods produced in Jordan whether sold in Jordan or exported.
- Selling or leasing of movable properties located in Jordan.
- Leasing immovable properties located in Jordan and the income from key money.
- Selling or leasing intangible assets in Jordan, including goodwill.
- Insurance premiums due according to insurance and re-insurance agreements for risk in Jordan.
- All forms of telecommunication services, including international telecommunications.
- Transportation between Jordan and any foreign country.
- Service compensation gained by a non-resident person from Jordan for a service provided to any person if the activity or the work related to this compensation was carried out or the output of this service was used in Jordan.
- Any contract in Jordan, such as construction contracting, commercial agencies profits, and any other similar entities whether their source is inside or outside Jordan.
- Any other employment or business activity, or investment, which has not been exempted according to the provisions of the law.

The following shall be exempted from tax:

- The King's allocations.
- Income of public and official institutions and municipalities, excluding its income from rent and key money.
- Income of unions, professional commissions, cooperation societies, and other societies legally registered and licensed from non-profit activities.
- Income of any religious, charity, cultural, educational, sports, or health institutions with a public character, not aiming to achieve profit and the income of charity awqaf (public endowment), and income from the Orphans Development Fund investment.
- Income of exempted registered companies according to the companies' law, which is incurred from activities undertaken outside Jordan, except income derived from income sources subject to tax according to the provision of the law.
- Profits from stocks and dividends distributed by a resident to another resident, except profits of mutual investment funds of banks and financial companies.
- Capital gains incurred inside Jordan, other than profits from assets subject to depreciation.

- Income derived from inside Jordan from trading in dividends and stocks, bonds, equity loan, treasury bonds, mutual investment funds, currencies, commodities in addition to futures and options contracts related to any of them, except that incurred by banks, financial companies, financial intermediation and insurance companies, and legal persons who undertake financial lease activities.
- Income from trading in immovable properties located in Jordan except the following:
  - Income incurred from such trade by a legal person.
  - Income incurred from building and selling real-estate.
- Income derived by non-Jordanian resident investors from sources outside Jordan that are initiated from their investments of their foreign capital, returns, profits, and proceeds from their investments' liquidation, returns, or selling of their projects, shares, or stocks after transferring them outside Jordan in accordance to the enacted Investment Law or any other law that will replace it.
- Compensation paid by insurance entities, other than what is paid as reimbursement for the loss of income from business activity or employment.
- Any income generated by banks and financial companies not operating in Jordan from banks operating in Jordan, such as deposit interest, commissions, and deposit profits from investment in interest-free banks and financial companies.
- Profits gained by re-insurance companies from insurance contracts concluded with insurance companies operating in Jordan.
- Income covered by double-taxation agreements (DTA) concluded by the government, to the extent of that which is covered under these agreements.
- The income of public or private pension funds and savings funds and any other funds approved by the Minister shall not be subject to tax if this income is derived from the employees and employers contributions.
- Certain types of local origin goods and services' exports outside Jordan may be totally or partially exempted from tax as set forth in regulations issued for this purpose.



### *Inventory valuation*
Inventory is generally valued in accordance to the International Financial Reporting Standards (IFRS) accounting framework.

### *Capital gains*
Capital gains are not taxable in Jordan except for capital gains that are generated from depreciable assets.

### *Dividend income*
Dividends are not taxable in Jordan.

### *Foreign income*
Jordanian resident corporations are not subjected to income tax on their foreign income, except for foreign branches of Jordanian resident corporations, whereby 20% of the branch net income after taxes is subject to Jordanian corporate tax.

## *Deductions*

Approved expenses, including the following, are deductible:

- Foreign income tax paid for income earned from sources outside Jordan that was subject to tax under the provisions of the tax law.
- Interest and Murabaha (profit-sharing) paid by banks or financial institutions.

- Interest and Murabaha that are paid by any taxpayer other than banks and financial institutions and finance leasing companies, provided that the deduction shall not exceed the rates that are determined in the thin capitalisation rules *(see Thin capitalisation in the Group taxation section)*.
- Bad debts.
- Insurance premiums.
- Maintenance expenses for assets that were spent within the tax period, provided that such expenses do not exceed 5% of their value.
- Taxes and fees paid on taxable activities.
- Amounts paid as civil compensation under contracts concluded by the taxpayer for the purpose of carrying out taxable activities.
- Amounts paid by the employer for employees to the Social Security Corporation.
- Hospitality and travel expenses incurred by the taxpayer.
- Expenditures for employees' medical treatment, meals during duty, travel, transport, and life insurance against work injuries or death.
- Marketing, scientific research, development, and training expenses.
- Expenses of prior tax periods, which were neither defined nor final.

### *Depreciation and amortisation*
Depreciation and amortisation of fixed assets are determined using the straight-line method, provided that the provisions, procedures, and rates shall be defined by the depreciation regime issued for this purpose. Assets with a cost of less than 100 Jordanian dinars (JOD) shall be totally deducted in the tax period in which they were acquired.

### *Net operating losses*
Losses may be carried forward indefinitely, but the carryback of losses is not permitted.

### *Payments to foreign affiliates*
A resident generally may claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates taking into account the transfer pricing regime and the applicable WHT.

## *Group taxation*

Group taxation is not permitted in Jordan.

### *Transfer pricing regime*
Any disposition transaction which is not based on arm's length, is with parties that have mutual interests, and leads to decrease the taxable income is ignored, and the real profits are estimated according to the regular market value of the transactions.

Any illusionary or fake disposition transactions are ignored and the tax due is estimated as if there were no transactions.

### *Thin capitalisation*
Interest and Murabaha that are paid by any taxpayer other than banks and financial institutions and finance leasing companies shall be accepted as a deduction provided that the deduction shall not exceed the following rates of relative value (i.e. total debt to the paid capital or average owners' equity, whichever is higher):

| Tax period | Relative value |
|---|---|
| 2010 | 6:1 |
| 2011 | 5:1 |
| 2012 | 4:1 |
| 2013 and following years | 3:1 |

## *Tax credits and incentives*

Jordan has had tax reductions for selective sectors categorised by development zones. Generally, these have required pre-approval.

### *Foreign tax credit*
Foreign tax credit treatment is not available in Jordan.

## *Withholding taxes*

### *Dividends*
Dividends are not taxable in Jordan.

### *Non-resident WHT*
With respect to services performed by a non-resident juristic or natural person, under the Income Tax Law, “Amounts received or earned by the non-resident person from the Kingdom, which are derived from services provided to any person if the work or service related has been performed in the Kingdom or if the outcome of such services has been used in the Kingdom as well, is subject to tax in Jordan.”

The current WHT rate on services performed by a non-resident juristic or natural person is 7% of the payment.

### *Resident WHT*
Resident juristic or natural persons that perform any services in Jordan are subject to a WHT on the services performed. The applicable WHT rate is the rate prevailing at the time the service is performed. The current WHT rate on services performed by a local subcontractor is 5% of the payment.

Services which are excluded from the 5% WHT regime include the following:

- Shipping services and related brokerage services.
- Road transport services and related brokerage services.
- Air transport services.
- Financing lease services.
- Hotels and restaurants services.
- Clearance services.
- Programming services provided by the company.
- Hospital services provided by hospitals.
- Advertising services.
- Cleaning services.
- Security services.
- Training services provided by the company.
- Insurance activities services.

- Banking services provided by banks.
- Communication activities and services provided by primary telecom companies (defined in the tax law as being communications companies individually licensed in accordance with the provisions of the communications law in effect and regulations and instructions issued pursuant thereto).
- Transportation and distribution of electric power services provided by the Electricity Company Plc.
- Contracting services implemented under contractor certified by the Jordanian Contractors Association.
- Public safety services.
- Maintenance services that include value of materials and goods and labour wages.
- Food processing services, correspondence, and transport and laundry provided to hospitals.
- Loading and unloading services.
- Services that are executed by a juristic person, excluding civil companies, and have a tax number (income and sales).
- Any other service approved by the Minister upon the recommendation of the Director General.

### *Tax treaties*

Jordan has entered income tax treaties with Algeria, Bahrain, Canada, Croatia, the Czech Republic, Egypt, France, India, Indonesia, Iraq, South Korea, Kuwait, Lebanon, Libya, Malaysia, the Netherlands, Pakistan, Poland, Qatar, Romania, Sudan, Syria, Tunisia, Turkey, the United Kingdom, and Yemen.

Jordan has transportation agreements with many countries and is negotiating treaties with more countries.

## *Tax administration*

### *Returns*

Taxpayers are obliged to file tax returns before the end of the fourth month following the end of the tax period, including details related to income, expenses, exemptions, and tax due. Tax returns are submitted by any of the following means approved by the department according to terms and procedures to be determined by instructions:

- Registered mail.
- Banks.
- Any licensed company to undertake the tasks of public or private mail post approved by the Council of Ministries upon the recommendation of the Minister.
- Electronic means.

The date of filing is considered to be the earlier of the date of receipt by the department, post seal, or deposit receipt at a bank or licensed company. In the case of sending electronic mail, implementation instructions have not yet been introduced to determine the approved date of submitting the same.

### *Payment of tax*

The tax balance is due before the end of the fourth month following the end of the tax period.

A taxpayer who is carrying out business activities and has gross income in the previous tax period exceeding JOD 500,000 from these activities is required to remit two advance payments on the accrued income tax from these activities using the rates determined for each tax period mentioned in the following schedule. The advance payments are calculated according to the income tax in the financial statements presented to the income tax department for the concerned period. In the absence of the financial statements for this period, the income tax included in the immediate preceding tax declaration will be used to calculate the advance payments.

| Tax period | Rate on accrued income tax (%) |
|---|---|
| 2010 | 7.5 |
| 2011 | 25 |
| 2012 and following years | 37.5 |

The first advance payment is due within a period not exceeding 30 days from the last day of the first half of that income tax period.

The second advance payment is due within a period not exceeding 30 days from the last day of the second half of that income tax period.



### *Fines and penalties*

Failure to pay tax on the assigned dates according to the provisions of the tax law will result in a delay fine at a rate of 0.4% of the value of the tax due or any deductible amounts for each full or partial week of delay.

If a taxpayer submits a tax return and pays the declared tax in a timely manner, but the declared tax is less than the actual amount due, a shortage fee for such differences will be imposed, as follows:

- 15% of the shortage if the difference exceeds 20% but less than 50% of the tax due by law.
- 80% of the shortage if the difference exceeds 50% of the tax due by law.

# Kazakhstan

## PwC contact

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## Significant developments

In June 2010, the President signed a law introducing changes to the Kazakhstan transfer pricing legislation. The changes introduced a number of clarifications to the law definitions and established quotation periods for commodities.

In July 2010, the President signed a law introducing changes and amendments to the Kazakhstan tax legislation. The most notable amendments included the introduction of new provisions related to transactions within the Customs Union and foreign currency transactions. These amendments also added new definitions such as 'operator' and 'import of goods' to the Kazakhstan Tax Code.

A Government Decree, which was signed and enacted in September 2010, excluded Switzerland from the list of countries with privileged taxation.

According to a law introducing amendments to the Tax Code, which was signed by the President in November 2010, the corporate income tax (CIT) rate and mineral extraction tax rates for 2011-2014 will remain at the current level, and certain transaction with 'investment gold', as defined by the Tax Code, are exempt from value-added tax (VAT).

### Customs union

A series of agreements and legislation effective in the Customs Union member states (i.e. Kazakhstan, Russia, and Belarus) came into force as of 1 July 2010, introducing changes to the customs and tax legislation of Kazakhstan. This includes the Customs Code of the Customs Union, Agreement on levy of indirect taxes within Customs Union territory, etc.

Kazakhstan adopted the new Code of Customs Affairs which is based on the provisions of the Customs Code of the Customs Union. The changes include amendments to the Tax Code with respect to VAT on transactions within the Customs Union.

## Taxes on corporate income

The tax rate for corporations is 20% and is based on a calendar year. All Kazakhstan legal entities and branches of foreign legal entities are subject to CIT. Taxable income is determined as the taxpayer's aggregate annual income less allowable deductions.

Resident companies are taxable in Kazakhstan on their worldwide profits, while non-resident companies operating through a permanent establishment (PE) in Kazakhstan are subject to Kazakhstan CIT only on the profits attributable to that PE.

Non-residents without a PE in Kazakhstan that receive income from sources in Kazakhstan are generally subject to income tax withheld at source of payment on Kazakhstan-source income *(please see the Withholding taxes section for more information)*.

### *Reduced CIT rates*

A reduced CIT rate of 10% applies to the agricultural income of legal entities producing agricultural products.

In addition, taxpayers operating in special economic zones may enjoy full exemption from CIT, land tax, and property tax, if certain statutory requirements established for such benefits are met.

### *Excess profit tax (EPT)*

EPT rates are progressive and range from 0% to 60%. The tax base is comprised of the portion of net income of subsurface users exceeding 25% of deductions for EPT purposes. Subsurface users may include asset acquisition costs, capital costs, and losses (with certain limitations) as deductions.



## *Corporate residence*

Generally, Kazakhstan incorporated companies or other legal entities that have their place of effective management located in Kazakhstan are treated as Kazakhstan tax residents.

### *Permanent establishment (PE)*

Non-resident legal entities having business activities in Kazakhstan may create a PE in the following cases:

- 'Fixed place PE': a non-resident enterprise carries on business activities in Kazakhstan through a fixed place, including, but not limited to, through a place of management.
- 'Services PE': a non-resident enterprise renders services in Kazakhstan through employees or other personnel engaged by the non-resident for such purposes, provided that these activities continue for more than 183 days within any consecutive 12-month period for the same or connected projects.
- 'Construction PE': a construction site, in particular a shop or an assembly facility, performance of projecting work, forms a permanent establishment, notwithstanding the timing of performing operations.
- 'Agency PE': a non-resident enterprise carries on business activities in Kazakhstan through a dependent agent. A dependent agent is an individual or legal entity that meets all of the following criteria simultaneously:
  - Is not an independent agent.
  - Has the contractual authority to represent the non-resident's interests in Kazakhstan and makes use of this authority by acting and signing (negotiating) contracts on behalf of the non-resident.
  - Carries on activities that are not limited to those of preparatory and auxiliary nature.

## Other taxes

### Value-added tax (VAT)

The current VAT rate is 12%. This tax is applicable to the sales value of products, works, and services, as well as imports. Exports of goods are taxed at 0%. There is a list of goods, works, and services exempt from VAT (e.g. financial services provided by financial institutions, financial leasing services, notary and advocacy services, operations with financial securities and investment gold).

Goods and services are subject to VAT if they are deemed to be supplied in Kazakhstan under the place of supply rules.

VAT refunds are generally available with respect to excess input VAT.

The VAT reporting period is the calendar quarter.

### Customs duties

Customs duties apply to goods imported to the Customs Union countries from third countries. The customs duties rates are established either based on a percentage (in general ranging between 0% and 30%; higher rates exist for certain goods) of the customs value of goods or in absolute terms in euros (EUR).

Goods of the Customs Union countries should be generally exempt from Kazakhstan customs duties.

In addition to membership in the Customs Union, Kazakhstan concluded a number of bilateral and multilateral Free Trade Agreements with the Commonwealth of Independent States (CIS), which provides for exemption of goods circulated between the CIS member states from customs duties, if certain conditions are met.

Kazakhstan is not yet a World Trade Organization (WTO) member.

### Customs fees

A customs processing fee is assessed at EUR 50 for the main page of a customs declaration plus EUR 20 for each supplemental page.

### Excise taxes

Excise taxes apply to the sale and import of crude oil, gas condensate, petrol/gasoline (excluding aviation fuel), diesel fuel, spirits and alcoholic beverages, beer, tobacco, and passenger cars.

### Property tax

Property tax is assessed annually at a general rate of 1.5% of the average net book value of immovable property.

### Land tax

Entities and individuals that own land plots (or land share in cases of commonly shared ownership of land plots) must pay land tax annually. Land tax rates vary based on the purpose for which the land is used as well as the size and quality of the land.

### Vehicle tax

The vehicle tax rate is based on monthly calculation indices and determined in accordance with the type of vehicle, engine volume, operation period of the vehicle (aircraft only), and other factors.

### Social tax

Employers must pay social tax at the rate of 11% of gross remuneration (salaries and certain benefits provided) of all employees (local and expatriate). A deduction is available for obligatory pension contributions.

### Mineral extraction tax

The mineral extraction tax applies to the monetary value of extracted volume of crude oil, gas condensate, natural gas, minerals, and groundwater.

The tax is calculated based on the value of the extracted content, which is computed by applying average global prices to the extracted volume (adjusted for content). The determination of average global prices is based on the list of publications that are considered official sources for computation of mineral production tax (Metal Bulletin, Metal Pages, Platts Crude Oil Marketwire, and Petroleum Argus).

Currently, the tax rates for crude oil and gas condensate range from 5% to 18%, depending on the accumulated production volume for the calendar year. For hydrocarbons, rates can be reduced by 50% if they are supplied to domestic refineries on the basis of a sale/purchase agreement or tolling agreement.

The tax rate for natural gas is set at 10%. For domestic sales of natural gas, tax rates range from 0.5% to 1.5%.



Tax rates for minerals which have undergone initial processing (except for widespread minerals) and for coal vary between 0% and 22%.

## Branch income

The net income of branches of foreign legal entities, after CIT at 20%, is subject to a branch profits tax at a rate of 15%, which may be reduced under an applicable double tax treaty (DTT). As such, the effective tax rate for the income of branches of foreign legal entities equals 32% if there is no reduction under a DTT.

## Income determination

Kazakhstan legal entities are taxable on aggregate annual income earned worldwide. Non-resident legal entities, carrying out business activities through a PE in Kazakhstan, are taxable on income attributed to the activities of that PE. All taxpayers must apply the accrual method for recognition of income.

### Inventory valuation

For tax purposes, inventory is valued in accordance with international financial reporting standards (IFRS) and Kazakhstan financial accounting legislation. As such, permitted inventory valuation methods include first in first out (FIFO), weighted average, and specific identification methods.

### Capital gains

Capital gains are subject to ordinary CIT rates. An exemption is available for capital gains realised from the sale of shares and participation interests in Kazakhstan legal entities or consortiums which are not engaged in subsurface activities.

### Inter-company dividends
Inter-company dividends are exempt from CIT in the hands of the recipient, except for dividends paid by certain types of investment funds. This exemption also applies to stock dividends.

### Interest income
Interest income should be included in the aggregate annual income of a taxpayer and taxed at the CIT rate.

### Foreign exchange gain
Foreign exchange gain should be determined in accordance with the provisions of IFRS and Kazakhstan financial accounting legislation. The excess of foreign exchange gain over foreign exchange loss should be included in the aggregate annual income of a taxpayer.

### Foreign income
Foreign income is subject to ordinary CIT. *For additional information, please refer to Controlled foreign company regime in the Group taxation section.*

## Deductions

Allowable deductions generally include expenses associated with activities designed to generate income, unless specifically restricted for deduction by tax legislation. All expenses require supporting documentation.

### Depreciation and depletion
Tax depreciation is calculated using the declining balance method at depreciation rates ranging from 10% to 40%, applied to the balances of four basic categories of assets:

- Buildings and facilities: 10%.
- Machinery and equipment: 25%.
- Computers and equipment for information processing: 40%.
- Fixed assets not included into other groups, including oil and gas wells, transmission equipment, oil and gas machinery and equipment: 15%.

### Interest expense
Interest paid to unrelated third parties and credit partnerships created in Kazakhstan are deducted in full. For information about taxation of interest paid to related parties, *please refer to Thin capitalisation in the Group taxation section.*

### Foreign exchange loss
Foreign exchange loss should be determined in accordance with the provisions of IFRS and Kazakhstan financial accounting legislation. The excess of foreign exchange loss over foreign exchange gain is allowed for deduction.

### Deduction of taxes
Taxes remitted to the state treasury of Kazakhstan are deductible, except for the following:

- Taxes excluded prior to the calculation of the aggregate annual income.
- Income taxes paid in Kazakhstan and other countries.
- Taxes paid in preferential tax jurisdictions.
- Excess profit tax.

### Fines and penalties
Generally, deductions are available for forfeits, fines, and penalties which are not payable to the state budget.

### Net operating losses
Net operating losses accumulated prior to 1 January 2009 may be carried forward for up to three years. Net operating losses generated after 1 January 2009 may be carried forward for up to ten years. Loss carryback is not permitted under Kazakhstan tax legislation.

### Payments to foreign affiliates
Payments to foreign affiliates are deductible for CIT purposes if the payments are intended to generate income, are supported by documentation, and comply with Kazakhstan transfer pricing law.

## Group taxation

Kazakhstan tax law does not permit group taxation.

### Transfer pricing
Under Kazakhstan transfer pricing law, both customs and tax authorities have the right to monitor and adjust prices used in cross-border and certain domestic transactions when prices are perceived to deviate from market prices, even if such transactions are with unrelated parties. If the authorities adjust prices, the re-assessed liability will include taxes, duties, penalty interest, and fines to the state budget.



Transfer pricing rules impact the following transactions:

- International commercial transactions.
- Domestic transactions that directly relate to international commercial operations where:
  - the sale relates to a subsurface use contract
  - one of the parties has tax preferences, or
  - one of the parties has losses for two years prior the year of the transaction.

### Thin capitalisation
Deduction of interest paid to related parties, or to unrelated parties under related parties warranties, or to parties registered in a country with privileged taxation depends on the borrower's capital structure; such that deductible interest will be limited with reference to an 'acceptable' proportion of debt to equity (9:1 for financial institutions, 6:1 for all other entities). The list of jurisdictions with privileged taxation, the so called 'black list' established by the Government, includes 62 jurisdictions *(see the Kazakhstan summary at www.pwc.com/taxsummaries for a current list)*.

### Controlled foreign company (CFC) regime
Under the CFC rules, if a Kazakhstan legal entity has 10% or more of direct or indirect ownership in the share capital or voting rights in a non-resident company, registered or located in a country with privileged taxation *(see above),* the legal entity is subject to Kazakhstan CIT on the portion of the undistributed profits from the non-resident company.

## Tax credits and incentives

### Investment incentives
Investment incentives are available to certain Kazakhstan legal entities that fit certain criteria and possess objects (e.g. certain fixed assets), for which investment incentives may be applied. Generally, the investment incentives allow companies to fully deduct, for CIT purposes, the cost of the investment objects and the cost associated with their reconstruction and modernization either at once or within first three years of their use.

Based on the Investment Law, incentives are granted under an investment contract between the Government and companies and focus on priority sectors of the economy, as determined by the Government.

### Special economic zones
Currently, the following special economic zones have been established in Kazakhstan:

- 'Astana, the New City' in Astana (the expiry date is in 2015).
- 'Aktau Sea Port' in Aktau (the expiry date is on 1 January 2028).
- 'Ontustik' in Sairam district of South-Kazakhstan region (the expiry date is on 1 July 2030).
- 'National Industrial Petrochemical Park' in Atyrau region (the expiry date is on 31 December 2032).
- 'Burabai' in Akmola region (the expiry date is on 1 December 2017).

In order to enjoy the incentives available in special economic zones, a legal entity must meet the following requirements:

- It must be registered by the tax authorities in the territories of special economic zones.
- It must have no structural subdivisions beyond the boundaries of the territories of the special economic zones.
- 90% of aggregate annual income must constitute income earned from activities in the special economic zone consistent with the objectives of the special economic zone's formation.

The general incentives available for legal entities in special economic zones are:

- CIT: 100% reduction.
- Land tax: 0% rate.
- Property tax: 0% rate.

### Foreign tax credit
In general, the Kazakhstan Tax Code allows taxpayers to credit the foreign income taxes paid against the income taxes payable in Kazakhstan provided the documents confirming the payment of such taxes are available. However, a tax credit may not be granted in certain cases (e.g. for taxes paid in countries with privileged taxation).

## Withholding taxes

Kazakhstan-source income of non-residents and the proceeds from the sale of shares in subsurface users are subject to withholding tax (WHT) at the rates shown in the table below.

A non-resident legal entity is exempt from dividend WHT if:

- the holding period of shares or participation interest is greater than or equal to three years, and
- 50% or more of the charter capital value of the entity paying the dividends is not the property of a subsurface user.

| Types of income at a source of payment | Tax rate (%) |
|---|---|
| Dividends, capital gains, interest, royalties | 15 |
| Any income of an entity registered in a tax haven jurisdiction | 20 |
| Insurance premiums under risk insurance agreements | 10 |
| Income from international transportation services; insurance premiums under risk reinsurance agreements | 5 |
| Other income | 20 |

Benefits paid by a company to a shareholder, founder, participant, or related party, falling under the definition of constructive dividends, are taxed at a rate of 15%.

The rate of WHT may be reduced under an applicable DTT. A list of DTTs concluded and ratified by Kazakhstan is detailed below.

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### *WHT rates between Kazakhstan and treaty countries as of 1 January 2011*

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| No treaty | 15 | 15 | 15 |
| Austria | 5/15 (4) | 10 | 10 |
| Azerbaijan | 10 | 10 | 10 |
| Belarus | 15 | 10 | 15 |
| Belgium | 0/5/15 (8, 4) | 10 | 10 |
| Bulgaria | 10 | 10 | 10 |
| Canada | 5/15 (1) | 10 | 10 |
| China | 10 | 10 | 10 |
| Czech Republic | 10 | 10 | 10 |
| Estonia | 5/15 (2) | 10 | 15 |
| Finland | 5/15 (1) | 10 | 10 |
| France | 5/15 (4) | 10 | 10 |
| Georgia | 15 | 10 | 10 |
| Germany | 5/15 (2) | 10 | 10 |
| Hungary | 5/15 (2) | 10 | 10 |
| India | 10 | 10 | 10 |
| Iran | 5/15 (5) | 10 | 10 |
| Italy | 5/15 (4) | 10 | 10 |
| Japan | 5/15 (11) | 10 | 10 |
| Korea | 5/15 (4) | 10 | 10 |
| Kyrgyzstan | 10 | 10 | 10 |
| Latvia | 5/15 (2) | 10 | 10 |
| Lithuania | 5/15 (2) | 10 | 10 |
| Malaysia | 10 | 10 | 10 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Moldova | 10/15 (2) | 10 | 10 |
| Mongolia | 10 | 10 | 10 |
| Netherlands | 0/5/15 (9, 10) | 10 | 10 |
| Norway | 5/15 (10) | 10 | 10 |
| Pakistan | 12.5/15 (10) | 12.5 | 15 |
| Poland | 10/15 (3) | 10 | 10 |
| Romania | 10 | 10 | 10 |
| Russia | 10 | 10 | 10 |
| Singapore | 5/10 (2) | 10 | 10 |
| Slovakia | 10/15 (7) | 10 | 10 |
| Sweden | 5/15 (1) | 10 | 10 |
| Switzerland | 0/5/15 (9, 10) | 10 | 10 |
| Tajikistan | 10/15 (6) | 10 | 10 |
| Turkey | 10 | 10 | 10 |
| Turkmenistan | 10 | 10 | 10 |
| Ukraine | 5/15 (2) | 10 | 10 |
| United Kingdom | 5/15 (1) | 10 | 10 |
| United States | 5/15 (1) | 10 | 10 |
| Uzbekistan | 10 | 10 | 10 |

Notes

1. 5% if the beneficial owner is a company owning, directly (or indirectly in case of Canada and the UK), at least 10% of the voting power of the company paying the dividends.
2. 5% (10% in case of Moldova) if the beneficial owner is a company that directly holds at least 25% of the capital of the paying company.
3. 10% if the beneficial owner is a company, directly or indirectly, holding at least 20% of the capital of the paying company.
4. 5% if the beneficial owner is a company (other than partnership), which owns not less than 10% of the capital of paying company.
5. 5% if the recipient is a company (other than partnership), which directly owns not less than 20% of the capital of paying company.
6. 10% if the actual owner is a legal entity, which owns not less than 30% of the authorized capital of the legal entity paying the dividends.
7. 10 % if the beneficial owner is a company which holds directly at least 30 % of the capital of the company paying the dividends.
8. 0% if dividends are paid in consideration of an investment of at least USD 50 million in the paying company.
9. 0% if the company receiving the dividends holds directly or indirectly at least 50% of the capital of the paying company and has made an investment in the company paying the dividends of at least USD one million, which investment is guaranteed in full or insured in full by the Government of the first Contracting State, the central bank of that State or any agency or instrumentality (including a financial institution) owned or controlled by that Government, and has been approved by the Government of the other Contracting State.
10. 5% (or 12.5% in case of Pakistan) if the beneficial owner is a company which directly owns (or indirectly in case of the Netherlands and Pakistan) at least 10% of the capital of paying company.
11. 5% if the beneficial owner is a company owning directly or indirectly, for the period of six months ending on the date on which entitlement to the dividends is determined, at least 10% of the voting power of the company paying the dividends.

## *Tax administration*

### *Returns*

The tax year in Kazakhstan is the calendar year. Annual CIT declarations are due by 31 March of the year following the tax year-end. However, a taxpayer may be granted a 30 calendar-day extension of the deadline upon request.

Certain taxpayers are required to submit their estimated calculation of monthly advance payments of CIT.

The deadline for other tax returns is the 15th calendar day of the second month following the reporting period. However, a taxpayer may be granted a 30 calendar-day extension of the deadline upon request.

### *Payment of tax*

For CIT, advance payments are due every 25th day of the month. Taxpayers with aggregate annual income during the tax period preceding the previous tax period of less than 325,000 times the amount of the monthly calculation index established for the relevant financial year (approximately USD 3.34 million) are exempt from the obligation to calculate and pay CIT advance payments. Payment of any outstanding CIT liabilities is required within ten calendar days following submission of the annual CIT declaration.

Most other taxes are payable by the 25th day of the second month following the end of reporting period.

### *Fines and interest penalties*

Interest penalties are assessed on late tax payments at 2.5 times the Kazakhstan National Bank refinancing rate. As of 1 November 2010, the National Bank refinancing rate was 7% per annum.

Substantial fines are imposed for understatement of tax liabilities. Generally, the fines amount to 50% of the understated tax.

For advance CIT payments, an administrative fine of 40% applies to understated advance tax payments compared with the final declared CIT, if the understated amount is greater than 20% of the final declared amount.

If a taxpayer is deemed to have concealed taxable income, a fine of 150% of the concealed amount may be assessed.

### *Statute of limitation*

The statute of limitation for tax purposes in Kazakhstan is five years. For taxpayers operating under subsurface use contracts, the tax authorities maintain the right to assess or revise the assessed amount of excess profit tax and other taxes and obligatory payments to the budget, where a methodology of calculation uses one of the following indices: internal rate of return (IRR) or internal revenue rate or R-factor (earning yield) during the effective period of a subsurface use contract and five years after the end of the effective period of a subsurface use contract.

## *Other issues*

### *Accounting system*

Kazakhstan legal entities should maintain accounts and produce financial statements in accordance with IFRS or national accounting standards (depending on the size of the company and other factors). In most cases, tax treatment follows accounting treatment.

# Kenya

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## Significant developments

Historically, one of the biggest tax incentives for investors into Kenya was the ability to carry forward tax losses indefinitely. This is now restricted to a maximum of five years, including the year in which the loss arises. This change is applicable to the years of income commencing on or after 1 January 2010 and applies to businesses as well as individuals.

Taxpayers may submit an application to the Minister of Finance to request an extension of the period in which losses may be carried forward where a person has provided evidence of inability to extinguish the deficit within that period.

The 2010 Finance Act introduced a significant change on interest free loans advanced by a related party to a thinly capitalised company resident in Kenya by deeming an interest rate pegged to the average 91-day treasury bill rate.

The 2010 Finance Act also expanded the application of transfer pricing not only to matters dealing with anti-avoidance but also to other matters. In this case, the tax authority just has to prove that the prices or results were not aligned to the market, regardless of the intention of the taxpayer. This allows the revenue authority to expand the tax net by assessing companies based on their inter-company pricing irrespective of whether they are aimed at avoiding tax or not. This move therefore necessitates multinationals to be more careful with intercompany pricing arrangements. In addition, the 2010 Finance Act extended the ambit of transfer pricing to include entities owned by individual persons related by marriage, consanguinity (blood relations), or affinity (an aspect of lifting the veil of incorporation) in the case of companies which were otherwise independent legal persons.

## Taxes on corporate income

Companies (including a branch of an overseas company) are subject to Kenyan corporate income tax at the following rates on all income accrued in or derived from Kenya:

| Entity | Rate (%) |
|---|---|
| Resident companies (including subsidiary companies of foreign parent companies) | 30 |
| Branches of foreign companies | 37.5 |
| Export processing zone (EPZ) enterprises: | |
| First ten years | 0 |
| Next ten years | 25 |

| Entity | Rate (%) |
|---|---|
| Thereafter | 30 |
| Newly listed companies: | |
| 20% of shares listed: for three years | 27 |
| 30% of shares listed: for five years | 25 |
| 40% of shares listed: for five years | 20 |

### *Industry-specific rates*
There are special provisions for non-resident shipping companies and airlines; non-residents providing broadcast, internet, and messaging services; and non-resident petroleum industry subcontractors providing exploration and production services in Kenya.

## *Corporate residence*

A company is considered resident in Kenya if it meets one of the following criteria:

- It is incorporated under Kenyan laws.
- The management and control of company affairs are exercised in Kenya.
- The company has been declared by the minister, by announcement in the gazette, to be resident in Kenya for any year of income.



### *Permanent establishment (PE)*
A business carried on in Kenya through a fixed place of business gives rise to a PE for branch purposes, as does a building site, or a construction or assembly project, that has existed for six months or more.

## *Other taxes*

### *Value-added tax (VAT)*
VAT is levied on the supply of taxable goods and services in Kenya, as well as on the importation of taxable goods and services into Kenya.

The following VAT rates apply in Kenya:

| Activity | VAT rate (%) |
|---|---|
| Standard rate on all goods and services that are neither exempt nor zero-rated | 16 |
| Electricity, diesel oil, and residual fuel oils | 12 |
| Export of goods and services, certain other goods and services | 0 |

Certain goods and services are designated as exempt from VAT. Exempt supplies do not count towards the registration threshold *(see below),* and the related input VAT is not recoverable.

Zero rating applies to the export of goods or services. The supply of goods or services to certain designated persons and projects are also zero rated.

The threshold for VAT registration is taxable supplies of 5 million Kenyan shillings (KES) per year. Registered persons must record their turnover using an approved electronic tax register or signature device. Only registered persons may recover input tax. An input tax credit is not available for several items such as non-commercial vehicles, office furniture, and hospitality and entertainment services. An excess input tax credit may be carried forward or refunded, subject to certain conditions.

Some entities such as central and local governmental entities, state corporations, banks, and insurance companies are required to withhold VAT on supplies received and pay the tax directly to the revenue authority.

Suppliers with turnover of less than KES 5 million in a period of 12 months are required to pay turnover tax at the rate of 3% based on gross sales.

### *Excise duty*

Excise duty is imposed on the manufacture or importation of certain commodities, principally bottled water, soft drinks, cigarettes, alcohol, perfumes, fuels, and motor vehicles at varying rates. There are various classes for each category and commodity where different rates of duty apply. Excise duty is also levied on mobile cellular phone and wireless telephone services at the rate of 10% and gambling services at the rate of 5%.

### *Import (customs) duty*

Import duty is levied under the East African Community Customs Management Act. Imports of goods are generally subject to import duty of 0% for raw materials and capital goods, 10% for intermediate goods, and 25% for finished goods. Enterprises established in an EPZ are exempt from customs duty on machinery and inputs for exported products. Under an import duty remission scheme, import duty may be remitted for raw materials used to manufacture goods for export. This is subject to a requirement for proof of export and execution of a bond.

### *Stamp duty*

Stamp duty is payable on transfer of properties. If real property, stamp duty is payable at the rate of 4% on the value of the land as assessed by a government valuer. For other properties, other rates of stamp duty apply as specified in the Schedule to the Stamp Duty Act. The rates of stamp duty are shown below:

| Activity | Rate (%) |
|---|---|
| Transfer of immovable property - Urban | 4 |
| Transfer of immovable property - Rural | 2 |
| Registration of share capital | 1 |
| Transfer of shares or marketable securities | 1* |
| Registration of a debenture or mortgage | 0.1 |
| Lease - Between one and two years | 1% of annual rent |
| Lease - Any other period | 2% of annual rent |

* Transfer of quoted securities is exempt.

Land purchased for expansion and development of schools is exempt from stamp duty, provided the land does not revert to any other use and approval has been obtained from the relevant authorities.

### *Property rates*

Rates are payable to local authorities on real estate based on the sale value of the property.

### Catering levy
This is a levy which is payable to Catering Levy Trustees by hotels and restaurants at a rate of 2%.

### Compensating tax
Where a company pays dividends out of profits that have not been subject to corporate income tax, the company will be liable to pay a compensating tax. The compensating tax rate is 42.8% of the dividends that have been distributed out of the untaxed profits. This tax effectively ensures that all distributions are paid out of profits that have been subject to corporate income taxes, prior to distribution.

### Advance tax on motor vehicles
Advance tax is payable at varying rates per year on commercial vehicles and is creditable against corporate income tax for the year.

### Fringe benefit tax
The fringe benefit tax is payable by companies at the rate of 30% of the benefit arising from a loan advanced to an employee at an interest rate lower than the rates prescribed by the Commissioner. The directors and employees are not personally taxed on the benefit.



## Branch income

The profit of a PE is taxed at the branch income tax rate of 37.5%, but there is no further taxation on the distribution of branch profits. However, there are certain restrictions with respect to costs paid to the head office.

## Income determination

### Inventory valuation
Inventory is stated at the lower of cost or net realisable value, with the exception of biological assets whose value is prescribed by the Commissioner.

### Capital gains
Taxation of capital gains was suspended in 1985.

### Stock dividends
Stock dividends issued in a ratio not proportionate to shareholding of the existing equity are considered as taxable dividends to the extent of the disproportionate increase in the value of the ownership of the company.

### Foreign income
Income from a business carried on partly in Kenya by a resident company is taxed on a worldwide basis.

## Deductions

The general principle in Kenya is that expenses are deductible if they are incurred wholly and exclusively to generate taxable income.

### *Depreciation and depletion*
No deduction is allowed for accounting depreciation or impairment. However, capital allowances are permitted at varying rates (on a straight-line basis) for certain assets used for business purposes, including buildings and machinery used in manufacturing, industrial buildings and hotels, machinery and plant, agricultural works, and mining.

#### Investment deduction
Expenditure incurred of a capital nature by manufacturers on the construction of an industrial building and/or the installation of machinery qualifies for an investment deduction of 100% irrespective of the location of the investment. For investment outside the municipalities of Nairobi, Mombasa, and Kisumu, subject to certain conditions, for both manufacturers and non-manufacturers, the rate for investment deduction is 150%.

#### Industrial building allowance
Hostels and certified education buildings qualify for an industrial building allowance at a rate of 50%.

Qualifying rental residential or commercial buildings qualify for an industrial building allowance at a rate of 25%.

Other qualifying buildings (including hotels) qualify for an industrial building allowance at a rate of 10%.

#### Wear and tear allowance
Expenditures incurred on heavy earth moving equipment qualify for a wear and tear allowance at a rate of 37.5%, while other self propelling vehicles (including aircraft) qualify for a wear and tear allowance at a rate of 25%.

Computers and peripheral computer hardware qualify for a wear and tear allowance at a rate of 30%.

Capital allowances were introduced, effective 1 January 2010, at a rate of 20% for computer software and 20% for telecommunications equipment not falling within the 12.5% category referred to below, purchased and used by telecommunications operators.

All other machinery (including ships) qualifies for a wear and tear allowance at a rate of 12.5%.

Telecommunications equipment purchased by a telecommunication operator enjoys a wear and tear allowance of 20%.

### *Charitable contributions*
Donations to charities and for certain public works are deductible, subject to certain conditions.

### *Taxes*
Kenyan income taxes are not deductible while computing income tax of a person. However, foreign income taxes incurred are generally deductible as an expense if tax credit relief is not available under a double tax agreement (DTA).

### *Net operating losses*
As of 1 January 2010, losses calculated under the tax rules may be carried forward against income from the same source for a maximum of five years, including the year in which the losses arise. Losses cannot be carried back, except for petroleum companies where losses can be carried back for three years from a year of income which the petroleum company has ceased permanently to produce petroleum.

### *Payments to foreign affiliates*
Transfer pricing rules based on Organisation for Economic Co-operation and Development (OECD) principles apply to transactions with foreign affiliates (both companies and branches/PE). Additionally, there are restrictions on the deductibility of expenses incurred outside of Kenya by non-residents with a Kenyan PE. Amendments in the 2010/2011 Finance Act stated that transfer pricing is no longer limited to anti-avoidance.

## *Group taxation*

Each company in a group is taxed as a separate entity in Kenya.

### *Transfer pricing*
A company that has related party transactions is required to ensure such transactions are at arm's length. The company is therefore required to prepare a transfer pricing policy to justify the pricing arrangements. The Commissioner is allowed to adjust the prices if they do not conform to the arm's-length principle. The policy should be prepared and submitted to the Kenya Revenue Authority (KRA) upon request.



### *Thin capitalisation*
In Kenya, a company is thinly capitalised if all of the following occur:

- The company is in control of a non-resident person alone or together with four or fewer persons.
- The company is not a bank or financial institution.
- The highest amount of all loans held by the company at any time exceeds the sum of three times the revenue reserves (including accumulated losses) and the issued and paid up share capital of all classes of shares of the company.

A company which is thinly capitalised cannot claim a deduction on the interest expense incurred by the company on loans in excess of three times the sum of revenue reserves and issued and paid up capital of all classes of shares of the company. The company also cannot claim a deduction for any foreign exchange loss realised by the company with respect to any loans from its shareholders in the period that the company remains thinly capitalised.

## *Tax credits and incentives*

### *Foreign tax credit*
For business income, there is no relief for foreign tax paid except as provided for by a double tax treaty (if existent) between Kenya and the other country.

### *Investment deduction*
Qualifying investments exceeding KES 200 million incurred outside Nairobi or the municipalities of Mombasa or Kisumu are allowed an investment deduction of 150%.

All other qualifying investments are allowed a 100% investment deduction in the year the asset is put into service.

### *Export processing zone (EPZ)*

Companies located in an approved EPZ, principally to export goods, are taxed at a 0% corporate income tax rate for ten years from its commencement and at a rate of 25% for the next ten years.

### *Listed companies*

Companies listed on the Nairobi Stock Exchange are entitled to reduced rates of income tax for a period, depending on the proportion of share capital listed *(see the Taxes on corporate income section for the rates)*.

## *Withholding taxes*

Withholding tax (WHT) is levied at varying rates (3% to 30%) on a range of payments to residents and non-residents. Resident WHT is either a final tax or creditable against corporate income tax. Non-resident WHT is a final tax.

| | Resident WHT rate (%) | Non-Resident WHT rate (%) |
|---|---|---|
| Dividend > 12.5% voting power | Exempt | 10 |
| Dividend < 12.5% voting power | 5 | 10 |
| Interest: | | |
| Bearer instruments | 25 | 25 |
| Government bearer bonds (maturity ≥ 2 years) | 15 | 15 |
| Bearer bonds (maturity ≥ 10 years) | 10 | N/A |
| Other | 15 | 15 |
| Qualifying interest: | | |
| Housing Bonds | 10 | N/A |
| Bearer instruments | 20 | N/A |
| Other | 15 | N/A |
| Royalty | 5 | 20 |
| Management or professional fees | 5 | 20 |
| Rent/leasing: | | |
| Immovable property | N/A | 30 |
| Others | N/A | 15 |
| Pension/retirement annuity | N/A | 5 |
| Contractual fees | 3 | 20 |

Lower rates may apply to non-residents where there is a double tax agreement in force. The following table shows the double tax treaty rates:

| Recipient | Dividends (%) | Interest (%) | Royalties and management & professional fees (%) |
|---|---|---|---|
| Canada | 15 | 15 | 15 |
| Denmark | 20 | 20 (1) | 20 |
| Germany | 15 | 15 (1) | 15 |

| Recipient | Dividends (%) | Interest (%) | Royalties and management & professional fees (%) |
|---|---|---|---|
| India | 15 | 15 | 20 (4) |
| Norway | 15 | 20 (1) | 20 |
| Sweden | 15 | 15 | 20 |
| United Kingdom | 15 | 15 (1) | 15 (2) |
| Zambia | 0 (3) | 15 | 20 |

Notes

1. Interest paid by the government and the Central Bank of Kenya is tax-exempt.
2. The rate is 12.5% for management and professional fees.
3. No Kenya tax is due if the dividend is subject to tax in Zambia.
4. The rate is 17.5% for management and professional fees.

Where the treaty rate is higher than the non-treaty rate, the lower rate applies.

## *Tax administration*

### *Returns*

Resident companies and PEs of non-resident companies must file a self-assessment tax return accompanied by audited or certified accounts annually. The return is due within six months following a company's year end.

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### *Payment of tax*

Quarterly payments of tax must be made during the year based on the lower of 110% of the previous year's liability or an estimate of the current year's liability. Agricultural companies are required to pay estimated tax in two instalments of 75% and 25% during the year. Any balance of tax at the end of the year must be paid within four months of the financial year end.

### *Payment of agency taxes*

The tax withheld from payments must be paid by the 20th day of the month following the month in which the deduction is made.

### *Penalties for non-compliance*

If a self-assessment tax return is not submitted by the due date, a penalty of 5% on the unpaid tax for the year may be imposed, subject to a minimum of KES 10,000. Failure or late submission of an EPZ company return will be subject to a penalty of KES 2,000 per day for as long as the failure continues.

A penalty of 20% and interest at 2% per month are imposed on underestimation and late payment of instalment tax and any balance of tax. Interest is charged only on the principal tax due.

Failure to make a deduction or to remit the WHT deducted attracts a penalty equal to 10% of the amount of tax involved (subject to a maximum of KES 1 million) and accrues interest at 2% per month.

# Korea, Republic of

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## Significant developments

### Tax credits to encourage job-creating investments

The sunset of the temporary tax credit for facility investments has been extended until 31 December 2011 at a reduced rate of 4% to 5%, based on company size and location.

Additionally, a 1% tax credit for job-creating investments can simultaneously be applied to investments made until 31 December 2011. The credit for job-creation may not exceed the ceilings set at 10 million Korean won (KRW) (or KRW15 million per employee aged between 15 and 29) multiplied by net new employment. A carryforward of the credit is allowed as long as there is an increase in employment. Further details, such as conditions and calculation method, on applying the new tax credit will be prescribed in the presidential decree.

### Foreign direct investment (FDI) incentive limitations

The FDI credit has been amended to limit incentives granted to qualified FDIs. The ceiling has been set to encompass both investment amount and job-creation. In terms of investment amount, the level of incentives for FDI has been reduced to 70% of the aggregated FDI amount for companies benefiting from a 7-year incentive period (50% ceiling for companies enjoying a 5-year incentive period). In terms of job-creation, the level of incentives for FDI has been reduced to the lower of either 20% of the aggregated FDI amount or KRW 10 million times the company's net increase in employment.

Companies that have enjoyed tax benefits based on job-creation will be subject to tax assessment in cases where there is a net decrease in employment within the subsequent two years in comparison to the year that the relevant tax credit was obtained.

The amended regulation will be applicable for FDIs made on or after 1 January 2011.

### Tax law changes upon the adoption of International Financial Reporting Standards (IFRS)

#### Depreciation of tangible assets

Under the existing tax law, depreciation is allowed for tax deduction only when expensed for book purposes. The same position would be maintained even after the implementation of IFRS in Korea (K-IFRS); but in order to alleviate any dramatic increase in tax burden due to decreased depreciation expenses, additional expense deduction through tax adjustment may be allowed on a temporary basis. For tax purposes, depreciable assets acquired on or before 2013 may be depreciated at the rate equivalent to the average of three years before the adoption of K-IFRS. Depreciable assets acquired after 2014 may be depreciated using the tax useful lives. This change is applicable as of the fiscal year that includes 31 December 2010.

**Functional currency**
In instances where the taxpayer adopts to use a foreign currency as its functional currency, there will be three ways to calculate the corporate income tax (CIT) base: (i) calculate the tax base using the financial statements in functional currency and translate it into KRW; (ii) prepare the financial statements in KRW and calculate the tax base; or (iii) translate the financial statements into KRW and calculate the tax base. Once elected, the same method shall be consistently used. This change is applicable as of the fiscal year that includes 31 December 2010.

**Bad debt allowance**
Although companies could set aside bad debt allowances based on reasonable estimates under the old generally accepted accounting principles (K-GAAP), the new GAAP for non-K-IFRS users and K-IFRS users requires objective evidence to recognise the allowance. This stricter rule is expected to create disproportionately higher taxable income on the first year of adoption. As K-IFRS is expected to be revised in a way to use the 'estimated loss model' from 2013 and thereafter (in which case the allowance would be increased significantly at the point of first implementation), the tax recognition of the income in the first year of K-IFRS adoption would be deferred for two years until the new model is implemented. This change is applicable as of the fiscal year that includes 31 December 2010.

### *Reporting requirements for foreign bank and financial accounts*



The amendments include a new provision requiring residents and domestic companies to file a report with the National Tax Service (NTS) of their bank and financial accounts in a foreign country if the aggregate value of these accounts exceeds KRW 1 billion at any time during the calendar year.

Foreign account holders must file their concerned overseas account information with the governing tax office for the period from 1 June to 30 June of the following year. For failure to comply with the filing requirements or incorrect filing, the account holder shall be subject to fines equaling 10% of the non-compliance amount or the difference between the amount actually filed and the amount which should have been filed. The new requirement will be applicable to overseas banking accounts owned since January 2010 with a lower penalty rate of 5% on holdings during 2010.

## *Taxes on corporate income*

The basic Korean CIT rates for fiscal year 2010 and fiscal year 2011 are 10% on the first KRW 200 million of the tax base and 22% for the excess. In fiscal year 2012 and thereafter, the respective rates will be 10% and 20%.

Capital gains from the disposal of non-business purpose land or houses may be subject to additional capital gains tax at rates ranging from 10% to 40% after the above CIT.

Resident corporations are taxed on their worldwide income, whereas non-resident corporations with a permanent establishment (PE) in Korea are taxed only to the extent of their Korean-sourced income. Non-resident corporations without a PE in Korea are generally taxed through a withholding tax (WHT) on each separate item of income.

### *Minimum tax*
Corporate taxpayers are liable for the minimum tax, which is defined as the greater of 10% (to the tax base of up to KRW 10 billion, 11% on the excess up to KRW 100 billion, 14% on the excess above KRW 100 billion) of the taxable income before various

deductions and exemptions pursuant to the Special Tax Treatment Control Law (STTCL) applied to arrive at adjusted taxable income or the actual tax after various deductions and exemptions.

For small and medium enterprises (SMEs), the minimum tax is the greater of 7% of adjusted taxable income or actual tax liability.

### Resident tax surcharges

A resident tax surcharge of 10% on CIT liability is assessed each year.

### Agriculture and fishery surtax

When a corporate taxpayer claims certain tax credits or exemptions under the STTCL, a 20% agriculture and fishery surtax is levied on the reduced CIT liability.

## Corporate residence

A corporation having its head office or principal office in Korea is a resident corporation. A corporation with a place of effective management in Korea is also treated as a resident corporation.

### Permanent establishment (PE)

A non-resident corporation is generally deemed to have a tax presence (i.e. PE) in Korea if one of the following applies:

- It has any fixed place of business in Korea, where the business of the entity is wholly or partly carried on.
- It is represented by a dependent agent in Korea, who has the authority to conclude contracts on its behalf and who has repeatedly exercised that authority.
- Its employee(s) provides services in Korea for more than six months within 12 consecutive months.
- Its employee(s) continuously or repeatedly renders similar services in Korea for two or more years, even if each service visit is for less than six months within 12 consecutive months.

Exceptions to a PE in Korea for a non-resident corporation include fixed places of business used only for purchasing or storage of property at which no sales activities, advertising, publicity, collecting, or furnishing of information, or other activities that are preparatory or auxiliary to the conduct of business, occur.

## Other taxes

### Value-added tax (VAT)

VAT is levied at a rate of 10% on sales and transfers of goods and services, except zero-rated goods and services (e.g. goods for exportation, services rendered outside Korea, international transportation service by ships and aircraft, other goods and services supplied for foreign exchange earnings) and exempt goods and services (e.g. basic life necessities and services, such as unprocessed foodstuffs and agricultural products, medical and health service, finance and insurance services, duty-exempt goods).

Electronic VAT invoicing is a compulsory requirement as of 1 January 2011. If a taxpayer fails to issue the electronic VAT invoice or report electronically to tax authorities, the relevant penalties shall be imposed.

### *Acquisition taxes*

Acquisition tax is charged on the price of real estate, motor vehicles, construction equipment, golf membership, boats, etc. The minimum rate is 2%. A 6% tax is charged on acquisitions in the Seoul metropolitan area, and a 10% rate is applied to luxury items, such as villas, golf courses, and yachts.

### *Customs duties*

Customs duties are generally assessed on imported goods. 'Importation' refers to the delivery of goods into Korea (in case of goods passing through a bonded area, delivery of such goods into Korea from such a bonded area) to be consumed or to be used in Korea.

### *Excise taxes*

The individual consumption tax is imposed on specific luxury goods, high-priced durable consumer goods, goods subject to consumption restraints, and certain luxury activities for the purpose of supplementing the VAT single-rate scheme. Tax rates range from 2% to 20%; in certain circumstances, a fixed amount is levied (e.g. KRW 12,000 per person for golf course greens fees).



### *Property taxes*

An annual tax ranging from 0.07% to 5% is charged on the statutory value of land, buildings, houses, vessels, and aircraft. Five times the property tax rate is applied to property that is newly constructed or expanded in the Seoul metropolitan area for five years from its relevant registration date.

### *Stamp taxes*

The stamp tax is levied on a person who prepares a document certifying establishment, transfer, or change of rights to property in Korea. The stamp tax ranges from KRW 100 to KRW 350,000, depending on the type of taxable document.

### *Securities transaction tax*

A securities tax of 0.5% is imposed on the total value of securities at the time of transfer, but the government is authorised to adjust the tax rate in certain circumstances. The flexible tax rate prescribed by the Presidential Decree is 0.3% on transactions in both the Korea Stock Exchange and Korean Securities Dealers Automated Quotations (KOSDAQ).

### *Registration taxes*

Registration tax ranging from 0.1% to 5% is also charged upon the transfer of title and incorporation. Registration upon the transfer of title and incorporation for corporations located in large cities may be subject to three times the rates otherwise applied.

## *Branch income*

In general, a branch office of a foreign corporation is taxed in the same manner as resident companies.

Remittance of retained earnings from a Korean branch to its head office is subject to reporting to a designated foreign exchange bank in Korea under the Foreign Exchange Transaction Act.

If the tax treaty between Korea and the country in which a foreign corporation is residing allows the imposition of a branch profits tax, the tax is imposed on the adjusted taxable income of the Korean branch.

Where applicable, the branch profit tax is levied in addition to the regular CIT, which is imposed at the rate of 20% (or at a reduced rate as provided in a treaty) of the adjusted taxable income of the Korean branch.

## Income determination

Gross income consists of gains, profits, income from trade and commerce, dealings in property, rents, royalties, and income derived from any ordinary transactions carried on for gain or profit. For the purposes of taxation, gross income does not include income derived from gains from capital transactions such as capital surplus, gains on reduction of paid-in capital, gains from merger, divisions, comprehensive share transfer, or comprehensive share exchange. But, gains from treasury stock transactions are taxed, and losses are deductible from taxable income.

### Inventory valuation

Inventories generally are stated at the lower of cost or market (LCM). Any one of seven inventory valuation methods, including LCM, specific identification, first in first out (FIFO), last in first out (LIFO), weighted-average, moving average, and retail method can be elected for tax purposes. The method elected should be applied consistently each year unless an application for change has been submitted before three months from the year-end. Different valuation methods may be used for different categories (i.e. products and merchandise, semi-finished goods and goods in process, raw materials, goods in stock) and different business places.

### Stock valuation

The valuation of securities or bonds shall be made using the cost method. For cost method, the weighted average cost method or moving average cost method shall be applied for the purpose of valuation of securities and individual cost method may be used for valuation of bonds.

### Dividend income

All distributions to shareholders are taxed as dividend income, whether paid in cash or in stock.

However, a qualified domestic holding company that owns more than 80% (40% in case of listed subsidiary) share ownership in its domestic subsidiary will receive a 100% deduction for dividends while an 80% deduction is allowed for share ownership of 80% (40% in case of listed subsidiary) or less. A domestic corporation other than a qualified holding company will also receive a 100% deduction for shared ownership of 100%, 50% for more than 50% (30% in case of listed subsidiary) share ownership, and 30% for share ownership of 50% (30% in case of listed subsidiary) or less.

### Interest income

Except for certain cases, all interest income must be included in taxable income. Generally, interest income is included in taxable income as it is received.

### Rents/royalties income
A company engaged in the business of the rental of real properties is also taxed on the deemed rental income calculated at the financial institutions' interest rate on the lease security money as well as on the recognised rental income. Royalties are considered to be taxable income when earned.

### Gains and losses on foreign currency translation
Non-banking companies are allowed to recognise unrealised gains and losses on foreign currency translation of their monetary assets in a foreign currency. This recognition will also be allowed with respect to currency forward transactions and swaps to hedge foreign exchange risks of such assets. Before fiscal year 2010, only banks were allowed to recognise such gains and losses with respect to foreign currency assets and liabilities as well as currency forwards or swaps.

### Foreign income
Resident corporations are taxed on their worldwide income. A Korean company is taxed on its foreign-sourced income as earned at normal CIT rates. To avoid double taxation, taxes imposed by foreign governments on income recognised by a resident company are allowed as a credit against the income taxes to be paid in Korea or as deductible expenses in computing the taxable income. In general, foreign taxes will generally be applied as credit rather than as a deduction.



Income of foreign subsidiaries incorporated outside Korea is not included in the taxable income of a resident company. Income is recognised by a resident company only upon the declaration of dividends from a foreign subsidiary. Therefore, the Korean tax impact may be delayed through deferring the declaration of dividends unless the anti-tax haven rule under the Law for Coordination of International Tax Affairs (LCITA) is triggered.

Korean anti-tax haven rules state that accumulated earnings (distributable retained earnings) of a resident company's subsidiary located in a low tax jurisdiction (i.e. a tax haven where the effective tax rate on the taxable income for the past three years averages 15% or less) are taxed as deemed dividends to the resident company, which has direct and indirect interest of 20% or more in such subsidiary.

The foreign tax paid by a qualifying subsidiary is eligible for foreign tax credit against the dividend income of a resident company if an existing tax treaty between Korea and the country of which the foreign subsidiary is a resident allows it. A qualifying subsidiary is one in which a resident corporation owns 10% or more of its shares for more than or equal to six consecutive months after the date of dividend declaration. Unused foreign tax credits can be carried forward for five years.

## Deductions

In general, expenses incurred in the ordinary course of business are deductible, subject to the requirements for documentary support.

A corporation's disbursements of more than KRW 30,000 for goods or services provided are required to be supported by corroborating documents, such as credit card sales vouchers, cash receipts, and tax invoices. The corporation is required to maintain these documents for five years. If the corporation fails to maintain proper evidences, a 2% penalty shall be levied on the amount of disbursement.

### Accrued expenses

Accrued expenses are not deductible until the expenses are fixed or paid.

### Contingent liabilities

In general, contingent liabilities are not deductible, except for reserves under the following items, which are counted as losses within the tax limit:

- Reserves for retirement allowance.
- Reserves for bad debts.
- Liability reserves and emergency reserves prescribed in the Insurance Business Law.
- Reserves for non-profit organisations.
- Reserves for the write-off of a compensation claim set aside by trust guarantee funds in each business year.

The amounts enumerated below are also counted as losses in calculating income for the business year:

- The amount of gains from insurance claims used to acquire the same kinds of fixed assets as the lost fixed assets, or to improve the damaged fixed assets within two years after the first day of the business year following the business year in which the gains fall.
- The amount of a beneficiary's share of construction costs received by a domestic corporation engaged in the electricity or gas business, etc., used for the acquisition of fixed assets.
- The amount of the national treasury subsidies actually used for acquisition or improvement of fixed assets for business.

### Depreciation and amortisation

With the exception of land, depreciation of all property, plant, and equipment (PP&E), which includes buildings, machinery, and auto-vehicles, used to generate income is allowed as a deduction for CIT. Generally, interest on debt acquired to purchase, manufacture, or construct PP&E must be capitalized until the PP&E is operational. This does not apply to the interest associated with the expansion or improvement of existing PP&E. A detailed list of fixed assets, gross values (including capitalized interest), the useful lives of the assets, and the current year's depreciation charge must be submitted to the tax authorities when filing the annual CIT return.

The tax law allows the following methods for calculating depreciation:

- Straight-line or declining-balance method for tangible fixed assets, other than plant and buildings.
- Straight-line method for plant, buildings, and intangible assets.
- Service-output or straight-line method for mining rights.
- Service-output, declining-balance, or straight-line method for tangible fixed assets used in mining.

In determining depreciation using a straight-line method, salvage value of the assets is regarded as zero. However, where the declining-balance method is used, 5% salvage value is required. Changes in the depreciation method must be approved by the tax authorities in advance, and such approval may only be obtained in exceptional cases (i.e. merger between two corporations having different depreciation methods). Although the tax law specifies the useful lives of assets, the useful life of a fixed asset can be increased or decreased by 25% of the specified useful life at the taxpayer's election. The selected depreciation method should be consistently applied.

The standard useful life and the scope of useful life for assets are provided in the following table:

| Tangible fixed assets | Standard useful life / Scope of useful life (years) |
|---|---|
| Autos and transportation equipment (excluding those used for transportation businesses, leasing service of machinery, equipment, and consumer goods), tools, equipment, and fixtures | 5 / 4 to 6 |
| Ships and aircraft (excluding those used for fishery, transportation, leasing service of machinery, equipment, and consumer goods) | 12 / 9 to 15 |
| All buildings and constructions of brick structure, block structure, concrete structure, mud structure, mud wall structure, wooden structure, wooden frame mortar structure, and other structures | 20 / 15 to 25 |
| All the buildings and constructions of steel-frame/iron bar concrete structures, stone structures, brick/stone structures, steel-frame structures | 40 / 30 to 50 |

| Intangible fixed assets | Useful life (years) |
|---|---|
| Goodwill, design rights, utility model rights, trademarks | 5 |
| Patents, fishery rights, extraction rights under the law of development of mineral resources at the sea bottom (may elect activity method), right of management for toll roads, water rights, right of use for electricity and gas service facilities, right of use for tap water facilities for industrial use, right of use for general tap water facilities, right of use for heating facilities | 10 |
| Mining rights (may elect activity method), right of use for exclusive telegraph and telephone facilities, right of use for exclusive sidetracks, right of management for sewage disposal, right of management for tap water facilities | 20 |
| Right of use for dams | 50 |

Under the existing tax law, depreciation is allowed for tax deduction only when expensed for book purposes. The same position would be maintained even after the implementation of IFRS in Korea (K-IFRS); but in order to alleviate any dramatic increase in tax burden due to decreased depreciation expenses, additional expense deduction through tax adjustment may be allowed on a temporary basis. For tax purposes, depreciable assets acquired on or before 2013 may be depreciated at the rate equivalent to the average of three years before the adoption of K-IFRS. Depreciable assets acquired after 2014 may be depreciated using the tax useful lives. This change is applicable as of the fiscal year that includes 31 December 2010.

### *Goodwill*

Goodwill for tax purposes is defined as "value transferred with consideration, apart from transferred assets included in business transfer, valuated by taking into account business premium factors of the transferor such as permission/license, legal privileges, geographical advantages, business secrets, credit, reputation, transaction partners, etc." Goodwill may be amortised over five years using the straight-line method for tax purposes.

### *Organisational and start-up expenses*

Start-up expenses such as incorporation expenses, founders' salary, and registration fees and taxes are deductible when the expenses are actually paid.

### *Interest expense*
Interest incurred in the ordinary course of business is deductible as long as the related loan is used for business purposes. There are, however, a number of exceptions to the general rule, as follows:

- If borrowings from a foreign shareholder, or from a third party under a guaranteed payment guarantee by the foreign shareholder, exceed three times the equity of the relevant foreign shareholder, the paid interest and discount fee as to the relevant excessive portion will be treated as a dividend payment and not allowed as a deduction.
- Debenture for which the creditor is unknown.
- Bonds and securities on which recipient of interest is unknown.
- Construction loans and loans for the purchase of land and fixed assets up to the date on which the assets are acquired or completed must be capitalised as a part of the cost of the asset and depreciated over the life of the asset. Interest after the date of completion or acquisition is deductible as incurred.
- Interest on loans related to non-business purpose assets or funds loaned to related parties.

### *Bad debts*
A doubtful accounts reserve is allowed for tax purposes of up to 1% (2% for certain financial institutions) or the previous year's ratio of actual loss from bad debts to total balance of account receivables at year-end. Actual losses on bad debts are allowed when certain legal proceedings are satisfied or the statute of limitations has lapsed.

Although companies could set aside bad debt allowances based on reasonable estimates under the old generally accepted accounting principles (K-GAAP), the new GAAP for non-K-IFRS users and K-IFRS users requires objective evidence to recognise the allowance. This stricter rule is expected to create disproportionately higher taxable income on the first year of adoption. As K-IFRS is expected to be revised in a way to use the 'estimated loss model' from 2013 and thereafter (in which case the allowance would be increased significantly at the point of first implementation), the tax recognition of the income in the first year of K-IFRS adoption would be deferred for two years until the new model is implemented. This change is applicable as of the fiscal year that includes 31 December 2010.

### *Charitable contribution*
Donations to public interest entities, such as government authorities and social welfare organizations, as well as donations for academic research, technical development, etc., are classified as Bub-jung donations. Bub-jung donations are tax-deductible up to 50% of the total taxable income for the concerned fiscal year after deduction of net operating loss (NOL). Ji-jung donations to public entities prescribed by Corporate Income Tax Law (CITL) are also tax-deductible up to 10% of the total taxable income for the fiscal year after the deduction of deductible Bub-jung donations and NOL.

The amount in excess of such limit may be carried over for one or five years. Donations other than the statutory donations above will not be deductible for tax purposes.

### *Employee remuneration*
There is no statutory limit for employee remuneration, which includes salaries, wages, stipends, bonuses, retirement payments, pensions, and meal and housing allowances as well as all other kinds of subsidies, payments, and compensation. Remuneration of foreign employees is determined according to their engagement contracts.

### *Pension expense*

For tax purposes, severance allowance may be deducted up to 5% of the annual total amount of wages paid. However, the accumulated amount of the severance allowance reserve may not exceed 30% of the actual aggregate liability to employees for fiscal year 2010. This deduction limit will be reduced by 5% every year from 2011 to be entirely eliminated for 2016. If a corporation subscribes to severance insurance with an insurance company to cover future payments of retirement allowances, additional tax deductions beyond the limits described above are available.

As of 2011, employers hiring five or more employees are required to set aside retirement pensions for their employees. Defined contribution (DC) and defined benefits (DB) will be two available schemes for the new retirement pension system. Under the DC scheme, the premiums paid by the employer will be deductible upon payment while the reserve under the DB scheme would be deductible subject to the limit, similar to the existing severance insurance.

### *Payment for directors*

Bonuses paid to directors in excess of the amount determined in the articles of incorporation or at a shareholders' meeting, etc. are not deductible. Also, severance benefits paid to directors in excess of the amount prescribed in the tax law are not deductible.



### *Entertainment expenses*

Entertainment expenses of more than KRW 10,000 on an event basis must be supported by corporate credit card vouchers, cash receipts, or tax invoices in order to be deductible. In addition, the entertainment expenses in excess of the tax limit are not deductible.

The deductible limit for entertainment expenses in a business year is computed as:

- an amount calculated by multiplying KRW 12 million (KRW 18 million for a SME) by the number of months in the respective business year divided by 12, plus
- an amount calculated by multiplying the amount of gross receipts for a business year by the rates listed in the following table (in the case of receipts from transactions between related parties, 20% of the amount calculated by multiplying the receipts by following rates shall be applied).

| Amount of gross receipts (KRW) | Rate |
| --- | --- |
| 10 billion or less | 0.2% |
| 10 billion to 50 billion | KRW 20 million + 0.1% of the excess over KRW 10 billion |
| Greater than 50 billion | KRW 60 million + 0.03% of the excess over KRW 50 billion |

### *Insurance premiums*

Insurance premiums paid to an insurance company are deductible if the business enterprise is the listed beneficiary. Insurance premiums for which the beneficiary is the employee are also deductible; however, they are treated as salaries for the employees and are subject to WHT on earned income (this excludes the severance insurance premium or social security taxes that are borne by the corporations).

### *Fines and penalties*

Fines, penalties, and interest on underpayment of taxes are not deductible.

### *Net operating losses (NOL)*

In general, a NOL carryover is allowed for ten years for fiscal years commencing after 31 December 2008 (five years for the prior years). Along with the extension of the NOL carryforward period from five years to ten years, when a taxpayer uses the NOL incurred more than five years ago, the statute of limitation shall be one year from the filing due date of the fiscal year when the NOL is utilised.

Generally, loss carrybacks are not allowed. However, SMEs can carryback a NOL for one year.

### *Payments to foreign affiliates*

With sufficient supporting documentation, interest, royalty, and management service fees paid to foreign affiliates are deductible for CIT purposes.

Under the LCITA, the following conditions must be met in order for a management service fee to be deductible:

- The services must be provided based on an agreement entered into by the service provider prior to the service transaction.
- The provision of the service can be verified by a schedule of services, description of services, description of the company providing services and its employees, detailed explanation of expenses incurred, and other supporting documentation.
- A company must be able to anticipate the company's additional profit or reduced expense through the services provided by a foreign affiliate.
- Payment for the provided services should be consistent with arm's-length standards.

## *Group taxation*

The consolidated corporate tax filing system can be adopted from the fiscal year commencing on or after 1 January 2010 for a domestic corporation in cases where two or more wholly-owned subsidiaries exist. It is up to the election of the taxpayer, but it cannot be revoked for at least five years after the election of the consolidated tax filing.

### *Transfer pricing regime*

The LCITA authorises the tax authorities to adjust the transfer price based on an arm's-length price (ALP) and to determine or recalculate a resident's taxable income when the transfer price of a Korean company and its foreign counterpart is either below or above an ALP.

The LCITA lists the following methods for determining an ALP: the comparable uncontrolled price (CUP) method, the resale price method, and the cost-plus method. Furthermore, the Decree elaborates upon the profit-split method, the transactional net margin method (TNMM), and the Berry Ratio method as methods for determining an ALP based on profits arising from controlled transactions.

The method used and the reason for adopting that particular one for an ALP determination must be disclosed to the tax authorities by a taxpayer in a report submitted along with his annual tax return.

### *Thin capitalisation rules*

In cases where a Korean company borrows from its controlling shareholders overseas, an amount greater than three times its equity (six times in the case of financial institutions) interest payable on the excess portion of the borrowing is characterised as dividends to which the article on dividends in tax treaty applies and therefore are treated as non-deductible in computing taxable income.

### *Anti-tax haven rules*
In cases where a Korean company invests in a company located in a tax haven, which unreasonably has reserved profits in the controlled foreign company, the profits reserved therein shall be treated as dividends paid out to that Korean company (individual), despite the fact that the reserved profits are not actually distributed.

Anti-tax haven rules are intended to regulate a company that has made overseas investments of an abnormal nature. Thus, these anti-tax haven rules apply to those Korean companies that have invested in a company incorporated in a foreign country with an average effective tax rate of 15% or less on taxable income for the past three years.

However, if a company incorporated in such a tax haven country actively engages in business operations through an office, shop, or a factory, then the anti-tax haven rules will not apply.

### *Related party transactions*
Under the provision of CITL, the tax authorities may recalculate the corporation's taxable income when CIT is unreasonably reduced due to transactions with related parties. Generally, if the discrepancy between the transaction price and fair market value exceeds 5% of the fair market value or KRW 300 million, the transaction will be subject to this provision.



## *Tax credits and incentives*

### *Foreign tax credit*
Taxes imposed by foreign governments on income recognised by a resident taxpayer are allowed as a credit within the limit against the income taxes to be paid in Korea, or as deductible expenses in computing the taxable income. In general, foreign taxes will be applied as credit rather than as a deduction. The excess foreign tax credit can be carried forward five years.

### *Investment incentives*
Tax credits are generally available for qualified investment in facilities for productivity enhancement, safety, job-creating investments, etc.

#### Tax credit for investment in facilities for productivity enhancement
If a resident makes an investment in facilities or equipment to increase productivity by no later than 31 December 2012, then 3% (7% in the case of SMEs) of such investment amount shall be deducted from CIT. The unused tax credit can be carried forward five years.

#### Tax credit for investment in facilities for safety
If a resident or a domestic corporation makes an investment in a facility (excluding any investment in used assets) for safety that is considered necessary for industrial purposes no later than 31 December 2012, then an amount of 3% of such investment shall be deducted from CIT. The unused tax credit can be carried forward five years.

### Tax credits to encourage job-creating investments

The sunset of the temporary tax credit for facility investments has been extended until 31 December 2011 at a reduced rate of 4% to 5%, based on company size and location.

Additionally, a 1% tax credit for job-creating investments can simultaneously be applied to investments made until 31 December 2011. The credit for job-creation may not exceed the ceilings set at KRW10 million (or KRW15 million per employee aged between 15 and 29) multiplied by net new employment. A carryforward of the credit is allowed as long as there is an increase in employment. Further details, such as conditions and calculation method, on applying the new tax credit will be prescribed in the presidential decree.

### *Research and development (R&D) tax incentives*

The STTCL provides various tax incentives to stimulate R&D activities. These include deduction of R&D reserve, tax credit for research, and manpower development expenses.

### Reserves for development of technology and manpower

In cases where a corporation has set aside development of technology and manpower reserves for expenses on development of technology and manpower on or before 31 December 2013, those reserves are considered as deductible expenses up to 3% of annual sales.

### Tax credit for development of technology and manpower

Companies presently claim a tax credit in relation to qualifying R&D expenditure to the extent of either (i) 3% to 6% (25% for SMEs) of the current R&D expenses or (ii) 40% (50% for SMEs) of the incremental portion of the current R&D expenses over the average of the previous four years. The tax credit has been extended to include R&D in relation to core technologies as authorised by government ministries as well as pre designated strategic growth industries until the end of December 2012, and for these industries, the credit rate for the current R&D expenditure is 20% (30% for SMEs).

### Tax credit for investment in facilities for technology and human resources development

A corporation purchasing facilities prescribed in the Presidential Decree with the purpose of R&D and job training is eligible for tax credit up to 10% of such investment. The unused tax credit can be carried forward five years.

### *Energy/environmental incentives*

### Tax credit for investment in energy-economizing facilities

If a resident makes an investment (excluding any investment in used goods) not later than 31 December 2011 in energy-economising facilities, 10% of such investment shall be deducted from CIT. The unused tax credit can be carried forward five years.

### Tax credit for investment in facilities for environmental protection

If a resident makes an investment (excluding any investment in used goods) in any facility for the purpose of environmental conservation no later than 31 December 2013, then 10% of the investment amount shall be deducted from CIT. The unused tax credit can be carried forward five years.

### *Employment incentives*

Under the STTCL, where a SME has regular employees that exceed the prior year's number of regular employees for the period from 1 March 2010 to 30 June 2011, KRW

3 million multiplied by the excess number of employees is deductible from CIT for the year. The unused tax credit can be carried forward five years.

### *Inbound investment incentives*

The Korean government provides various incentives and benefits for inducing foreign investment under the Foreign Investment Promotion Law.

Foreign invested companies that engage in certain qualified high-technology businesses can apply for 100% exemption from CIT for five years, beginning from the first year of profitable operations (from the fifth year, if not profitable until then) and a 50% reduction for the following two years in proportion to the foreign shareholding ratio. An exemption from WHT on dividends is available for foreign investors in the same manner as above during the same grace period. In addition, the taxpayer can apply for 100% exemption from local taxes, such as acquisition tax, registration tax, and property tax on assets acquired for their business for five years after the business commencement date and 50% reduction for the following two years. For local tax exemption, some local governments grant longer exemption periods (up to 15 years) in accordance with their local ordinances. Qualified foreign investment also can be eligible for exemption from customs duties, VAT, and special excise tax on imported capital goods for the first three years.



In addition, foreign investors satisfying specified criteria are provided with tax incentives and other benefits for investment in specially designated areas, including foreign investment zones (FIZ), free economic zones (FEZ), free trade zones (FTZ), and strategic industrial complexes exclusively developed for foreign invested companies. The tax incentives for qualifying foreign investors in FIZ are similar to those of the above foreign invested high-tech companies. Qualifying investors in FEZ, FTZ, and strategic industrial complexes may receive the 100% exemption from corporate or individual income tax as well as local taxes for the first three years and 50% reduction for the next two years. An exemption from WHT on dividends is granted to qualifying foreign investors in FEZs, FTZs, and such industrial complexes in the same manner as above during the same grace period. They also receive exemption from customs duties on imported goods for the first three years.

#### Foreign direct investment (FDI) incentive limitations

The FDI credit has been amended to limit incentives granted to qualified FDIs. The ceiling has been set to encompass both investment amount and job-creation. In terms of investment amount, the level of incentives for FDI has been reduced to 70% of the aggregated FDI amount for companies benefiting from a 7-year incentive period (50% ceiling for companies enjoying a 5-year incentive period). In terms of job-creation, the level of incentives for FDI has been reduced to the lower of either 20% of the aggregated FDI amount or KRW 10 million times the company’s net increase in employment.

Companies that have enjoyed tax benefits based on job-creation will be subject to tax assessment in cases where there is a net decrease in employment within the subsequent two years in comparison to the year that the relevant tax credit was obtained.

The amended regulation will be applicable for FDIs made on or after 1 January 2011.

## *Withholding taxes*

Foreign corporations with income derived from sources in Korea are subject to CIT on such income. If the foreign corporation has no ‘domestic place of business’ in Korea, it will be subject to tax on its Korean-source income on a withholding basis in accordance with the tax laws and the relevant tax treaty, if applicable. Any Korean-source income attributable to a domestic fixed place of business of a foreign corporation will be subject to Korean CIT.

There are various limitations on the WHT rates for residents of countries with a tax treaty with Korea. For dividends, interest, and royalties, the WHT rates are limited as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations (1) | 0 | 14/25 | 0 |
| Resident individuals (1) | 14 | 14/25/30 | 0 |
| | | | |
| Non-resident corporations and individuals: | | | |
| Non-treaty (2) | 20 | 14/20 (36) | 20 (39) |
| Treaty: | | | |
| Albania | 5/10 (8) | 10 | 10 |
| Algeria | 5/15 (8) | 10 | 2/10 (15) |
| Australia | 15 | 15 | 15 |
| Austria | 5/15 (8) | 10 | 2/10 (15) |
| Azerbaijan | 7 | 10 (37) | 5/10 (22) |
| Bangladesh | 10/15 (3) | 10 | 10 |
| Belarus | 5/15 (8) | 10 | 5 |
| Belgium | 15 | 10 | 10 |
| Brazil | 10 | 10/15 (5) | 10/25 (6) |
| Bulgaria | 5/10 (7) | 10 | 5 |
| Canada | 5/15 (8) | 10 | 10 |
| Chile | 5/10 (8) | 10/15 (31) | 5/15 (33) |
| China, P.R. | 5/10 (8) | 10 | 10 |
| Croatia | 5/15 (8) | 5 | 0 |
| Czech Republic | 5/10 (8) | 10 | 10 |
| Denmark | 15 | 15 | 10/15 (4) |
| Egypt | 10/15 (8) | 10/15 (9) | 15 |
| Fiji | 10/15 (8) | 10 | 10 |
| Finland | 10/15 (8) | 10 | 10 |
| France | 10/15 (3) | 10 | 10 |
| Germany | 5/15 (8) | 10 | 2/10 (15) |
| Greece | 5/15 (8) | 8 | 10 |
| Hungary | 5/10 (8) | 0 | 0 |
| Iceland, Rep. of | 5/15 (8) | 10 | 10 |
| India | 15/20 (11) | 10/15 (12) | 15 |
| Indonesia | 10/15 (8) | 10 | 15 |
| Ireland, Rep. of | 10/15 (3) | 0 | 0 |
| Israel | 5/10/15 (13) | 7.5/10 (14) | 2/5 (15) |
| Italy | 10/15 (8) | 10 | 10 |
| Japan | 5/15 (8) | 10 | 10 |
| Jordan | 10 | 10 | 10 |
| Kazakhstan | 5/15 (3) | 10 | 2/10 (15) |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Kuwait | 10 | 10 | 15 |
| Laos | 5/10 (3) | 10 | 5 |
| Lithuania | 5/10 (8) | 10 | 5/10 (38) |
| Luxembourg | 10/15 (8) | 10 | 10/15 (16) |
| Malaysia | 10/15 (8) | 15 | 10/15 (17) |
| Malta | 5/15 (8) | 10 | 0 |
| Mexico | 0/15 (18) | 5/15 (19) | 10 |
| Mongolia | 5 | 5 | 10 |
| Morocco | 5/10 (8) | 10 | 5/10 (20) |
| Nepal | 5/10/15 (32) | 10 | 15 |
| Netherlands | 10/15 (8) | 10/15 (21) | 10/15 (22) |
| New Zealand | 15 | 10 | 10 |
| Norway | 15 | 15 | 10/15 (22) |
| Oman | 5/10 (3) | 5 | 8 |
| Pakistan | 10/12.5 (11) | 12.5 | 10 |
| Papua New Guinea | 15 | 10 | 10 |
| Philippines (2) | 10/25 (23) | 10/15 (24) | 10/15 (25) |
| Poland | 5/10 (3) | 10 | 10 |
| Portugal | 10/15 (8) | 15 | 10 |
| Qatar | 10 | 10 | 5 |
| Romania | 7/10 (8) | 10 | 7/10 (22) |
| Russia | 5/10 (26) | 0 | 5 |
| Saudi Arabia, Kingdom of | 5/10 (8) | 5 | 5/10 (33) |
| South Africa (2) | 5/15 (8) | 10 | 10 |
| Singapore | 10/15 (8) | 10 | 15 |
| Slovak Republic | 5/10 (8) | 10 | 0/10 (34) |
| Slovenia | 5/15 (8) | 5 | 5 |
| Spain | 10/15 (8) | 10 | 10 |
| Sri Lanka | 10/15 (8) | 10 | 10 |
| Sweden | 10/15 (8) | 10/15 (10) | 10/15 (22) |
| Switzerland | 10/15 (8) | 10 | 10 |
| Thailand (2) | 10 | 10/15 (27) | 5/10/15 (35) |
| Tunisia | 15 | 12 | 15 |
| Turkey | 15/20 (8) | 10/15 (28) | 10 |
| Ukraine | 5/15 (11) | 5 | 5 |
| Union of Myanmar | 10 | 10 | 10/15 (4) |
| United Arab Emirates | 5/10 (3) | 10 | 0 |
| United Kingdom | 5/15 (8) | 10 | 2/10 (15) |
| United States (2) | 10/15 (30) | 12 | 10/15 (29) |
| Uzbekistan | 5/15 (8) | 5 | 2/15 (15) |
| Venezuela | 5/10 (3) | 5/10 (19) | 5/10 (33) |
| Vietnam | 10 | 10 | 5/15 (22) |

Notes

1. Dividends and interest paid to resident individuals by corporations generally are subject to a 14% WHT rate. In addition to this, there is a resident surtax of 10% on the CIT liability.

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2. In addition to the indicated tax rate, a resident surtax is charged at a rate of 10% of the respective tax rate.
3. Lower rate applies in case of equity ownership of 10% or more.
4. 10% rate applies to royalties paid for the use of or the right associated with industrial activities.
5. 10% rate applies if the loan period extends to seven years or more, the recipient is a financial institution, and the loan is used for certain designated purposes.
6. 25% rate applies to royalties associated with the use of trademarks or trademark rights.
7. 5% rate applies in case of equity ownership of 15% or more.
8. Lower rate applies in case of equity ownership of 25% or more.
9. 10% rate applies if the term of loans exceeds three years.
10. 10% rate applies when a recipient of interest income is a bank and income is connected with a loan with a term in excess of seven years.
11. Lower rate applies in case of equity ownership of 20% or more.
12. 10% rate applies if a recipient is a bank.
13. 5% rate applies if a recipient holds 10% or more ownership in a paying corporation but, even in case of 10% or more ownership, 10% rate applies if the dividends are paid out of profits subject to tax at a lower rate than the normal corporate tax rate of a country where a payer resides. In other cases, 15% rate applies.
14. 7.5% rate applies when a recipient of interest income is a bank or a financial institution.
15. 2% rate applies to royalties paid for use of or the right to use industrial, commercial, or scientific equipment.
16. 10% rate applies if it is for the use of or the right to use industrial, commercial, and scientific equipment or information.
17. 15% rate applies if royalties are for use of or the right to use cinematography films or tapes for radio or television broadcasting or any copyright of literary or artistic work.
18. 0% rate applies in case of equity ownership of 10% or more.
19. 5% rate applies if a recipient is a bank.
20. 5% rate applies to royalties for use of copyrighted literature and music.
21. 10% rate applies if the term of the loans exceeds seven years.
22. Lower rate applies if it is for the use of or the right to use a patent, trademark, design, or secret formula, or industrial, commercial, and scientific equipment or information.
23. 10% rate applies in cases of equity ownership of 25% or more, or dividend paid by a resident company engaged in a preferred pioneer area and registered with the Board of Investment.
24. 10% rate applies in cases where the interest is paid in respect of public offering of bonds, debentures, or similar obligations or interest paid by a company that is a resident of the Philippines, registered with the Board of Investment, and engaged in preferred pioneer areas of investment under the investment incentive laws.
25. 10% rate applies in case of royalties paid by a company that is a resident of the Philippines, registered with the Board of Investment, and engaged in preferred pioneer areas of investment under the investment incentives laws.
26. 5% rate applies if a recipient holds 30% or more of equity interest in the amount of at least USD 100,000.
27. 10% rate applies if a beneficial owner of the income is a financial institution (including insurance company) or resident of Thailand who is paid with respect to indebtedness arising as a consequence of a sale on credit by a resident of Thailand of any equipment, merchandise, or services, except where the sale was between persons not dealing with each other at arm's length.
28. 10% rate applies if the term of the loan exceeds two years.
29. 10% rate applies to royalties for use of copyrighted literature, music, films, and television or radio broadcasts. Otherwise, 15% rate applies.
30. 10% rate applies if equity ownership is 10% or more and not more than 25% of the gross income of a paying corporation for a preceding tax year consists of interest or dividends.
31. 10% rate applies when a recipient of interest income is a bank or an insurance company.
32. 5% rate applies when a recipient holds 25% or more of equity interest, and 10%, when a recipient holds 10% or more of equity interest. In other cases, 15% rate applies.
33. 5% rate applies to royalties paid for the use of or the right associated with industrial, commercial, or scientific equipment.
34. 0% rate applies to royalties paid for the use of academic rights.
35. 5% rate applies to royalties paid for the use of or the right associated with any copyright of literary, artistic, or scientific work, including software, and motion pictures and works on film, tape, or other means of reproduction for use in connection with radio or television broadcasting. 10% rate applies to royalties paid for the use of or the right to use a patent, trademark, design or model, plan, secret formula, or process. 15% rate applies to royalties paid for the use of or the right to use industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.
36. 14% rate applies if interest arises from bonds issued by a Korean company or government bodies.
37. 0% rate applies if a recipient of interest income is government, central bank, etc.
38. 5% rate applies to royalties paid for the use of industrial, commercial, or scientific equipment.
39. Fees arising from rental of industrial, commercial, scientific equipment, etc. are classified as rental income subject to 2% WHT.

If a foreign company is located in a foreign jurisdiction designated as a tax haven by the Minister of Strategy & Finance, any Korean-source income of such foreign company will be subject to the domestic withholding rate of 20% regardless of whether or not the foreign company is resident of a treaty country. Currently, only Labuan is designated as such a jurisdiction. The foreign company may claim a refund of any excess WHT paid within three years, if it proves to the Korean Tax Office that it is entitled to the reduced treaty rates as the substantive and beneficial owner of the income. Alternatively, a foreign company may attempt to seek a pre-approval in order to have the treaty benefits apply upfront by making an application to the Commissioner of Taxation.

## Tax administration

### Returns

In Korea, the taxable year is on a fiscal-year basis as elected by the taxpayer. However, it cannot exceed 12 months.

A corporation must file an interim tax return with due payment for the first six months of the fiscal year and the filing/payment must be made within two months after the end of the interim six-month period.

A corporation must file an annual tax return with due payment for the fiscal year and the filing/payment must be made within three months from the end of a fiscal year.



### Payment of tax

Where the tax amount to be paid by a resident corporation is in excess of KRW 10 million, part of the tax amount to be paid may be paid in installments within one month of the date of the expiration of the payment period (two months for SMEs).

Where the tax amount to be paid is less than KRW 20 million, the excess of KRW 10 million shall be paid in installments; where the tax amount to be paid exceeds KRW 20 million, 50% or less of the tax amount shall be paid in installments.

### Statute of limitation

The statute of limitation is generally five years from the statutory filing due date of the annual CIT return. However, the statute of limitation is extended further in the following cases:

- Ten years if a taxpayer evades taxes by fraud or unjustifiable means.
- Seven years if a taxpayer does not file its tax base by the statutory due date.

Along with the extension of the NOL carryforward period from five years to ten years, when a taxpayer uses the NOL incurred more than five years ago, the statute of limitation shall be one year from the filing due date of the fiscal year when the NOL is utilised.

### Audit cycle

In March 2010, NTS announced the ‘Plan for Tax Audits’ which is the criteria for selecting a tax audit target company.

For large companies whose sales revenue is KRW 500 billion or more, the tax audit will be conducted every four years. Other companies are selected by certain standards which were announced by NTS.

### Topics of focus for tax authorities

Recently, topics of focus for tax authorities are as follows:

- Increased scrutiny for the prevention of offshore tax evasion through aggressive tax planning.
- Denial of unfair transactions between related parties.
- Entertainment expenses.
- Deductibility of management service fees or allocated expenses incurred by foreign affiliates.
- International inter-company transactions and transfer pricing.

## Other issues

### Reporting requirements for foreign bank and financial accounts

Residents and domestic companies must file a report with the NTS of their bank and financial accounts in a foreign country if the aggregate value of these accounts exceeds KRW 1 billion at any time during the calendar year.

Foreign account holders must file their concerned overseas account information with the governing tax office for the period from 1 June to 30 June of the following year. For failure to comply with the filing requirements or incorrect filing, the account holder shall be subject to fines equaling 10% of the non-compliance amount or the difference between the amount actually filed and the amount which should have been filed. The new requirement will be applicable to overseas banking accounts owned since January 2010 with a lower penalty rate of 5% on holdings during 2010.

### Functional currency

In instances where the taxpayer adopts to use a foreign currency as its functional currency, there will be three ways to calculate the CIT base: (i) calculate the tax base using the financial statements in functional currency and translate it into KRW; (ii) prepare the financial statements in KRW and calculate the tax base; or (iii) translate the financial statements into KRW and calculate the tax base. Once elected, the same method shall be consistently used. This change is applicable as of the fiscal year that includes 31 December 2010.

### Exchange controls

Most transactions involving foreign exchange generally do not require approval or reporting under the Foreign Exchange Trade Act (FETA), with a few exceptions as prescribed by the FETA. Receipt of foreign exchange from outside Korea is freely permitted, and payments to foreign companies are not regulated. Most restrictions on Korean companies' foreign currency transactions with foreigners have been removed. However, the government continues to monitor certain flows of foreign currency in an attempt to minimise incoming speculative currency and outgoing capital flight.

Ever since Korea's currency crisis, most restrictions on short-term as well as mid and long-term borrowings from overseas by corporations have been removed. Most foreign currency loans are allowed and are subject to reporting to a foreign exchange bank. There are no specific regulations, except the reporting requirements, on borrowings from overseas by foreign investment companies in Korea.

### *Choice of business entity*
The following types of commercial entities are permitted in Korea:

- Corporation (Hoesa): There are five classes of corporation, outlined as follows:
  - Limited corporation:
    - Jusik Hoesa (JH): A corporation incorporated by one or more promoters, with each shareholder's liability limited to the amount of contributed capital. This type of entity is the most commonly used in Korea.
    - Yuhan Hoesa (YH): A corporation incorporated by one or more members, with each member's liability limited to the amount of that member's contribution to the corporation.
    - Yuhan Chegim Hoesa (a newly proposed form for legislation): A corporation incorporated by one or more members, with each member's liability limited to the amount of that member's capital contribution. With significantly fewer restrictions for establishment and operation, Yuhan Chegim Hoesa provides more flexibility and self-control than YH.
  - Unlimited corporation:
    - Hapmyong Hoesa: A corporation incorporated jointly by more than two members who are responsible for corporate obligations, if the assets of the corporation are insufficient to fully satisfy those obligations.
    - Hapja Hoesa: A corporation composed of one or more partners who have unlimited liability and one or more partners with limited liability.
- Partnership: Hapja Johap, a newly proposed form, is a legal form of partnership allowed under the Commercial Code.
- Joint venture: A joint venture is generally established as a domestically incorporated corporation whose shareholders have limited liability regarding the obligations of the corporation under the Commercial Code.
- Branch: A foreign corporation can perform its business operation in Korea by setting up a taxable presence in the form of a branch office.
- Liaison office: A foreign corporation can establish a liaison office which is not allowed to execute income-generating business activities in Korea.
- Sole proprietorship: Sole proprietorships are not a legal form of entity in Korea.

# Kuwait

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## Significant developments

The Tax Authority in Kuwait has recently issued updated Executive Rules and Regulations for implementation of Law No. 2 of 2008.

The Department of Inspection and Tax Claims (DIT) in Kuwait intends, by the issuance of those rules, to update a few of the existing Executive Rules already issued earlier following the publication of Law No. 2 of 2008 and to determine/regulate the tax treatment for fund investment, trading in the Kuwait Stock Exchange (KSE), and dividend distribution for foreign investors operating in Kuwait.

The following are the key changes and updated/new rules issued by the DIT.

### *Executive Rule No. 25 of 2010 - Design and consultancy costs*

Executive Rule No. 25 of 2010 was issued to update Executive Rule No. 22 of 2008 pertaining to design and consultancy services provided outside Kuwait.

In addition to the tax treatment for design cost conducted outside of Kuwait, the DIT has now also determined the allowable profit for consultancy works conducted outside of Kuwait. Under this new rule, consultancy and design cost incurred outside of Kuwait will be allowed as deductible cost. However the allowable costs will be restricted, depending on the party providing the services, as follows.

For design costs incurred outside Kuwait:

| Work conducted by | Percentage of allowed costs of % of revenue |
|---|---|
| Head office | 75% to 80% |
| Affiliated companies | 80% to 85% |
| Third parties | 85% to 90% |

For consultancy costs incurred outside Kuwait:

| Work conducted by | Percentage of allowed costs of % of revenue |
|---|---|
| Head office | 70% to 75% |
| Affiliated companies | 75% to 80% |
| Third parties | 80% to 85% |

In case there is no separate revenue for the consultancy and design work, although the nature of the contract requires the existence of consultancy work, the following formula shall be applied by the DIT:

Consultancy or design revenue = (consultancy or design costs/total direct costs) x contract revenue

### *Executive Rule No. 40 of 2010 - Reimbursable costs*

The DIT has now determined the tax treatment for reimbursable costs claimed by the taxpayer in Kuwait filing tax declarations on a deemed profit basis. Executive Rule No. 40 of 2010 states that reimbursable cost shall be allowed, provided all of the following conditions are met:

- The reimbursable cost must be necessary to perform the operations as per the contract and must be clearly stated in the contract.
- Such costs must not exceed 30% of the annual revenue.
- The reimbursed cost must be substantiated by proper documents in support.

In case the reimbursement costs exceed 30% of the revenue, the company following the deemed profit basis will be required to follow the account basis of filing and shall be assessed on account basis accordingly.

### *Executive Rule No. 49 of 2010 - Disposal of foreign shares*

Executive Rule No. 49 of 2010 states that foreign corporate bodies selling part or all of their share in a Kuwait entity must comply with all of the following requirements:



- Submission of a copy of the selling contract stamped by the Ministry of Justice to the DIT.
- A copy of the amended articles of association.
- Documents in support of the share selling transaction, such as proof of assets acquired and consideration of assets sold. The transaction may also be disclosed in the company's balance sheet and financial closing accounts.

In addition to the above, in case required by the DIT, the company acquiring the shares will be required to submit copies of the following to the DIT, for the year in respect of the selling transaction:

- Balance sheet.
- Closing accounts and balances.
- Books and records.
- Documents in support of the acquisition.

### *Executive Rule No. 36 of 2010 - Foreign currency exchange rates and related profits and losses*

Executive Rule No. 20 of 2008 deals with the tax treatment for realised and unrealised losses and gains related to foreign currency transactions and provides for the following:

- Unrealised foreign exchange gains are required to be reported in the tax declaration. However, unrealised gains may be excluded from taxable income for calculating the tax due for the fiscal year.
- Realised foreign exchange gains are taxable in Kuwait and therefore added to calculate taxable profits.
- Unrealised losses are not considered as tax deductible costs and therefore excluded for calculating taxable profits.
- Realised losses may be claimed as tax deductible costs, provided such losses are supported by adequate supporting information and documents.

### Executive Rule No. 18 to 22 of 2010 - Tax on dividend distribution and registration requirements for funds, portfolio managers, and direct investors trading in the Kuwait Stock Exchange

The DIT has issued Executive Rules No. 18, 19, 20, 21, and 22 of 2010 to regulate and determine the tax treatment for foreign entities' investment in Kuwait. The following are the key updates of such rules:

- Fund managers, investment trustees, and investment companies running the portfolios for organizations are required to register themselves with the DIT, by submitting a registration form and providing information about their operations in Kuwait, among other information as specified in the specified registration forms.
- Companies investing directly in the Kuwait Stock Exchange are also now required to comply with the same registration procedures as above.
- Specific forms and procedures are now required from the fund managers/custodians in order to provide information about the withholding tax (WHT) on dividend distribution to foreign investors and for the settlement of such WHTs to the DIT.
- Fund managers, custodians, and portfolio managers should notify the DIT with any changes or update to the information provided on the registration forms periodically.
- Foreign investors claiming refunds of excess or wrong WHTs should apply for refund in specific forms to claim such taxes within a maximum period of 5 years from the rate on which the tax was collected by the DIT.

### Memorandum of Understanding signed between Kuwait and the United States for tax exemptions on revenue from aircraft operations

Kuwait and the United States signed a Memorandum of Understanding (MoU) for tax exemptions on revenue of aircraft operation during March 2011. The Kuwait Ministry of Finance issued a public statement that the aim of the MoU was to support airlines' operations and activities and boost overall air transport, as well as bring down tax paid in both countries.

## Taxes on corporate income

The taxation on income in Kuwait is governed by the following two enactments, Kuwait Income Tax Decree No. 3 of 1955 and Law No. 23 of 1961, which regulate the income of companies in the neutral zone area. Tax law No. 2 of 2008, which was issued by the Kuwaiti government on 22 January 2008, amended the Kuwait Income Tax Decree No. 3 of 1955 and other corporate and taxation related matters in Kuwait.

One of the major changes of the Law No. 2 of 2008 was the reduction of the tax rates, which previously reached a maximum rate of 55%, to a flat rate of 15%.

Kuwait does not impose income tax on companies wholly owned by the nationals of Kuwait or other Gulf Cooperation Council countries (GCC), including Bahrain, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. However, GCC companies with foreign ownership are subject to taxation to the extent of the foreign ownership. Income tax is imposed only on the profits and capital gains of foreign 'corporate bodies' conducting business or trade in Kuwait, directly or through an agent.

### Governing laws

The taxation on income in Kuwait is governed by the Kuwait Income Tax Decree No. 3 of 1955 and Law No. 2 of 2008, amending the income tax decree. These laws are applicable to business activities carried out in Kuwait, exclusive of the neutral zone.

In addition, Law No. 23 of 1961 is applicable to business activities carried out in the neutral zone. Foreign companies carrying on trade or business in the offshore area of the partitioned neutral zone under the control and administration of Saudi Arabia are subject to tax in Kuwait on 50% of taxable profit under the law.

### *Income subject to tax*

Article 2 of the amended tax law, provides that income earned from the following activities in Kuwait shall be considered subject to tax in Kuwait:

- Any activities or business carried out either entirely or partially in Kuwait, whether the contract has been signed inside or outside Kuwait, as well as any income resulting from supply or sale of goods, or from providing services.
- The amounts collected from the sale, rent, or granting of a franchise to utilise any trademarks, design, patents, copyright, or other moral rights, or those related to intellectual property rights for use of rights to publish literary, arts, or scientific works of any form.
- Commission earned or resulting from agreements of representation or commercial mediation, whether such commissions are in cash or in kind.
- Having permanent office in Kuwait where the sale and purchase contracts are signed and/or where business activities are performed.
- Profits resulting from the following:
  - Any industrial or commercial activity in Kuwait.
  - Disposal of assets, either through the sale of the asset, part of the asset, the transfer of the asset's ownership to others, or any other form of disposal, including the disposal of shares in a company whose assets mainly consist of non-movable capital existing in Kuwait.
  - Granting loans in Kuwait.
  - Purchase and sale of property, goods, or related rights in Kuwait, whether such rights are related to monetary assets or moral rights such as mortgage and franchise rights.
  - Lease of property used in Kuwait.
  - Providing services, including profits from management, technical, and consultancy services.
  - Carrying out trading activities in the Kuwait Stock Exchange, whether directly or through portfolios or investment funds.



### *Tax imposed on Kuwaiti-source income*

In cases where a contract involves the performance of work both inside and outside Kuwait, the entire revenue from the contract must be reported for tax in Kuwait, including the work carried out outside Kuwait.

### *Tax rate*

The current tax rate in Kuwait is a flat tax rate of 15%.

### *Capital gains*

Capital gains on the sale of assets and shares by foreign shareholders are treated as normal business profits and are subject to tax at a 15% rate. Article 1 of Law No. 2 of 2008 provides for a possible tax exemption for profits generated from dealing in securities on the Kuwait Stock Exchange (KSE), whether directly or through investment portfolios.

### *Dividends or distribution of profits*

Treatment of dividends is not specifically addressed in the amended tax law or in its bylaws. The bylaws to the amended tax law, however, require investment companies or banks that manage portfolios, funds, or act as custodians of shares for foreign entities to deduct corporate tax due from payments due to foreign investors. Tax payment should be made within 30 days from the date of the deduction of tax, together with a list showing names of the foreign entities and the amount withheld from each.

Under the original tax law, no tax was imposed on dividends paid to foreign shareholders by Kuwaiti companies.

### *Tax exemption*

The following sources of income are exempt from tax in Kuwait, as per the amended Law No. 2 of 2008:

- Kuwaiti merchants purchasing, transporting, and selling goods imported on their own account where the foreign supplier has not been involved in Kuwait operations.
- Profits of a corporate body generated from dealing in securities listed in the KSE, whether such activities are carried out directly or through investment portfolios or funds.

## *Corporate residence*

A foreign corporate body is any association formed and registered under the law of any country or state other than Kuwait that is registered as having a legal existence entirely separate from that of its individual members. No Kuwait-registered company is subject to income tax. However, any foreign corporate body that is a shareholder in a Kuwait-registered company undertaking business in Kuwait is subject to tax *(see the Taxes on corporate income section)*. For the purposes of this law, GCC residents and entities wholly owned by GCC residents are treated in the same manner as Kuwaiti business entities.

## *Other taxes*

### *National Labour Support Tax (NLST)*

NLST Law No. 19 of 2000 was issued by the Ministry of Finance (MOF) on 21 May 2000 and came into effect a year later on 21 May 2001. The purpose of the law is to encourage the national labour force to work in the private sector by closing the gap in salaries and benefits between public and private sectors.

As per the law, Kuwaiti companies listed in the Kuwait Stock Exchange (KSE) are required to pay an employment tax of 2.5% of the company’s net annual profits.

### *Zakat*

Zakat Law No. 46 of 2006 was issued on 27 November 2006 and came into effect as of 10 December 2007.

Zakat is imposed on all publicly traded and closed Kuwaiti shareholding companies at a rate of 1% of the companies’ net profits.

### *Contribution to the Kuwait Foundation for the Advancement of Sciences (KFAS)*

Closed Kuwaiti shareholding companies are required to pay 1% of their net profits as per their financial statements after their transfer to the statutory reserve and the offset of loss carryforwards, to the KFAS, which supports scientific progress.

### *Social security*
There are no social security obligations for expatriate workers. However, for foreign employees, it is generally necessary to make terminal indemnity payment calculated at 15 days' pay-per-year for the first five years of service and one month's pay-per-year thereafter.

For Kuwaiti employees, contributions are payable monthly by both the employer and employee under the Social Security Law. The employer's contribution is 11% and the employee's is 7.5% of monthly salary, up to a ceiling of 2,500 Kuwaiti dinars (KWD) per month. Benefits provided, include pensions on retirement and allowances for disability, sickness, and death.

## *Branch income*

Tax rates on branch profits are the same as on corporate profits.

## *Income determination*

Income tax is imposed on the profit of a business in Kuwait as calculated by the normal commercial criteria, using generally accepted accounting principles, including the accrual basis. Note that provisions, as opposed to accruals, are not deductible for tax purposes. In addition, for contract accounting, revenue is recognized by applying the percentage of completion method. Work-in-progress carried forward may not exceed 20% of work executed.



## *Deductions*

For expenses to be deductible, they must be incurred in the generation of income in Kuwait. Such expenses must be supported by adequate documentary evidence.

Such expenses include the following:

- Salaries, wages, and end of service benefits.
- Taxes and fees, except income tax.
- Grants, donations, and subsidies paid to licensed Kuwaiti public or private agencies.
- Expenses of head office.

### *Depreciation*
In accordance with Article 4 of Law No. 2 of 2008, depreciation is taken on a straight-line basis at specified rates. However, within 90 days prior to submission of the tax declaration, the taxpayer may request that the tax department calculate the depreciation using a different method than the straight-line method. The tax department shall accept this request provided it is based on a reasonable basis in accordance with the tax accounting principles and rules.

The principal depreciation rates are specified in the law.

### *Net operating losses*
As per the amended tax law, losses may be carried forward for a maximum of three years, provided that the following situations do not arise in the fiscal period following the period in which the loss was recorded:

- The tax declaration does not include any revenue from the business activities of the taxpayer in Kuwait.
- Change in the legal structure of the taxpayer.
- Merger of the taxpayer with another entity.
- Liquidation or ceasing of the activities of the taxpayer in Kuwait.

### *Head office expenses/payments to foreign affiliates*

Head office expenses (e.g. allocations of head office expenses) or payments to a head office may not be deductible in full. The bylaws to the amended tax law contain specific provisions relating to head office administrative expenses, and specialist tax advice should be sought on this subject. This matter is frequently raised during tax audits in Kuwait.

## *Group taxation*

If a foreign company conducts more than one business activity in Kuwait, one tax declaration aggregating the income from all activities is required to be submitted in Kuwait. In addition, in the case where two affiliates are involved in similar lines of business or work on the same project, their taxable results may be aggregated for the assessment of tax.

## *Tax credits and incentives*

### *Leasing and Investment Companies Law No 12 of 1998*

Leasing and Investment Companies Law No 12 of 1998 allows the formation of investment and leasing companies having their principal place of business in Kuwait, with Kuwaiti or foreign shareholders. The law grants a five-year tax holiday to non-Kuwaiti founders and shareholders of such companies, beginning on the date of establishment of the companies.

### *Direct Foreign Capital Investment Law (DIFCL) No 8 of 2001*

Direct Foreign Capital Investment Law (DIFCL) No 8 of 2001 aims to encourage foreign investment participation in Kuwait, allowing up to 100% of foreign ownership in Kuwaiti businesses. It also provides a tax holiday of up to ten years with respect to non-Kuwaiti shareholders shares of the profits from qualifying projects. An additional tax holiday for a similar period is granted for further investment in an already approved project.

### *Kuwait Free Trade Tone*

Businesses set up in the Kuwait Free Trade Zone for carrying on specified operations are exempt from taxes on operations conducted in the zone. Foreign entities can own 100% of such businesses.

### *Build, operate, and transfer*

Kuwait has begun to use the build, operate, and transfer (BOT) method in respect of some large infrastructure projects. Tax and tariff concessions may be built into a BOT contract.

### *Circular No. 50 of 2002*

As per Circular No. 50 of 2002 issued by the Director of Income Taxation (DIT) regarding treatment of exempted companies, the exempted companies shall, however, comply with the provisions of submission of tax declaration, inspection, and assessment procedures like other companies in order to be eligible for exemption.

Some of the privileges under this law include:

- Exemption from income tax or any other taxes for a period of ten years from the commencing of the actual operations of the enterprise.
- Benefits under double taxation agreements.
- Benefits under investment encouragement and protection agreements.
- Total or partial exemption from custom duties on imports.
- Recruitment of required foreign labour.
- Allotment of land and real estate.

## *Withholding taxes*

Apart from the WHT on dividends arising from trading in the KSE, there are no other WHTs. However, under Executive Rule No. 12 of Law No. 2 of 2008, all government bodies and private entities are required to retain the final payment due to a contractor or subcontractor until presentation of a tax clearance certificate from the MOF, confirming that the respective company has settled all of its tax liabilities. The final payment should not be less than 5% of the total contract value.



### *Tax treaties*

Kuwait has entered into tax treaties with several countries for the avoidance of double taxation. Treaties with several other countries are at various stages of negotiation or ratification.

However, little experience has been gained in Kuwait regarding the application of tax treaties. As a result, disputes about the interpretation of various clauses in tax treaties between taxpayers and the DIT are not uncommon. Disputes with the DIT regarding tax treaties normally arise with respect to the following issues:

- Existence of a permanent establishment (PE).
- Income attributable to a PE.
- Tax deductibility of costs incurred outside Kuwait.

The domestic tax law in Kuwait does not provide for WHTs. As a result, it is not yet known how the Kuwaiti government will apply the WHT procedures included in the treaties listed in the table below. The withholding rates listed in the table are for illustrative purposes only.

| Country | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Non-treaty countries | 0 | 0 | 0 |
| | | | |
| Austria | 0 | 0 | 10 |
| Belarus | 5 (3) | 5 (3) | 10 |
| Belgium | 10 | 0 | 10 |
| Bulgaria | 5 (10) | 5 (6) | 10 |
| Canada | 5/15 (13) | 10 | 10 |
| China | 5 (1) | 5 (1) | 10 |
| Croatia | 5/10 (12) | 10 | 10 |

| Country | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Cyprus | 10 | 10 (2) | 5 |
| Czech Republic | 5 (10) | 0 | 10 |
| Ethiopia | 5 (3) | 5 (2) | 30 |
| France | 0 | 0 | 0 |
| Germany | 5/15 (5) | 0 | 10 |
| Hungary | 0 | 0 | 10 |
| India | 10 (14) | 10 (14) | 10 |
| Indonesia | 10 (3) | 5 (2) | 20 |
| Italy | 5 | 0 | 10 |
| Jordan | 5 (3) | 5 (2) | 30 |
| Korea | 10 | 10 | 15 |
| Lebanon | 0 | 0 | 30 |
| Malta | 10/15 (4) | 0 | 10 |
| Mauritius | 0 | 0 (6) | 10 |
| Mongolia | 5 (8) | 5 (8) | 10 |
| Netherlands | 10 (9) | 0 | 5 |
| Pakistan | 10 | 10 (7) | 10 |
| Poland | 5 (10) | 5 (10) | 15 |
| Romania | 1 | 1 | 20 |
| Russian Federation | 5 (3) | 0 | 10 |
| Singapore | 0 | 7 (2) | 10 |
| South Africa | 0 | 0 | 0 |
| Sri Lanka | 5/10 | 10 | 20 |
| Sudan | 5 (8) | 5 (8) | 10 |
| Switzerland | 15 | 10 | 10 |
| Syria | 0 | 10 (11) | 20 |
| Tunisia | 10 (3) | 2.5 (2) | 5 |
| Turkey | 10 | 10 | 10 |
| Ukraine | 5 (6) | 0 | 10 |
| United Kingdom | 5/15 (5) | 0 | 10 |

Notes

1. The rate is 0% for amounts paid to a company of which the government owns at least 20% of the equity.
2. The rate is 0% for interest paid to the government of the other contracting state. Under the Ethiopia treaty, the rate is also 0% for the interest paid to entities in which the government owns a specified percentage of the equity and for interest paid on loans guaranteed by the government.
3. The rate is 0% for dividends and interest paid to the government of the other contracting state. Under the Ethiopia treaty, the rate is also 0% for dividends paid to entities in which the government owns a specified percentage of the equity.
4. The rate is 10% for dividends paid to the government of Kuwait or any of the institutions or any intergovernmental entities. The rate is 15% for other dividends.
5. The 5% rate applies if the recipient of the dividends owns directly or indirectly at least 10% of the payer. The 15% rate applies to other dividends.
6. The rate is increased to 5% if the beneficial owner of the interest carries on business in the other contracting state through a permanent establishment and the debt on which the interest is paid is connected to such permanent establishment.
7. The rate is 0% for amounts paid to the government of the other contracting state and to entities of which the government owns at least 51% of the paid-up capital.

8. For dividends and interest, the rate is 0% if the payments are made to the government or a governmental institution of the other contracting state, or to a company that is a resident of the other contracting state and is controlled by, or at least 49% of the capital is owned directly or indirectly by, the government or a governmental institution. A 0% rate also applies to interest arising on loans guaranteed by the government of the other contracting state or by a governmental institution or other governmental entity of the other contracting state.
9. A 0% rate applies if the beneficial owner of the dividends is a company that holds directly at least 10% of the capital of the company paying the dividends.
10. The rate is 0% if the payments are made to the government or a governmental institution of the other contracting state, or to a company that is resident of the other contracting state and is controlled by, or at least 25% of the capital is owned directly or indirectly by, the government or a governmental institution of the contracting state.
11. The rate is 0% if the beneficial owner of the interest is a resident in the other contracting state and the loan is secured or financed directly or indirectly by a financial entity or other local body wholly owned by the government of the other contracting state.
12. The 5% rate applies if the recipient of the dividends owns directly or indirectly at least 25% of the payer. The 10% rate applies to other dividends.
13. The rate is 5% if the beneficial owner of the dividends is a company that owns 10% or more of the issued and outstanding voting or 25% or more of the value of all of the issued and outstanding shares. The 15% rate applies to other dividends.
14. Dividends or interest paid by a company that is resident of a contracting state is not taxable in that contracting state if the beneficial owner of the dividends or interest is one of the following:
    - The government.
    - A political subdivision or a local authority of the other contracting state.
    - The Central Bank of the other contracting state.
    - Other governmental agencies or governmental financial institutions as may be specified and agreed to in an exchange of notes between the competent authorities of the contracting state.



In addition to the above existing tax treaties, Kuwait has signed the following tax treaties, but such treaties have not yet been ratified:

| Country | Date of signing | Type of Agreement | Status of the treaty |
|---|---|---|---|
| Cyprus | 7 October 2010 | avoidance of double taxation and income tax evasion | Finally signed |
| Djibouti | 28 March 2010 | avoidance of double taxation and income tax evasion | Finally signed |
| Egypt | 30 December 2010 | avoidance of double taxation and income tax evasion | (initially signed) |
| Goiania | 19 July 2010 | avoidance of double taxation and income tax evasion | Finally signed |
| Indonesia | 22 September 2010 | avoidance of double taxation and income tax evasion | Finally signed |
| Ireland | 23 November 2010 | avoidance of double taxation and income tax evasion | Finally signed |
| Japan | 17 February 2010 | avoidance of double taxation and income tax evasion | Finally signed |
| Kenya | 7 January 2010 | avoidance of double taxation and income tax evasion | (initially signed) |
| Menemar | 16 December 2010 | avoidance of double taxation and income tax evasion | (second round discussion) |
| Nigeria | 1 May 2010 | avoidance of double taxation and income tax evasion | (initially signed) |
| North Korea | 24 March 2010 | avoidance of double taxation and income tax evasion | (initially signed) |
| Syria | 1 May 2010 | avoidance of double taxation and income tax evasion | (initially signed) |

# Kuwait

## Tax administration

### Return

Tax is imposed on profits arising in a taxable period, which is defined as the accounting period of the taxpayer and further assumed to be the calendar year. However, the DIT may agree to a written request from the taxpayer to change the year-end to a date other than December 31. Also, at the taxpayer's request, the DIT may agree to extend the accounting period, provided it does not exceed 18 months.

The taxpayer must submit a tax return, based on the taxpayer's books of account, within three months and 15 days of the end of the taxable period. A foreign entity can request an extension of up to 30 days for filing the tax declaration. Upon application, the DIT may extend the filing period by a maximum of 60 days.

The taxpayer must keep in Kuwait certain accounting records, which are subject to inspection by the tax department's officials. Accounting records may be in English and may be in a computerized system used to prepare financial statements, provided that the system includes the required records and the tax department is previously informed.

The tax return should be supported by the following:

- Audited balance sheet and profit-and-loss account for the period.
- Detailed list of fixed assets (e.g. additions, disposals).
- List of inventory (e.g. quantities and values).
- List of subcontractors and the latest payments to them.
- Copies of current contracts and a statement of income and expenditure for each.
- Trial balance, forming the basis of the accounts.
- Last payment certificate from the client.
- Insurance companies must attach to the Public Budget and the tax declaration a detailed statement with the reinsured documents and the related terms and conditions.

As a general rule, an assessment is finalised only after inspection of records by the tax department. As indicated above, proper documentation must be kept to support expenditure and to avoid disallowances at the time of tax inspection. If support is considered inadequate, the assessment is apt to be made on the basis of deemed profitability. This is computed as a percentage of turnover and is fixed arbitrarily, depending on the nature of the taxpayer's business.

### Payment of tax

Tax is payable in four equal installments on the 15th day of the fourth, sixth, ninth, and 12th months following the end of the tax period. If an extension is approved by the DIT, all of the tax is payable upon the expiration date of the extension. Failure to file or pay the tax on time attracts a penalty of 1% of the tax liability for every 30 days of delay or part thereof.

### Objection

If a company disagrees with an assessment issued by the DIT, the company should submit an objection within 60 days from the date of the assessment. The DIT is required to resolve the objection within 90 days of the filing of the objection, after which a revised tax assessment is issued by the DIT. Upon issuance of a revised tax assessment, any additional tax is payable within 30 days. If the DIT issues no response within 90 days of filing the objection, this implies that the taxpayer's objection has been rejected.

### Appeal

In case the objection is rejected or the taxpayer is still not satisfied with the revised tax assessment, the company may contest the matter further with the Tax Appeals Committee (TAC) by submitting a letter of appeal within 30 days from the date of the objection response or 30 days from the expiry of the 90 days following submission of an objection if no response is provided by the DIT.

The matter is then resolved through appeal hearings, and a final revised assessment is issued based on the decision of the TAC. Tax payable per the revised assessment must then be settled within 30 days from the date of issuance of the revised assessment. Failure to do so results in a delay penalty of 1% of the amount of the tax due per the final assessment for each period of 30 days or part thereof of the delay.

## Other issues

### Offset program

Kuwait has designed a counter-trade offset program to meet the objectives of its economic development plan. The offset program derives from the government's concern that the long-term benefits from job creation and capital accumulation resulting from government contracts with foreign suppliers unfairly accrue to the suppliers, at the expense of Kuwaiti companies and citizens. The objective of the offset program is to remedy this problem by encouraging collaborative business ventures between foreign contractors and the Kuwaiti private sector. Accordingly, the offset program has been established with the following objectives:



- Promote sustainable economic development in Kuwait, by the assimilation of modern technology and know-how in the local economy.
- Support projects that generate high skilled jobs for Kuwaiti nationals.
- Attract foreign investment capital to facilitate economic development in Kuwait.

The MOF initially issued guidelines for the program in 1995. The MOF has also issued Ministerial Order 13 of 2005 reactivating the program. The following are significant aspects of the program:

- All civil contracts with a value of KWD 10 million and more, and defence contracts with a value of KWD 3 million and more, attract the offset obligations for contractors. The obligations become effective on the signing date of the contract.
- The contractors covered by the offset obligation are required to invest 35% of the value of the contract with Kuwaiti government bodies.
- Offset obligators have the following options for fulfilling their offset obligation:
  - Implement investment projects suggested by the Offset Program management.
  - Propose their own investment projects, and seek approval of the Offset Program management.
  - Participate in any of the funds that the Offset Program management may establish.
  - Purchase of commodities and services of Kuwaiti origin. The MOF is, however, still finalising detailed regulations in this regard.
- Contractors covered by the offset obligation must provide unconditional, irrevocable bank guarantees issued by Kuwaiti banks to the MOF equal to 6% of the contract price. The value of the bank guarantee submitted will be reduced gradually based on the actual execution of its work by the foreign contractor/supplier. The MOF has the right to cash in the bank guarantee if the offset obligor fails to respect their offset obligation.

# Kyrgyzstan

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## Significant developments

There have been no significant corporate tax developments in Kyrgyzstan during the past year.

## Taxes on corporate income

Pursuant to the tax code, resident entities are subject to a corporate income tax, called the 'profit tax', on their aggregate annual income earned worldwide. Non-resident legal entities carrying out business activities through a permanent establishment (PE) in Kyrgyzstan are subject to profit tax on the income attributed to the activities of that PE.

Profit tax is calculated at a rate of 10% of aggregate annual income less allowed deductions.

## Corporate residence

There is no concept of corporate residence in the Kyrgyzstan tax legislation.

Legal entities formed under the Kyrgyz law should be taxed in Kyrgyzstan on their worldwide income, whereas foreign legal entities should be taxed only in relation to Kyrgyzstan-sourced income.

### Permanent establishment (PE)

Under Kyrgyzstan tax legislation, a PE is a permanent place of business, through which a non-resident carries out business operations, including activities performed through an authorised person. A PE includes the following:

- Any place of management, department, office, factory, workshop, mining, oil and gas wells, land, construction site or project.
- Any services rendered by non-residents by hiring personnel working in the territory of Kyrgyzstan for a duration of more than 183 calendar days within any consecutive12-month period.

A PE is not created in Kyrgyzstan if a non-resident is limited to the following activities in Kyrgyzstan:

- Use of warehouses or buildings exclusively for storage or demonstration activities.
- Use of a fixed place of business exclusively for preparatory purposes.
- Performance of activities in Kyrgyzstan through an agent in cases where such agent usually performs such activities in the ordinary course of business.

Creation of a PE may be connected with the establishment of a branch or subsidiary. Both branches and subsidiaries are considered appropriate business vehicles for foreign investors and the choice between them is determined by the business the investor is engaged in, along with various other factors.

## *Other taxes*

### *Value-added tax (VAT)*

In Kyrgyzstan, VAT is assessed on taxable supply and taxable imports. Input VAT assessed on purchases used for business purposes is generally offset against output VAT on taxable supplies. The VAT rate is 12%, except for certain zero-rated supplies and certain exempt turnover *(see below)*.

All taxpayers registered for VAT purposes are required to charge VAT on their taxable supply, and calculate and report their VAT liabilities. Taxpayers are required to register for Kyrgyzstan VAT purposes if their taxable supply in the preceding 12 calendar months exceeds 4,000,000 Kyrgyzstani soms (KGS). Even if an entity is not required to register for VAT purposes, it may still do so voluntarily by submitting an application to the appropriate tax committee.

#### Place of supply of goods



Goods and services are subject to VAT if they are deemed to be supplied in Kyrgyzstan under the place of supply rules. According to these rules, transactions are deemed to be made at the place where transport of the goods begins if the goods are transported by the supplier, and in all other cases, at the place where the goods are transferred to the customer. The rules regarding services are more complicated. Services that are not specifically mentioned are deemed to be supplied at the place where the service provider has established his place of business. Certain other services are deemed to be supplied at the place of the purchaser.

#### Import of goods

Generally, imports of goods are subject to VAT.

#### Non-deductible input VAT

The input VAT is not allowed for offset if it is subject to payment in connection with the receipt of goods (work, services) not related to entrepreneurial activity, or if it relates to inputs for VAT exempt supplies.

#### Zero-rated supplies

Certain supplies are zero-rated for VAT purposes. These include exports (except for certain limited types of export) and international transportation. Supply of goods (works, services) for official use of diplomatic and consular representations is taxable, but may be refunded provided that certain conditions are met.

#### Exempt supplies

Certain supplies are VAT-exempt, including supplies and exports of gold alloy and refined gold, supplies of pharmaceuticals, land plots, residual buildings and construction, and financial services. When a taxpayer generates both taxable and exempt supplies, input VAT proportional to the ratio of the exempt supply to the total supply is disallowed for offset.

### VAT incentives
Certain imports are VAT exempt, including imports of technological equipment, if it is used for own production purposes. Recently, a preferential offset method of VAT settlement in respect of certain fixed assets imported to Kyrgyzstan has been introduced, whereby the import VAT does not need to be paid to customs but is reflected simultaneously as input and output VAT in the VAT accounts.

### Reverse-charge VAT
The current tax code does not have any provisions on reverse-charge VAT.

### VAT liability calculation and VAT offset carryforward
In general, the VAT liability of a taxpayer is calculated as output VAT (i.e. VAT charged by a taxpayer) less input VAT (i.e. VAT paid by a taxpayer to its suppliers) in a reporting period. The excess of input VAT over output VAT may generally be carried forward against future VAT liabilities.

### VAT compliance
The tax period for VAT is a calendar month. The submission of the VAT declaration is due by the end of the month following the reporting period. Payment of the VAT liability is due by the 25th day of the month following the reporting period.

## *Sales tax*
Sales tax is assessed on Kyrgyz legal entities or foreign entities operating through a PE in Kyrgyzstan for any sales of goods or rendering of services. The sales tax mechanism differs from VAT, i.e. the sales tax is levied for the whole sales turnover and does not take into account the purchases (input turnover).

Sales tax rates are as follows:

- In case of the sale of goods, works, or services by VAT payers:
  - Trading activities: 1.0%.
  - For other activities: 2.0%.
- In case of the sale of goods, works, or services by non-VAT payers:
  - Trading activities: 2.0%.
  - For other activities: 3.0%.

The Kyrgyz Tax Code further defines trading activities as activities on sale of goods purchased for re-sale purposes.

The tax period of sales tax is a calendar month. Taxpayers have to submit tax returns and make payments of sales tax at the place of tax registration by the 20th day of the month following the reporting month.

## *Customs duties and regimes*
According to the Customs Code, the customs value of goods imported to the customs territory of Kyrgyzstan is determined by applying the following methods:

- Transaction value of imported goods.
- Transaction value of identical goods.
- Transaction value of similar goods.
- Deductive method.
- Computed method.
- Provisional method.

Based on the Kyrgyzstan customs legislation, the rates of customs duties may be:

- *Ad valorem* - charged in percentage to customs value of the taxable goods.
- Specific - charged within established size for unit of the taxable goods.
- Combined - including both abovementioned types.

The rates in percentage range from 0% to 30%; however, the maximum rate of 35% may be charged if the country of origin in unknown.

**Import restrictions**
Generally all entities or persons have equal rights to import and export or transfer goods into the Kyrgyzstan territory, including when carrying out foreign trade activity, except in special cases as stipulated by legislation and international treaties.

Import of certain goods (e.g. weapons, nuclear materials) is subject to licensing.

**Temporary import relief**
There is a temporary import regime under which foreign goods are used in Kyrgyzstan with full or partial conditional exemption from the payment of customs duties and taxes and without application of non-tariff regulatory measures. The term of the 'temporary import' customs regime may not exceed two years.



**Customs duties incentives**
Certain items are exempt from customs payments, including:

- Transportation vehicles used in the international conveyance of passengers and goods and items of material and technical supply in transit.
- Goods imported in the customs territory or imported from the customs territory for official and personal use by official state representatives of foreign states.

Kyrgyzstan provides preferential rates or exemptions on the importation (and export) of certain goods, including goods originating from the states which form free trade zones or a customs union with Kyrgyzstan and goods originating from developing countries, included on a special list provided by the government.

**Documentation and procedures**
Kyrgyzstan pays close attention to formalities/documentation and, thus, it is necessary to furnish the customs authorities with a set of required documents. For import, such documents usually include cargo customs declaration, invoices, contracts, etc.

**Warehousing and storage**
There is a bonded warehouse customs regime in Kyrgyzstan. Under this regime, imports entering into Kyrgyzstan may be stored in special facilities or special areas that have the status of a customs warehouse under the customs legislation of Kyrgyzstan. This regime implies exemption from customs duties and taxes.

Generally, most goods (unless otherwise specifically provided for) can be placed under the bonded warehouse customs regime. The period for storage of goods at a bonded warehouse is determined by the person placing the goods into the customs warehouse but cannot exceed three years from the date when the goods were placed under the bonded warehouse customs regime.

## Re-exports

The re-export regime is similar to that used in international practice. It is defined as a customs regime under which goods previously imported into Kyrgyzstan are exported without payment or with a refund of the paid amounts of import customs duties and taxes and without applying the non-tariff regulatory measures with respect to the goods in compliance with Kyrgyz legislation.

There are certain conditions under which goods can be re-exported. Customs duties and taxes are not charged for goods declared as goods intended for re-export. However, if the goods do not meet the re-export criteria, customs duties and taxes are paid in the amount which would be payable if the goods, at their importation, were declared for release for free circulation, as well as interest on them paid at the National Bank rates, as if deferment was provided with respect to the amounts at placement of the goods under the customs regime of re-export.

### *Excise tax*

Certain goods manufactured in Kyrgyzstan or imported to Kyrgyzstan are subject to excise tax. These include certain alcohol and alcoholic drinks; fortified drinks; tobacco goods; jewellery made of gold, silver, or platinum; and oil products.

The rates of excise tax are adopted annually by the Kyrgyzstan government and range from KGS 5 for 1 litre of alcohol drinks to KGS 3,000 for 1 ton of fuel (approximately USD 64). For certain goods, such as jewellery made of gold, silver, or platinum, excise rate is determined in percentage (for jewellery, it is 5% of the retail sales price).

### *Property tax*

Property tax is a local tax payable quarterly by legal entities owning transport vehicles and immovable property in Kyrgyzstan, including apartment houses, apartments, boarding houses, holiday inns, sanatoria, resorts, production, administrative, industrial, and other buildings or facilities. Certain real estate may not be subject to this tax according to special lists approved by the government.

In respect of immovable property, the tax rate is established by the city or local authorities at a rate not to exceed 0.8% of the estimated value of taxable objects, except for apartment houses and apartments designated solely for residence, for which the rate may not exceed 0.35% of the estimated value. The estimation can be performed by the state competent body and independent appraisers. For transport vehicles, the tax is computed in KGS depending on engine volume.

### *Land tax*

Land tax is paid quarterly by legal entities on the area of owned land. The basic rates are provided in the tax code, depending on the location and purposes of the land. The basic rates may range from KGS 0.9 to KGS 2.9 per square metre (approximately USD 0.02 to USD 0.06).

### *Subsurface use taxes*

The subsurface use taxes consist of separate bonus and royalty taxes on subsurface users, both Kyrgyz legal entities and branches of foreign legal entities. Under Kyrgyz legislation, subsurface users are legal entities and individuals who perform exploration and/or extraction of mineral resources.

The government, depending on the type of mineral resources, establishes the bonus rates.

The royalty rates are estimated either as a percentage of sales turnover (1% to 12%) or in absolute terms in KGS depending on the type of mineral resources.

### *Stamp taxes*
There are no stamp taxes in Kyrgyzstan.

## *Branch income*

Branch income is subject to the profit tax. There is no special branch profits tax in addition to profit tax.

## *Income determination*

Aggregate annual income is comprised of all types of income, including but not limited to the following, in addition to gross revenue from the sale of goods (work, services):

- Interest income (except for income already subject to withholding tax).
- Dividends.
- Royalties.
- Assets received free of charge.
- Rental income.
- Income from the reduction of liabilities.
- Foreign exchange gain.
- Write-off liability.

The tax code envisages some profit tax privileges aimed at developing certain areas of the business economy. Currently, these include privileges/preferences for:

- Charity organisations.
- Associations of invalids of I and II groups, (i.e. persons with disability with different levels of physical disability), associations of blind and deaf persons.
- Agricultural organisations.
- Growing of berries, fruits, and vegetables.
- Credit unions.
- Companies that have been involved in the food industry for less than three years and included in the Kyrgyzstan government's list of exempt companies.

Non-taxable revenues include, inter alia, the following:

- Property received as a charter capital contribution and income from realisation of shares of organisations.
- Property donated to special organisations using such property for development purposes under the government's social culture plan. Despite being designated as property used for social culture purposes, such property may still be used for other purposes (i.e. citizen defence projects, mining equipment, water intakes, heat networks, roads, stations).

### *Inventory valuation*
There are no special provisions on inventory valuation in the Kyrgyzstan Tax Code. Inventory valuation is conducted in accordance with the International Financial Reporting Standards (IFRS).

### *Capital gains*
Capital gains are subject to the ordinary profit tax rate. There is an exemption available for capital gains from selling shares that occur on the date of a given sale in the official lists of the stock exchange in the top two categories of listing.

### *Dividend income*
Dividends from participation in Kyrgyz legal entities are exempt from profit tax. All other dividends are subject to the ordinary profit tax rate.

### *Partnership income*
Simple partnerships are not taxpayers in their own right, and income and expenses flow through to the partners for tax reporting purposes. Kyrgyzstan limited liability partnerships are taxed as corporations.

### *Foreign income*
Generally, Kyrgyz legal entities are taxable on income earned worldwide. Foreign income is subject to the ordinary profit tax rate.

There are no tax deferral provisions in Kyrgyzstan tax legislation.

## *Deductions*

Generally, expenses related to the earning of aggregate annual income are considered deductible for profit tax purposes, including:

- Business trip expenses that were actually incurred and supported by appropriate documentation (per diems during business trips are deductible only within the established statutory limits).
- Commissions on payroll expenses for labour.
- Material and social benefits provided to employees.
- Representational expenses connected with earning income (transportation, hotel, and translator services).
- Training and retraining of employees.
- Scientific development and exploration works (deductions are relevant for fixed assets).
- Any other costs related to earning income, which can be supported by appropriate documentation in terms of their nature and amount (e.g. invoices, payment orders, receipts).

The principal categories of expenses which are not deductible include:

- Capital expenses and expenses connected with the purchase, production and installation of equipment.
- Fines and interest penalties paid to the state budget.
- Taxes paid in accordance with the tax code, except for land tax, property tax, VAT that cannot be offset, and subsurface use taxes.
- Any expenses incurred on behalf of any other third persons, except in cases where documentation proves business needs for such expenses.
- Pricing losses caused by rates, understated below-market prices, and price incentives.
- Expenses connected with purchases of services in entertainment, vacations, and leisure.

### *Depreciation*
The tax code establishes a deduction for depreciation based on the declining balance method. Depreciable fixed assets are divided into several groups, for which maximum depreciation rates range from 10% to 50%.

| Group | Assets | Maximum rate of depreciation (%) |
|---|---|---|
| I | Cars, automobile and tractor equipment for use on roads, special instruments, sundries, and accessories; computers, telephone sets, peripherals, and equipment for data processing | 30 |
| II | Automotive transport rolling stock: trucks, buses, special automobiles, and trailers; construction equipment; machines and equipment for all sectors of industry, including the foundry; smith-pressing equipment; electronic and simple equipment, agricultural machines. Office furniture, intangible assets | 25 |
| III | Depreciable fixed assets not listed in other groups and expenses equated to them | 20 |
| IV | Railroad, sea, and river transport vehicles, power machines, and equipment: thermal-engineering equipment, turbine equipment, electric motors and diesel-generators, electricity transmission and communication facilities, pipelines | 10 |
| V | Buildings and constructions | 10 |
| VI | Taxpayer's costs of geological preparation of deposit reserves, design and engineering-research works, and obtaining the license for the use of deposits, as well as mining-capital and mining pre-works aimed at further extraction of minerals, as well as the fixed assets of the mining and/or mining-processing enterprises put into operation and actually used in deposit exploration | 50 |

Certain expenses are deductible within specified limits, including expenses on repairs, expenses on procuring and producing capital production assets, and certain other expenses.

### *Interest expenses*
Deductions for interest actually paid on debts, where the loan proceeds were used to fund expenses incurred for the taxpayer's business activity, are allowed within limitations provided in the tax code depending on methodology and nature of the debt. For example, interest on loans connected with the purchase of depreciable assets is not deducted, but increases their value.

### *Charitable contributions*
Deductions for donations of assets to charity and budget organisations are limited to 10% of taxable income.

### *Taxes*
The following taxes may be deducted:

- Land tax.
- Property tax.
- VAT not allowed for offset.
- Subsurface use taxes.

### *Net operating losses*
Net operating losses can be carried forward for up to five years. There are no provisions in Kyrgyz legislation allowing carryback of losses.

### *Payments to foreign affiliates*
Payments to foreign affiliates are deductible for profit tax purposes if they are aimed at earning income and supported by documentation.

## *Group taxation*

Group taxation is not permitted in Kyrgyzstan.

### *Transfer pricing*
While there is no special law on transfer pricing in Kyrgyzstan, rules on transfer pricing are found in the tax code. The general transfer pricing provisions set in the tax code do not follow Organisation for Economic Co-operation and Development (OECD) guidelines (thus, no advance pricing agreement (APA) mechanism is provided). According to the Kyrgyz transfer pricing regulations, the tax authorities are empowered to determine the value of the following transactions:

- Transfers between related parties.
- Barter transactions.
- Cross-border transactions.

### *Thin capitalisation*
There are no thin capitalisation limitations under the Kyrgyzstan tax code.

## *Tax credits and incentives*

The legislation currently provides the following tax incentives.

### *Investment incentives*
There are no special tax preferences in the Kyrgyzstan Tax Code; however, Kyrgyz Law on Investments envisages that in case of changes in the tax and customs legislation, investors may apply terms which are more beneficial to them.

### *Special economic zones*
There are four special economic zones in Kyrgyzstan: Naryn, Karakol, Bishkek, and Maimak. The special economic zones generally provide for a tax-neutral regime, exemption from customs duties, and a liberal currency control regime. However, there is a special fee for incentives which varies from 0.1% to 2% of sales (depending on the region).

### *Foreign tax credits*
There is no possibility to offset the amount of tax paid outside Kyrgyzstan against the Kyrgyz tax if there is no double tax treaty (DTT) with this country.

## *Withholding taxes*

Passive income from sources in Kyrgyzstan by a non-resident that is not connected with a PE is taxable at the source of payment, without deductions, at the following rates:

- Dividends and interest: 10%.
- Insurance premiums received under risk insurance or re-insurance agreements: 5%.
- Authorship fee: 10%.

Income obtained by a non-resident from performing activities and services in Kyrgyzstan, not connected with a PE, is taxable at the source of payment, without deductions (with the exception of VAT), at the following rates:

- Income from telecommunication or freight services in international communication and transportation between Kyrgyzstan and other countries: 5%.
- Income from management and consulting services: 10%.
- Other services and activities: 10%.

Withholding tax (WHT) applies to Kyrgyzstan source income regardless of whether the payment is made within or outside of Kyrgyzstan.

The application of DTTs often effectively provides a reduction of WHT rates or, in the case of non-passive income, an income tax exemption. Note that the application of treaty privileges is not necessarily automatic, and taxpayers may need to comply with certain administrative procedures to secure relief.

### *Tax treaties*

According to the tax code, the provisions of international tax agreements and other acts to which Kyrgyzstan is a party and ratified by the president or the parliament (as appropriate) take precedence over the provisions of the tax code.

As of 31 January 2011, Kyrgyzstan has concluded DTTs with the countries listed in the following table, which shows the corresponding WHT rates:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| No treaty | 10 | 10 | 10 |
| Austria | 5/10 (1) | 10 | 10 |
| Belarus | 15 | 10 | 15 |
| Canada | 15 | 15 | 10 |
| China | 10 | 10 | 10 |
| Finland | 5/10 (1) | 10 | 5 |
| Germany | 5/10 (1) | 5 | 10 |
| India | 10 | 10 | 15 |
| Iran | 5/10 (1) | 10 | 10 |
| Kazakhstan | 10 | 10 | 10 |
| Latvia | 5/10 (1) | 10 | 5 |
| Malaysia | 5/10 (2) | 10 | 10 |
| Moldova | 5/10 (1) | 10 | 10 |
| Mongolia | 10 | 10 | 10 |
| Pakistan | 10 | 10 | 10 |
| Poland | 10 | 10 | 10 |
| Russia | 10 | 10 | 10 |
| Switzerland | 5/10 (1) | 5 | 5 |
| Tajikistan | 5/10 (3) | 10 | 10 |
| Turkey | 10 | 10 | 10 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Ukraine | 5/10 (3) | 10 | 10 |
| Uzbekistan | 5/10 (3) | 10 | 10 |

Notes

1. 5% if the beneficial owner is a company (other than a partnership) that directly holds at least 25% of the capital of the paying company.
2. 5% if the beneficial owner is a company (other than a partnership), which owns not less than 10% of the capital of the paying company.
3. 5% if the beneficial recipient is a company, which owns not less than 50% of the capital of the paying company.

## *Tax administration*

### *Returns*

The tax code stipulates that the following key tax reports must be filed with the tax authorities:

- Aggregate Annual Income Tax Declaration: 1 March of the year following the reporting year.
- VAT reporting: on a monthly basis, by the 25th day (or, on the last day for large taxpayers) of the month following the reporting month.
- Other tax reports: as required according to relevant legislation.

Tax authorities may grant an extension for filing a tax return for up to one month upon application by the taxpayer. Such extension does not relieve or prolong the taxpayer's obligation to pay the tax in a timely manner.

### *Payment of tax*

Tax payments should be made as follows:

- Advance payments on profit tax: quarterly by the 20th day of the second month of the reporting quarter.
- Final payments on profit tax: 1 March of the year following the reporting year.
- Tax withheld at the source of payment by a tax agent: the 15th day of the month following the month when income was paid.
- VAT: on a monthly basis, by the 25th day of the month following the reporting month.
- Other tax payments: as required according to relevant legislation.

### *Tax audits*

The State Tax Inspectorate of the Ministry of Finance of Kyrgyzstan and its local tax authorities are the only state authorities that have the right to perform tax audits. The Kyrgyzstan tax service consists of relevant subdivisions of the revenue committee of the Ministry of Finance of Kyrgyzstan and its local authorities.

A tax audit is performed based on a written notification from the Head of the State Tax Inspectorate, which specifies the name of the company to audit, the scope of the audit, and the terms of the audit. Tax audits may be performed not more than once a year by one of the tax authorities (district, city, region, or the state tax authorities) and should not last more than 30 days. If necessary, however, a tax audit may be extended for 10 additional days with written approval from the State Tax Inspectorate.

# *Lao People's Democratic Republic*

## *PwC contact*

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## *Significant developments*

On 13 May 2011, the President of Lao People's Democratic Republic (PDR) issued an edict amending Lao PDR corporate tax rates effective from 1 October 2011 onwards, as follows:

- The standard rate of profits tax (PT) will be reduced from 35% to 28%. This rate is applicable to both domestic and foreign investors, in accordance with the Law on Promotion of Foreign Investment.
- A specific PT rate for tobacco producers will be set at 30%.

## *Taxes on corporate income*

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### *Profits tax (PT)*

The standard rate of PT for companies in Lao PDR is 35%.

Tax holidays and reduced PT rates are applicable to companies that qualify as promoted investment activities *(see the Tax credits and incentives section for more information)*.

### *Minimum tax (MT)*

Companies that operate at a loss or have profits below a certain level are subject to MT. However, if the company's loss or profit is certified by an independent auditing firm recognized by the government and registered with the Ministry of Finance, MT will not be payable.

MT rates are .25% of gross receipts for manufacturing companies and 1% of gross receipts for trade and service companies.

### *Surtaxes*

There are no surtaxes in Lao PDR.

### *Industry-specific rates*

There are no industry-specific tax rates in Lao PDR

### *Provincial/local income tax rates*

There are no provincial or local income taxes in Lao PDR.

## *Corporate residence*

There is no definition of residence or permanent establishment for tax purposes under Lao PDR law. All companies (including all forms of legal entities) that are registered under Lao PDR law are subject to PT on their worldwide income. Companies formed under foreign law, operating a business in Lao PDR, and conducting business in Lao PDR are subject to tax on their income derived in Lao PDR.

## Other taxes

### Valued-added tax (VAT)

Beginning 1 January 2010, a VAT replaced the prior indirect tax, the Business Turnover Tax, in Lao PDR.

VAT is imposed on the final consumer of goods and services. Goods and services used for production, trading, and consumption in Lao PDR, goods imported into Lao PDR, and services rendered by foreigners to Lao PDR customers are subject to VAT.

Certain goods and services are exempt from VAT. Exempted items include unprocessed agricultural products, seeds, fertilizers, textbooks, education services, medical services, banking services, and insurance.

The standard VAT rate is 10%. Exported goods and services are VAT 0% rated. The conventional credit method is used to calculate the VAT payable (i.e. output VAT less input VAT). Excess input VAT can be carried forward for six months (extendable). Input VAT for exports is refundable.

Organisations engaged in production or trading of taxable goods and services must register for VAT if their annual revenue is 400,000,000 Lao kips (LAK) or more. Companies below this threshold may voluntarily register. Only registered VAT taxpayers may claim VAT refunds.

One unique feature of Lao PDR VAT is that VAT is charged on withholding taxes *(see the Withholding taxes section for more information)*.

### Property taxes

Land taxes vary depending on the location and the type of the land (e.g. land for construction, agriculture). The calculation of the land tax is based on both the location and the size of the land and is levied at annual rates per square meter. Land tax is payable in the first quarter of the relevant calendar year.

### Customs duties/Import tariffs

All goods imported into Lao PDR are subject to import duty. Exemptions are available to enterprises operating promoted investment activities *(see the Tax credits and incentives section for more information)*.

Lao PDR has adopted the General Agreement on Tariffs and Trade (GATT) valuation principles. Duty rates are based on the ASEAN harmonized tariff nomenclature. Duty rates range between 0% and 40% depending on whether the goods are ASEAN or other source.

### Excise taxes

Excise tax applies to the import and sale of certain luxury products. Excisable goods include alcohol, beer, cigarettes, perfume, cosmetics, motor vehicles, soft drinks, mineral water, and many types of electrical equipment. Excise tax rates range from 5% to 90%.

### Transfer taxes
There are no transfer taxes in Lao PDR.

### Stamp taxes
There are no stamp taxes in Lao PDR.

### Administrative fees
Under the Tax Law, government sectors can collect fees for issuing fiscal licences, business licences, permits, visas, advertisement boards, broadcasting rights, and other services. The charges and service fees are set periodically by Presidential Decree.

## Branch income

Branches of foreign companies are taxable on their income from carrying on business in Lao PDR.

## Income determination

The PT calculation is based on an entity's actual accounting profits as adjusted for tax purposes. The Lao PDR Tax Regulations are silent on the treatment of a large number of items. Generally, in such cases, the tax treatment will follow the accounting treatment. Some of the more common differences are depreciation, entertainment expenses, and the non-deductibility of reserves and provisions (until actually paid).



### Capital gains
There is no separate tax on capital gains in Lao PDR; however, profits from the sale of shares are subject to tax at a rate of 10%. The buyer of the shares is required to withhold and remit the tax.

### Dividend income
Dividends received from another Lao PDR company or a foreign company are taxed at a flat rate of 10%.

### Interest income
Interest income is taxable in Lao PDR.

### Inventory valuation
Inventory valuation for tax purposes follows the method used for accounting purposes in Lao PDR.

### Rents/royalties income
Rents and royalties income are taxable in Lao PDR.

### Unrealised exchange gains/losses
Unrealised exchange gains are not taxable and losses are not deductible in Lao PDR.

## Deductions

### Accrued expenses
Accrued expenses are deductible in Lao PDR.

### *Bad debt*
Bad debt reserves are not deductible in Lao PDR. However, a deduction is allowed when debt is written off.

### *Charitable contributions*
Charitable contributions in Lao PDR are limited to the smaller of .15% of taxable income or LAK 4,000,000.

### *Entertainment expenses*
Entertainment expenses are capped at .4% of annual revenue.

### *Contingent liabilities*
Reserves and provisions are not deductible until actually settled.

### *Depreciation*
Depreciation rates are prescribed in the tax law and may differ from financial accounting. Prescribed rates are as follows:

| | |
|---|---|
| **Buildings used for industrial purposes** | |
| 20 years old or less | 20 years |
| Over 20 years | 40 years |
| **Buildings used for commercial and residential purposes** | |
| Permanent structures | 20 years |
| Semi permanent structures | 10 years |
| Machinery, equipment, vehicles | 5 years |
| Office equipment | 10 years |
| Ships and passenger aircraft | 20 years |

### *Fines and penalties*
Fines and penalties are not deductible in Lao PDR.

### *Interest expenses*
Interest is deductible on an accrual basis following the accounting treatment. All interest payments must be supported by documents showing that the payments are commercially reasonable. Interest paid to a shareholder is not deductible.

### *Net operating and capital losses*
Tax losses can be carried forward for three years, but no carryback is allowed. A change in control will not impact a company's loss carryforward. Capital losses are treated as ordinary losses.

### *Start-up expenses*
Start-up expenses are amortizable over two years in Lao PDR.

### *Payments to foreign affiliates*
Payments to foreign affiliates are deductible if in ordinary course of business.

### *Pension expenses*
Pension expenses are deductible when paid in Lao PDR.

### *Bribes, kickbacks, and illegal payments*
Bribes, kickbacks, and illegal payments are not deductible in Lao PDR.

## Group taxation

Consolidation or grouping is not permitted, and each entity must file on a separate basis in Lao PDR.

### Transfer pricing regime

There are no specified transfer pricing rules in Lao PDR. However, inter-company transactions should be at arm's length.

### Thin capitalisation rules

There are no thin capitalisation or debt to equity rules in Lao PDR.

## Tax credits and incentives

### Promoted investment activities

The following activities are promoted under the Law on the Promotion of Foreign Investment No. 11/NA, dated 22 October 2004 (Existing Foreign Investment Law):

- Production for export.
- Activities relating to agriculture or forestry and agricultural, forestry, and handicraft processing activities.
- Activities relating to industrial processing, industrial activities using modern techniques and technology, research and development, and activities relating to the protection of the environment and biodiversity.
- Human resource development, skills development, and public health.
- Construction of infrastructure.
- Production of raw materials and equipment to be supplied to key industrial activities.
- Development of the tourism industry and transit services.

The following three zones are promoted under the Existing Foreign Investment Law:

| | |
|---|---|
| Zone 1: | Mountainous, plain, and plateau zones with no economic infrastructure to facilitate investments. |
| Zone 2: | Mountainous, plain, and plateau zones with a moderate level of economic infrastructure suitable to accommodate investments to some extent. |
| Zone 3: | Mountainous, plain, and plateau zones with good infrastructure to support investments. |

The tax incentives are as follows:

- Investment in Zone 1 shall be entitled to a PT exemption for seven years and thereafter shall be subject to PT at the rate of 10%.
- Investment in Zone 2 shall be entitled to a PT exemption for five years, then shall be subject to a reduced PT rate of 7.5% for three years, and thereafter a PT rate of 15%.
- Investment in Zone 3 shall be entitled to a PT exemption for two years, then shall be subject to a reduced PT rate of 10% for two years, and thereafter a PT rate of 20%.

In addition to the incentives as mentioned above, foreign investment enterprises shall be entitled to the following incentives:

- During the tax exemption period and during the tax reduction period, the enterprise shall be entitled to an exemption from MT.

- Profits used for the expansion of licensed business activities shall be exempted from PT during the accounting year.

The Law on the Promotion of Foreign Investment grants incentives to foreign investors investing in activities within the promoted sectors and zones. Raw materials, equipment, machines, and vehicles used directly in production will be exempted from import duties and taxes or will be subject to a combined import duty and VAT (formerly Business Turnover Tax) rate of 1%. An application/request letter for incentives in respect of the importation of raw materials, equipment, machines, and vehicles used directly in production will be considered within 30 working days from the date of receipt of the application/request letter.

## *Withholding taxes*

Withholding taxes (WHT) are applied to various types of payments made to domestic and foreign recipients.

| | |
|---|---|
| Dividends | 10% |
| Profit from the sale of shares | 10% |
| Interest and guarantee fees | 10% |
| Payments for use of trademarks and intellectual property | 5% |

*As mentioned in the Other taxes section, VAT of 10% is charged on the above WHT.*

In the case of a foreign recipient, the WHT is considered a final tax.

Lao PDR has double tax treaties with the following countries, and WHT rates under the treaties are as follows:

| | Dividends | Interest | Royalties |
|---|---|---|---|
| Brunei (not in force) | - | - | - |
| China | 5% | 5% | 5% |
| Kuwait (not in force) | - | - | - |
| North Korea | 5% | 10% | 5% |
| Russia | 10% | 10% | 0% |
| South Korea (not in force) | - | - | - |
| Thailand | 10% | 10% | 5% |
| Vietnam | 10% | 10% | 5% |

### *Foreign contractor withholding tax (FCWT)*

A withholding tax on payments to foreign contractors applies where a Lao PDR contracting party contracts with a foreign party that does not have a licensed presence in Lao PDR regardless of whether the services are provided in Lao PDR or outside Lao PDR. The FCWT comprises both a PT and VAT element and is intended to be a final tax on the foreign company. The FCWT withholding and filing obligation rests with the Lao PDR customer.

For foreign contractors, PT must be withheld at a deemed percentage of taxable turnover. The deemed rates are determined according to the nature of the contract or activity.

| | Deemed profit margin (% of business revenue) | Deemed PT rate |
|---|---|---|
| Commerce | 5% | 1.75% |
| Production | 8% | 2.8% |
| Transportation and construction | 10% | 3.5% |
| Service | 20% | 7% |

These PT rates are then added to the VAT at 10% to determine the total FCWT. For example, a foreign service charge of LAK 1,000 would result in LAK 70 of PT and LAK 100 of VAT for a total FCWT of LAK 170.

## Tax administration

### Tax return due dates

PT is determined on a calendar year basis, and the tax return is due 10 March of the subsequent year. Submission of the final tax return will be followed by an audit by the Tax Department.

### Payment of tax

PT is payable quarterly in advance with a final payment after year end. The first three payments are due 10 April, 10 July, and 10 October of the current tax year. The final payment is due with the submission of the final tax return on 10 March of the subsequent year. The quarterly payments are based on the prior year’s PT (or expected tax for the current year). Any excess PT payment can be carried forward to the subsequent year.

### Audit cycle

Most large companies are audited annually in Lao PDR.

### Statute of limitations

The statue of limitations is generally three years in Lao PDR.

# Latvia

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## Significant developments

### Large investment relief (effective as of 1 January 2011)

The government has introduced corporate income tax (CIT) relief for investments over 5 million Latvian lati (LVL) in qualifying industries in new, unused fixed assets (buildings and structures classified as industrial buildings and new plant and technological equipment) which they can use for business purposes. The available tax relief is 25% of the amount of investments made (15% for investments over LVL 35 million). Yet companies have to make their investment decisions quickly, as investment projects must be completed by the end of 2016. Companies have to go through certain procedures in order to receive a Cabinet decision by the end of 2013 in support of a qualifying investment project.

Investments have to enable a company to launch a new line of business or to modernise its existing production, which includes manufacturing new goods, a shift of business activity from producing one type of goods to producing another type of goods, or a complete overhaul of the manufacturing process.

### New Micro-business Tax Act (effective as of 1 September 2010)

The Micro-business Tax Act gives existing and newly-formed businesses the opportunity of acquiring micro-business status and registering for micro-business tax (MBT) if they meet the following criteria:

- The shareholders are individuals who are also concurrently members of the board.
- The turnover does not exceed LVL 70,000 in a calendar year.
- The number of employees does not exceed five at any time. Absent employees or employees suspended from work shall not be included in the number of employees.

The standard MBT rate is 9% of a micro-business's turnover and covers payroll taxes, business risk duties, and CIT. The standard rate may be increased in the following cases:

- If its quarterly staff count exceeds five, then two percentage points per extra employee will be added to the standard rate.
- If the turnover exceeds LVL 70,000 in a calendar year, the excess will attract a rate of 20%.
- If an employee's net income exceeds LVL 500 a month, the excess will also attract a rate of 20%.

### Doubtful debts and debt assignments (effective as of 1 January 2011 for debt assigned after 1 January 2009)

New amendments state that, subject to certain criteria, a loss arising on the assignment of a debt is now deductible for CIT purposes. Additionally, under certain conditions, payment of tax on a provision for doubtful debts may be deferred for three years without increasing taxable income at the time of making that provision.

### Value-added tax (VAT) (effective as of 1 January 2011)

Amendments have raised the standard rate of VAT to 22% and the reduced rate to 12%. In addition, electricity supplies to households have been deleted from the list of goods and services attracting the reduced rate. The zero-rating conditions have been adjusted, among other things, to make imports of gas, electricity, heat energy, and cooling energy zero-rated.

The concept of a fiscal representative has been introduced. The law now defines a fiscal representative, lays down the procedure for their VAT registration and deregistration, prescribes the VAT treatment (i.e. zero-rating, input tax deduction, and tax period), and defines their responsibility for VAT obligations resulting from transactions they represent and for presenting all supporting documents.

There is a new threshold of LVL 35,000 for VAT registration (up from LVL 10,000).

There is also an updated procedure for applying a zero-rating to imported goods that are later supplied to a customer in another member state under a valid VAT registration number.

## Taxes on corporate income

The standard rate of CIT is 15%. The tax is assessed on a company's financial profit (loss) that has been adjusted by certain corrections required by law. There are no other taxes on corporate income.



Resident companies are taxed on their worldwide income.

If the company has been registered as a micro-business taxpayer, it pays 9% of its turnover, and this tax covers CIT, payroll taxes, and business risk duties that are paid by other taxpayers.

Non-resident companies are taxed on their Latvia-source income through permanent establishment (PE) at the standard CIT rate. If no PE is created, non-residents may be taxed with 2% to 15% withholding tax (WHT) for qualifying payments (e.g. royalties, management fees, interest).

## Corporate residence

A company is resident in Latvia if it is incorporated or had to be incorporated in Latvia.

### Permanent establishment (PE)

Under the Latvian Taxes and Duties Act, a non-resident has a PE in Latvia if all three of the following conditions are met simultaneously:

- The non-resident uses a fixed place for activities in Latvia.
- The place for activities is permanently used or is established for the purpose of being used permanently.
- The place for activities is used for the performance of commercial activities.

In addition, it is considered that a non-resident has a PE in Latvia if the non-resident performs in Latvia at least one of the following activities:

- Uses a construction site or performs building or installation activities or supervision or consultative activities related to the construction site or aforementioned activities.
- Uses equipment or installations, drilling platforms and special ships intended for the research or extraction of natural resources, or carries out supervisory or consultative work related thereto.
- Within a time period, which together exceeds 30 days in any six-month period, provides services, including consulting, management, and technical services, utilising one's employees or associated personnel.
- Uses the activity of an individual, legal, or other person for the benefit of one's commercial activities, provided that this person is authorised to enter into contracts in the name of the foreign entity and the person regularly (more than once in a taxation period) exercises such an authority.

Note that the PE risk for entities located in treaty countries should be tested in accordance with the relevant double tax treaty (DTT).

## *Other taxes*

### *Value-added tax (VAT)*

The following VAT rates apply in Latvia:

| Description of goods | VAT (%) |
|---|---|
| The standard rate on supplies of goods and services, commodity imports, certain services rendered by non-residents and treated as supplied in Latvia, intra-community acquisitions of goods, and personal consumption. | 22 |
| A reduced rate on medicines, medical devices and goods, specialised baby food, domestic public transport services, household heating charges, household natural gas supplies* (except gas for vehicles), firewood and wooden heating material to households, textbooks, and original literature publications. | 12 |
| Exemption with credit on supplies of goods within the EU to taxable persons registered for VAT in other EU member states. | 0 |
| Exemption with credit on commodity exports and imports not released for free circulation in the EU, supplies of goods and services to diplomats, supplies of goods and services financed by foreign aid, etc. | 0 |

* Note that the reduced VAT rate will no longer apply to household gas supplies as of 1 July 2011.

A number of services are exempt, including education, financial, medical and insurance services, nursery fees, and the sale of used real estate including land (except for the first sale of unused real estate, which is taxable).

Because of the recent amendments to the EU Council Directive 2006/112/EC (VAT directive) and respective amendments of the VAT Act, the new place-of-supply rules for cross-border services (i.e. transactions involving a supplier and a customer located in different countries) went into force on 1 January 2010.

### *Excise duty*

An excise duty is levied on specific categories of goods, mostly as a fixed amount per unit. Excise duties are applied to the following goods, whether made in Latvia or imported:

| Product | Excise amount |
|---|---|
| Oil and oil products | Up to LVL 320 per 1,000 litres, depending on the type of the product. |

| Product | Excise amount |
|---|---|
| Alcohol | LVL 45 to 940 per 1,000 litres, depending on the type of alcohol. |
| Beer | LVL 2.18 for each percent of absolute alcohol, but not less than LVL 4 per 100 litres of beer (LVL 1.09 on the first 10,000 hectolitres for small breweries). |
| Tobacco products | LVL 32 per 1,000 cigars or cigarillos.<br><br>LVL 32 per 1,000 cigarettes plus 33% of the maximum retail selling price.<br><br>LVL 64 per 1,000 cigarettes plus 33% of the maximum retail selling price for cigarettes 80mm to 110mm in length.<br><br>LVL 96 per 1,000 cigarettes plus 33% of the maximum retail selling price for cigarettes 111mm to 140mm in length.<br><br>LVL 128 per 1,000 cigarettes plus 33% of the maximum retail selling price for cigarettes exceeding 140mm in length.<br><br>LVL 43 per 1,000 grams of fine-cut smoking tobacco intended for the rolling of cigarettes.<br><br>LVL 43 for other smoking tobacco. |
| Coffee | LVL 100 per 100 kg. |
| Certain soft drinks | LVL 5.2 per 100 litres. |



### *Customs duty*

Customs duty is levied on goods imported into Latvia. The rate of customs duty generally is between 0% and 20% of the value of imported goods, depending on the type and origin of such goods. Exports are generally exempt from customs tax.

### *National social insurance contributions (NSIC)*

The company as an employer is liable to pay 24.09% NSIC calculated on employee's gross salary.

### *Real estate tax*

Prior to 2010, the real estate tax was payable only for business properties such as land and buildings used for economic activities. However, as of 2010, real estate tax is also payable for engineering structures such as motorways, streets, roads, bridges, elevated highways, tunnels, pipelines, communication lines and power lines, and buildings that form part of a private dwelling house development.

The following real estate tax rates apply as of 1 January 2011:

- The standard rate of 1.5% on the cadastral value of land, buildings, and engineering structures.
- A progressive rate for dwelling houses, their parts, and any parts of a non-residential building that are functionally used for living and not used in trade or business:
  - 0.2% of cadastral values up to LVL 40,000.
  - 0.4% of cadastral values exceeding 40,000 but not exceeding LVL 75,000.
  - 0.6% of cadastral values exceeding LVL 75,000.
- A double rate of 1.5% for uncultivated land capable of agricultural use, unless it is up to one hectare in area or subject to statutory restrictions on agricultural activity. By law, uncultivated land capable of agricultural use is agricultural land that is not used for making or growing agricultural products (including harvesting, grazing, and

keeping animals for agricultural purposes) or is not kept in good agricultural and environmental condition.

Newly constructed or reconstructed buildings are exempt from real estate tax for one year after completion. Other reliefs are available under the Real Estate Tax Act or determined by municipalities.

### *Natural resource tax*

Any natural resources acquired as a result of economic activities (e.g. surface and underground water, dolomite, and quartz sand), the collection of edible park snails, pollution (waste, emissions, and pollutants), products harmful to the environment (e.g. lubricating oil, electric batteries, oil filters, and tyres), radioactive substances, packaging, disposable tableware, vehicles, the volume of emitted greenhouse gasses, and electrical and electronic equipment and appliances are subject to a natural resource tax in Latvia. The rates are specific for each product and are based on weight, volume, or the amount of the product.

The taxpayer may reduce the natural resource tax by taking part in recycling programs. Taxpayers do not have an obligation to recycle themselves to be entitled to the relief; instead they can conclude an agreement with the recycling company.

For some of the products, the taxpayer must also pay the disposal tax. The rates differ for a large variety of products.

### *Light corporate vehicle tax*

As of 1 January 2011, a new light corporate vehicle tax (LCVT) has been introduced in Latvia. LCVT is paid for vehicle(s) owned or held (e.g. rented) by a business person, which is registered for the first time after 1 January 2005, and with information on the engine volume in the registration certificate. There is fixed rate of LCVT calculated according to the engine volume, as follows:

- Up to 2,000 cc: LVL 19 per month.
- From 2,001 cc to 2,500 cc: LVL 30 per month.
- Over 2,500 cc: LVL 40 per month.

For vehicles not mentioned in the above criteria, the LCVT will be LVL 30 per month.

### *Car and motorcycle tax*

Cars and motorcycles registered for the first time or after modification are subject to a car and motorcycle tax. This is tax payable by any individual or entity registered as the owner of a car or motorcycle.

The applicable tax rates for cars registered in foreign countries are calculated based on the carbon dioxide ($CO_2$) on each kilometre constituted by the car. The rates range from LVL 0.3 to LVL 5 where the carbon dioxide is from 120 grams to 350 grams for each kilometre. The rate for newly registered motorcycles is LVL 0.10 for each cubic-centimetre of the engine's capacity.

For other cars, rates range from LVL 75 to LVL 850, depending on age and capacity. The rate for motorcycles depends on age and is 25% of the rate for cars.

### *Lottery and gambling tax*

A lottery and gambling tax is levied on licensed organisers of games or lotteries. License fees range from LVL 3,000 to LVL 300,000. Game organisers, gambling places, and gambling machines are subject to the gambling tax. The tax rates depend on the number and type of gambling machines or percentage of income for several gambling types.

### *Electricity tax*

This electricity tax is levied on electricity supplied to final consumers or consumed by suppliers. The rate is LVL 0.71 per mega-watt-hour. Exemptions are available to producers of electricity and for electricity used by domestic public transport and households.

### *Stamp duty*

Stamp duties are levied on certain legal and other kinds of services, such as court trials, company formation and registration, licenses for certain types of business activity, provision of information, notary services, operation of bills of exchange, and registration of real estate at the Land Registry (2% of the higher of deal value or cadastral value capped at LVL 30,000 per property).

Stamp duty is not payable if re-registration of real estate in the Land Registry is necessary due to the reorganisation process. The maximum amount of stamp duty payable for re-registration of the title to immovable property in case of contribution in kind to a company's capital is LVL 1,000.

### *Local duties*

Certain activities are subject to local duties (e.g. construction permits).



## *Branch income*

As a general rule, branches and resident companies are taxed alike, with certain adjustments for payments to the head office. Branch income is subject to a 15% CIT.

## *Income determination*

### *Inventory valuation*

Dictated by the matching and prudence concepts, stock should be valued at the lower of cost or net realisable value. Cost must be computed on a first in first out (FIFO) basis. Cost can mean purchase price or production cost. Any unrealised losses from stock revaluation are non-deductible.

### *Capital gains*

A capital gain on the disposal of a capital asset is calculated as the difference between the sale proceeds and cost. This gain is subject to a 15% CIT as ordinary income.

Losses on the sale of shares may be carried forward and offset against future profits. However, profits on trading in securities publicly quoted in the European Union or the European Economic Area (EEA) are not taxable, and losses from these securities are not deductible.

Losses on the sale of public securities traded outside the EU/EEA or non-public securities (private shares, unlisted bonds and shares, claim securities) are not deductible but may be offset chronologically in eight subsequent tax periods against income from the sale of other securities. However, if a company makes a one-off sale of securities that it has held for more than 12 months, then such losses may be offset chronologically against total taxable income from operating activities in eight subsequent tax periods.

### *Dividend income*

Dividends from Latvian companies are exempt from CIT, except for dividends from companies paying CIT at a reduced rate (e.g. companies operating in free ports or special economic zones).

Dividends from companies registered in blacklisted tax havens are taxable (a list of blacklisted tax havens is provided by the Cabinet of Ministers).

Dividends paid by a non-resident company based outside blacklisted tax havens to a Latvian person, directly holding at least 25% of shares in that company at the time the dividends are paid, are exempt.

Dividends from a company resident in another EU or EEA country are also tax exempt.

### *Stock dividends*

The distribution of new shares to a company's shareholders in proportion to their existing shareholdings (after a share capital increase by conversion of accrued capital) is not a taxable event for the shareholders.

### *Foreign income*

Resident companies are taxed on their worldwide income. Income is taxed for the given taxation period; there is no possibility to defer taxation until the profit is repatriated to Latvia. Tax paid abroad on income included in the taxable base is allowed as a credit against the CIT charged for the year. However, the credit must not exceed the Latvian tax attributable to the income taxed abroad. Any unused tax credits may not be carried forward.

## *Deductions*

### *Non-business expenses*

A tax deduction is not allowed for any expense not directly related to business activities. As of 2010, non-deductible expenses have to be increased by coefficient 1.5 (except donations made to qualifying institutions). Effectively, such expenses are taxed at 22.5% (15% x 1.5).

Non-business expenses include costs that are not directly related to commercial activities; all expenses incurred for the pleasure and recreation of owners and employees; entertainment trips taken by owners and employees in company vehicles; any benefits, gifts, credits, and loans turned into gifts to owners and employees; and any other disbursements in cash or in kind to owners or employees that are not part of remuneration or that are not related to the taxpayer's commercial activities.

### *Representation expenses*

Under the Latvian CIT Act, representation expenses are costs that a company incurs in developing and maintaining its prestige at a level acceptable to society. Representation expenses include costs incurred in holding public conferences, receptions, and meals, and the cost of producing items to represent the company (e.g. items bearing its logo). As of 1 January 2010, 40% of representation expenses are deductible for CIT purposes (60% prior to 1 January 2010).

### *Depreciation and amortisation*
Fixed assets may be depreciated for tax purposes according to the reducing-balance method by applying the following rates to tax written-down values:

| Types of property | Depreciation rate (%) |
|---|---|
| Buildings, structures, and perennial plantations | 10 |
| Technology and energy installations, fleet, railway | 20 |
| Computer hardware and software, information systems, electronic equipment | 70 |
| Light passenger cars (except special purpose vehicles), motorcycles, and air transport means | 30 |
| Oil rigs, oil exploration and extraction ships, sea and river transport means | 15 |
| Other fixed assets | 40 |

The value of new technological equipment is multiplied by a coefficient (1.5 from 2009 to 2013) before claiming capital allowances. The effect of applying a coefficient is reversed if the new technological equipment is disposed of within five years from acquisition.

Non-business assets are ineligible for capital allowances.

Intangible assets are eligible for capital allowances on a straight-line basis over the following recovery periods:

- Concessions: 10 years.
- Patents, licences, and trademarks: 5 years.
- Research and development (R&D) expenses: 1 year.

Any intangible assets not fitting into any of these categories (such as goodwill) are ineligible for capital allowances.

The cost of intangible investments is increased by a coefficient of 1.5 if such investments result in a trademark or patent being registered.

### *Luxury vehicles*
Luxury vehicles (i.e. light passenger cars with a value greater than LVL 25,424, excluding VAT) are not eligible for capital allowances. A tax deduction is denied for expenses incurred in using and maintaining luxury vehicles and for lease or hire purchase payments associated with leasing such vehicles. These rules do not, however, apply to special purpose vehicles (such as emergency vehicles and special passenger vehicles).

### *Provisions*
Any increase in general provisions and reserves for the tax period as compared with the previous tax period is non-deductible. These provisions include accruals for accrued benefits, bonuses and commissions, and other expenses.

### *Provision for doubtful debts*
Recent amendments allow taxpayers, under certain conditions, to defer payment of CIT on a provision for doubtful debts for three years, without increasing taxable income at the time of making that provision. A special provision for doubtful debts in a tax period

that does not increase taxable income must not exceed 20% of taxable income. To take this relief, the following conditions must be met:

- The payment became due more than six months ago.
- The income associated with these debts has been added to taxable income.
- The debtor is a legal entity resident in the EU/EEA or in a country that has an effective DTT with Latvia.
- The taxpayer and the debtor are not related companies and neither of them is a person related to the company.
- Dealings with the debtor were stopped at least six months ago and have not been resumed since.
- The taxpayer can prove that steps were taken to recover the doubtful debt.
- The taxpayer has given the debtor written notice by 31 December in the tax year that the debt (with details of the supporting document) is covered by a provision for doubtful debts made in line with this clause.

Unless the provision is reduced within three years by being added to taxable income or through a bad debt being written off, the amount of doubtful debts covered by the special provision will have to be added to taxable income.

The amendments relating to the provision for doubtful debts apply from 2011 to 2013.

### *Amounts unpaid by a debtor*
A taxpayer who has not paid for goods or services within six months after the due date for payment must not deduct the amount of the debt from taxable income if the creditor has notified one that the debt is classified as doubtful and covered by a special provision for doubtful debts. Taxable income can be reduced in the tax period the debt is paid.

The amendments relating to the provision for doubtful debts apply from 2011 to 2013.

### *Bad debts*
Bad debts may only be deducted for CIT purposes if certain conditions are met.

### *Penalties*
Fines, contractual penalties, and statutory interest on arrears (including increase in principal debt) levied under the Taxes and Duties Act and specific tax laws are not deductible.

### *Taxes*
Excise duties, employer's national social insurance contributions, natural resource taxes, customs duties, and real estate taxes are deductible.

### *Net operating losses*
As of 2010, losses may be carried forward eight years (formerly five years). The carryback of losses is not permitted.

A company in which more than 50% of shares (a controlling interest) have changed hands may utilise its tax losses if it continues for five years the same business that it carried on during the two years prior to the change of control. When companies are reorganised by a merger or spin-off, it may be possible to utilise losses accrued.

### *Payments to foreign affiliates*
In general, a Latvian company may deduct the full amount of royalties, service fees, and interest (subject to statutory limits) made to related parties to the extent that such

payments are made at arm's length. Such payments may be subject to a WHT *(see the Withholding taxes section)*. However, if a taxpayer fails to deduct the WHT due, the amounts paid cease to be deductible for tax purposes.

## Group taxation

Group consolidation is not permitted for tax purposes. However, the members of a group of Latvian companies, whose parent owns directly or indirectly 90% of the capital of its subsidiary or subsidiaries, may surrender their current-year tax losses to one another.

### Transfer pricing

The Latvian Regulation governing the application of the CIT Act states that for transfer pricing calculation purposes, use may be made of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, a document issued by the Organisation for Economic Co-operation and Development (OECD).

Latvian law requires that related-party transactions be in compliance with the arm's-length principle. Under the arm's-length principle, the conditions made or imposed between two related enterprises in their commercial or financial relations must not differ from those that would be agreed between independent enterprises engaging in similar transactions under similar circumstances.

A tax audit may examine and adjust the price of a transaction in the following circumstances:

- The transaction is between related parties.
- Barters and set-offs.
- A price deviation exceeds 20% of prices that the taxpayer has applied to similar goods or services over a short period.
- Exports and imports.

The transfer pricing requirements for the arm's-length price of a related-party transaction primarily apply to transactions between two or more related companies. Latvian legislation has broadened these requirements, and section 12 of the CIT Act requires the taxpayer to adjust one's taxable income for the difference between the price applied to a transaction and the arm's-length value if the transaction involves:

- individuals related to the company
- related foreign companies
- companies exempt from CIT or enjoying CIT relief pursuant to other Latvian laws, or
- a related company with which it forms a single tax group.

This provision may apply to any transaction, including purchases and sales of fixed assets and goods, supplies of services, loans and borrowings, and intellectual property. It should also be pointed out that the traditional view that transfer pricing rules only apply to transactions with foreign related companies is no longer consistent with the law because transfer pricing issues are now also important to companies doing business with Latvian-related companies.

There are no obligatory transfer pricing documentation requirements in Latvia yet. Nevertheless, it is highly advisable to prepare the transfer pricing documentation as it may be of valuable support during tax audits.

### *Thin capitalisation*
Thin capitalisation rules apply when claiming a tax deduction for interest payments on loans and leasing services.

Taxable income should be adjusted for either:

- interest paid in excess of interest calculated by applying to the liability 1.2 times the average short-term interest rate at Latvian banks as determined by the Central Statistical Office for the last month of the tax period, or
- interest in proportion to the excess of the average liability over an amount equal to four times shareholders' equity at the beginning of the tax year less any revaluation reserve.

The higher of these calculations should be added to taxable income.

The following interest payments are fully deductible:

- Interest paid on borrowings from credit institutions resident in Latvia, EEA member states, or countries with which Latvia has an effective DTT.
- Interest paid to the Latvian Treasury, Nordic Investment Bank, European Bank for Reconstruction and Development, European Investment Bank, European Council Development Bank, or the World Bank Group.
- Interest paid on Latvian or EEA debt securities in public trading.
- Interest expenses incurred by credit institutions and insurance institutions, regardless of the lender.

Interest paid on borrowings from a financial institution is deductible up to the amount of interest calculated by applying to the liability 1.2 times the average short-term interest rate at Latvian banks as determined by the Central Statistical Office for the last month of the tax period. The qualifying financial institution must meet the following criteria:

- It is resident in Latvia, the EEA, or a country with which Latvia has an effective DTT.
- It provides lending services or finance lease and is monitored by the controlling institution that supervises credit institutions or the financial sector.

### *Controlled foreign company (CFC) rules*
There is no CFC regime in Latvia.

## *Tax credits and incentives*

### *Foreign tax credit*
Tax paid abroad on income included in the taxable base is allowed as a credit against the CIT charged for the year. However, the credit must not exceed the Latvian tax attributable to the income taxed abroad. Any unused tax credits may not be carried forward.

### *Donations to public benefit organisations*
CIT liability may be reduced by 85% of amounts donated to qualifying state-funded institutions; Latvian-registered societies, establishments, and religious organisations; or to institutions qualifying as public-benefit organisations under the Public Benefit Organisations Act. Such a reduction may not exceed 20% of the total CIT liability. When

making a donation, the donor is not permitted to impose an obligation on the recipient of the donation or carry out any acts that may be classified and treated as consideration.

As of 2011, donation relief is also available for donations to EU/EEA entities that have statuses similar to public-benefit organisations in the country of residence.

### *Large investment relief*

As of 2011, the government has introduced CIT relief for investments over LVL 5 million in qualifying industries in new, unused fixed assets (buildings and structures classified as industrial buildings and new plant and technological equipment) which they can use for business purposes. The available tax relief is 25% of the amount of investments made (15% for investments over LVL 35 million). Yet companies have to make their investment decisions quickly, as investment projects must be completed by the end of 2016. Companies have to go through certain procedures in order to receive a Cabinet decision by the end of 2013 in support of a qualifying investment project.

Investments have to enable a company to launch a new line of business or to modernise its existing production, which includes manufacturing new goods, a shift of business activity from producing one type of goods to producing another type of goods, or a complete overhaul of the manufacturing process.

### *Incentives for shareholders to invest profits in companies*

Recent changes in CIT law encourage shareholders to invest profits in the development of their company rather than take them out as dividends. Businesses may reduce their taxable income by a notional amount of interest that a taxpayer would have to pay on a loan equal to one's prior-year undistributed profit. This adjustment is calculated by multiplying the annual weighted average rate of interest on loans issued to non-financial Latvian businesses as determined by the Bank of Latvia for the tax period by undistributed profits accrued since 31 December 2008.



### *Free ports and special economic zones*

Companies operating in special economic zones are entitled to CIT and real estate tax relief. These areas include the free ports of Ventspils and Riga and the special economic zones of Rezekne and Liepaja.

The qualifying companies may apply CIT relief of 80%, yet the CIT must be calculated at a 25% rate resulting in an effective CIT rate of 5%. The companies may also apply 80% WHT relief for dividends, management services, and payments for intellectual property made to non-resident companies.

Real estate tax relief amounts to 80%, and the municipality may waive the remaining 20%. Therefore, when meeting certain criteria, qualifying companies may decrease real estate tax to zero.

The amount of total CIT and real estate tax relief that may be claimed by the company depends on the amount of qualifying investments made by the company in the free port or SEZ area. Depending on the size of the company, the total tax relief available ranges from 50% to 70% from the amount of investments made.

### *Deferred tax on asset replacements*

Latvia will allow a deferred payment of tax on profits arising on the sale of a replaced asset in order to encourage manufacturing companies to replace inefficient and outdated plant and machinery.

If a company acquires a functionally similar asset within 12 months before or after the old equipment is disposed of, then any income (profit) on the disposal of the old equipment is ignored in this tax period (i.e. the profit is deductible from taxable income). Tax payment is deferred until the new equipment is sold and may be further postponed if the equipment is replaced.

## *Withholding taxes*

The following types of payments to non-residents are subject to WHT.

### *Dividends*

Dividends are generally subject to a 10% WHT. DTTs generally reduce the rate to 5%. However, dividends paid to a company that is a resident of and meets the criteria of parent-subsidiary directive in any EU or EEA member state are exempt.

### *Interest*

Interest payments to related non-resident parties are generally subject to a 10% WHT. Interest payments to non-related creditors are not subject to WHT. If a bank registered in Latvia pays interest to related companies at the bank's normal interest rate level, then a 5% WHT applies.

Through 30 June 2013, Latvian companies will have to comply with transitional rules of the CIT Act, which provide a 5% WHT on interest payments to a related EU company. From 1 July 2013 onwards, WHT no longer will apply to interest paid by a Latvian company to a related EU member state company that holds at least 25% of the share capital or voting power in that Latvian company and meets certain other statutory criteria.

### *Royalties*

Payments for intellectual property (copyright in literary or artistic works, including movies, videos, and sound recordings) are subject to a 15% WHT. A 5% WHT is applied on other intellectual rights, such as patents, royalties, and trademarks. DTTs may reduce the rate.

If the recipient is an EU-related company that holds at least 25% of the share capital or voting power in that Latvian company and meets certain other statutory criteria, the applicable rate for intellectual property is 5% through 30 June 2013 and exempt from 1 July 2013 onwards.

### *Rentals of industrial, commercial, or scientific equipment and real estate*

Rental payments for property in Latvia are subject to a 5% WHT.

### *Management fees*

Management and consulting fees are subject to a 10% WHT. The term 'management and consulting' means activities carried out by a non-resident directly or by outsourced personnel to ensure the management of a Latvian company or to provide necessary advice. DTTs may reduce the rate to 0%.

### *Disposal of real estate*

A 2% WHT applies to proceeds from real estate disposals. This applies to income from disposed shares or other participation in a Latvian or foreign-registered company or other entity, if real estate in Latvia made up (in the period of disposal or the previous period, whether directly or indirectly, through shareholdings in one or more other entities established in Latvia or abroad) more than 50% of the asset value of the company being disposed of.

### *Double tax treaties (DTT)*

A Latvian company can rely on a DTT to reduce the rate of WHT on any payments previously mentioned. To this end, the Latvian company must obtain a valid residence certificate for each type of payment to each recipient prior to making the actual payment. A valid residence certificate is one approved by the foreign tax authority and the Latvian tax authority.

Please see the following table for WHT rates applicable to the payments described above:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Rentals of industrial, commercial, or scientific equipment and real estate (%) | Management fees (%) | Disposal of real estate (%) |
|---|---|---|---|---|---|---|
| Related Latvian companies using certain CIT reliefs | 0 | 5/10 | 5/15 | 5 | 10 | 2 |
| Companies in tax havens (1) | 10 | 5/15 | 15 | 15 | 15 | 15 |
| | | | | | | |
| Treaty: | | | | | | |
| Albania | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Armenia | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Austria | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Azerbaijan | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Belarus | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Belgium | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Bulgaria | 5/10 (2) | 0/5 | 0/5 | 5/7 | 0 | 2 |
| Canada | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| China | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Croatia | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Czech Republic | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Denmark | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Estonia | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Finland | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| France | 5/10 (3) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Georgia | 5/10 (5) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Germany | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Greece | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Hungary | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Iceland | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Italy | 5/10 (3) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Ireland | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |

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| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Rentals of industrial, commercial, or scientific equipment and real estate (%) | Management fees (%) | Disposal of real estate (%) |
|---|---|---|---|---|---|---|
| Israel | 5/10 (4) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Kazakhstan | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Kirghizia | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Lithuania | 0 | 0 | 0 | 0/5 | 0 | 2 |
| Luxembourg | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Macedonia | 5/10 (3) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Malta | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Morocco | 10/6 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Moldova | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Montenegro | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Netherlands | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Norway | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Poland | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Portugal | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Romania | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Serbia | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Singapore | 5/10 (2) | 0/5/10 | 5/7.5 | 5 | 0 | 2 |
| Slovak Republic | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Slovenia | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Spain | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Sweden | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Switzerland | 5/10 (5) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Tajikistan | 0/5/10 (6) | 0/7 | 5/10 | 5 | 0 | 2 |
| Turkey | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |
| United Kingdom | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| United States | 5/10 (3) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Ukraine | 5/10 (2) | 0/5/10 | 5/10 | 5 | 0 | 2 |
| Uzbekistan | 10 | 0/5/10 | 5/10 | 5 | 0 | 2 |

Notes

1. 15% applies to all payments to companies located in tax havens, with the following exceptions:
   - 10% for dividends paid by Latvian residents.
   - 5% for interest on deposits and current accounts paid by Latvian banks at their general rate.
   - Repayments of loan principal are exempt.
   - Goods originating in the tax haven are exempt.
2. A 25% minimum shareholding is required for the lower rate.
3. A 10% minimum shareholding is required for the lower rate.
4. A 25% and USD 75,000 minimum shareholding is required for the lower rate.
5. A 20% minimum shareholding is required for the lower rate.
6. 0%: a 75% minimum shareholding is required; 5%: a 25% minimum shareholding is required.

## *Tax administration*

### *Returns*

The fiscal year may not exceed 12 months and is normally based on the calendar year. However, companies are permitted to choose alternative start and end dates for the tax year. The first year of trading may last up to 18 months. Tax returns are filed annually, together with annual accounts, within one month after they have been approved but not later than four months after the end of financial year. Thus, if the financial year ends on 31 December, the CIT return and annual accounts must be filed not later than by 1 May of the following year. Larger companies may file the CIT return and annual accounts not later than seven months after the end of financial year.

### *Payment of tax*

CIT usually is paid monthly on or before the 15th day of each month, with a final adjustment when the annual tax return is filed. Monthly tax installments are based on the tax liability in the previous fiscal year and adjusted by the consumer price index. A company may choose quarterly installments if its monthly advances in the previous period were less than LVL 500. For a new company, advance payments are voluntary.

# Lebanon

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## Significant developments

The Ministry of Finance published Decision No. 1216, dated 21 November 2009, containing a list of updated forms and declarations to be used by taxpayers starting in year 2010. A listing and copies of these forms and declarations is found in Official Gazette No. 62 1/2, dated 31 December 2009. Original copies of these forms and declarations may be obtained from the Ministry of Finance.

The Ministry of Finance has introduced new fiscal obligations for Lebanese representative offices, effective for financial year 2010. The major obligation is that representative offices will be required to submit annual tax declarations using specific forms which were published under the above decision.

The Ministry of Finance issued Instructions No.4068 on 23 December 2010 in relation to the accounting system that may be adopted by institutions exempt from income tax (other than companies) and the deadlines of submitting the declarations.

## Taxes on corporate income

Under the income tax law in Lebanon, tax is levied based on income type. Accordingly, the income tax law divides income into the following three categories:

- Chapter I – profits from industrial, commercial, and non-commercial professions.
- Chapter II – salaries and wages and pension salaries.
- Chapter III – revenues from moveable capital (chapter III mainly covers all types of dividend income, board member appropriations from profits, and interest income, including interest on bonds and treasury bills).

The income tax law does not provide for a single tax on income. Accordingly, where a taxpayer has income from different sources, each type of income is taxed according to the tax chapter it falls under. The applicable rates are as follows:

- Corporate income tax (CIT): 15%.
- Dividend distribution tax: 10% (may be reduced to 5% in certain cases).
- Capital gains tax: 10%.
- Non-resident withholding tax (WHT): 7.5% for services and 2.25% for other than services.
- Payroll tax: from 2% to 20%.
- Moveable capital tax: 5% or 10%.

Not all businesses are taxed in the same manner, and, depending on the relative size and structure of a business, the tax method applied is assessed depending on real (or actual) profits or deemed profits.

### *Real profit tax*

In Lebanon, tax is charged on the total income or profits derived in Lebanon. Based on the income tax law and the principle of territoriality, the main premise for considering a profit to have been realized in Lebanon is if it was generated through an effort or activity exerted in Lebanon.

The tax base (the determination of profits) and the tax rates differ between resident and non-resident tax payers.

For resident corporate entities, real profit: tax is computed at 15% based on the taxpayer's accounting profits after adjustments resulting from tax rules through the schedule of accounting-to-tax calculation.

The use of the real profit method is mandatory for the following:

- Corporations (SAL).
- Limited liability companies (SARL).
- Companies of individuals.
- Branches of foreign companies.
- All entities employing more than four employees or importing goods.



Small entities may choose voluntarily to be subject to the real profit method; however, once they choose the real profit method, they cannot revert back to the deemed profit method.

Concerning tax non-residents, WHT applies at 2.25% on payments for goods and 7.5% on payments for services.

### *Deemed profit tax*

A deemed profit tax is imposed on insurance and savings institutions, taxable transport companies, oil refineries, and public work contractors. Taxation is based on deemed profits and is levied at a flat rate of 15%.

The rate of deemed profit for public work contractors, as approved by the Ministry of Finance, is currently set at either 10% or 15% of total amounts collected per year, based on the type of activity performed by the contractor. For insurance companies, the deemed profit rate varies depending on the type of insurance activity (i.e. life, motor, accident, etc.). In addition to the flat rate tax imposed on deemed profits, a distribution tax of 10% is levied on dividends.

## *Corporate residence*

Tax is levied on all corporeal/natural and incorporeal/artificial persons, resident in Lebanon or outside, on all profits that they generate in Lebanon. The main premise for considering profits to have been realised in Lebanon is when such profits have occurred from an effort exerted in Lebanon, irrespective of the identity of the taxpayer or place of residency.

There are no clear provisions in the Lebanese income tax law to define permanent establishments.

Tax is levied on profits generated by two categories of taxpayers: resident taxpayers and non-resident taxpayers.

### *Resident taxpayers*

A person, establishment, or company is considered resident for tax purposes, even if not physically resident in Lebanon, when any of the following two terms are satisfied:

- Have an office or a fixed place of business in their name in Lebanon, even when they are not undertaking their business in a normal and repetitive manner.
- Practising a profession or business activity in a normal or repetitive manner in Lebanon, even if they do not have a known registered place of business in Lebanon. This is because they are considered to have practised their profession from the place in which they contact their customers, even if such place is a hotel or a café.

### *Non-resident taxpayers*

Non-resident taxpayers can consist of persons residing in Lebanon and persons residing outside Lebanon. A corporeal person residing in Lebanon is subject to the non-resident WHT *(see the Withholding taxes section for more information)* if neither of the following two terms are satisfied:

- Practise a certain trade in a normal and repetitive manner in Lebanon, irrespective of whether or not they have a known registered place of business.
- Have a known registered place of business in Lebanon.

A person residing outside Lebanon is subject to the non-resident WHT on the amounts, revenues, profits, or proceeds obtained from Lebanon as a result of undertaking an activity in whole or in part on Lebanese territory or as a result of exploiting rights in Lebanon.

## *Other taxes*

### *Value-added tax (VAT)*

The standard VAT rate in Lebanon is 10%. Unless specifically exempt, VAT is levied on all commercial transactions undertaken by business entities. Export of goods and services and export-related services, international transport, and some of the intermediate operations are zero-rated. Banking, financial services, and insurance operations are exempt from VAT.

### *Built property tax*

The built property tax is an annual progressive tax, ranging between 4% and 14%, on built property.

### *Stamp duty*

Two kinds of stamp duties are levied. A proportionate stamp duty of 0.3% is levied on all deeds and contracts (written or implied) that mention specific payments or other sums of money. A fixed stamp duty ranging between a minimum of 100 Lebanese pounds (LBP) and a maximum of LBP 2 million is applicable on documents in accordance with schedules appended to the stamp duty law.

### Registration taxes

The estimated cost of establishing a company in Lebanon is USD 7,500. This includes lawyer's fees and registration fees. The registration fees will increase if the company is established with capital exceeding the minimum requirement. However, the registration fees should not normally exceed 1% of the value of capital.

For branch offices and representative offices, establishment costs are lower and may be estimated at USD 5,000.

When transferring ownership of real estate, registration fees of approximately 6% are applicable.

### Customs duties

Modern, simple, and efficient assessment means are adopted by the customs authorities (e.g. electronic declarations, declaration in advance, applying international procedures in clearing the goods, selective inspection, auditing the goods after their release, and adopting the unique declaration).

Customs rates are imposed and modified according to decisions from the Lebanese customs authorities. These decisions are adopted based on the need of the Lebanese markets of some goods and the will to protect national production sectors.

Safeguard measures are provided for in relation to imported goods. The purpose behind such measures is to protect the domestic production sectors when an increase of imports is witnessed when compared to the same period during the previous year.



The rates are determined based on a specific schedule created in conformity with the Harmonised System of Nomenclature. This conformity with the unified system allows Lebanon to represent an 'importer friendly' environment for importers.

The normal rates are applied where there is no preferential agreement. When the origin of the good or part of the good is from a country with which Lebanon has a preferential customs treatment, preferential rates apply.

Customs rates in Lebanon are either determined in percentage or paid as a lump sum per unit of imported products.

## Branch income

Net income derived from a branch's operations in Lebanon is subject to Lebanese real profit tax, levied at a rate of 15%. Taxable profits of foreign branch offices are deemed to be distributed and are subject to a dividend distribution tax at the rate of 10%.

### Representative offices

Representative offices do not pay CIT as long as they do not carry out commercial activities. Representative offices are required to submit annual tax declarations along with detailed company information that includes employee information, a balance sheet, an income statement, a non-resident tax schedule, and a schedule of payments to professionals. The declaration, with all relevant documentation, should be submitted as one single set. All the information included should be based on accounting records. The deadline for submitting the declaration depends on the legal form of the parent company (i.e. before 1 June of the following year for SAL or SARL companies and before 1 May of the following year for others).

## Income determination

### Inventory valuation
For tax purposes, inventory is valued using the weighted average cost method.

### Capital gains
Under local legislation, companies are permitted to revalue their fixed assets every five years. Capital gains recognised from such a revaluation, as well as any profits that may be realised from the disposal of fixed assets, are subject to a capital gains tax of 10%.

Income from disposal of shares realised by a company is subject to 10% capital gains tax when the shares are classified as financial assets in the company's balance sheet.

Income from disposal of shares realised by a company whose main activity is the acquisition of investments is subject to 15% CIT.

### Inter-company dividends
Dividends received as a result of a taxable person's activity are deemed trading income and are subject to 15% CIT. Dividends received as passive income are subject to 10% tax in Lebanon. However, dividends received from Lebanese entities are exempt from CIT, as the dividend tax is withheld at source, but are not exempt from further tax upon distribution from the recipient entity.

### Stock dividends
The Lebanese law is silent on the tax implications of stock dividends. However, when share capital is increased by reducing retained earnings, no tax is applicable.

### Interest income
Interest earned by corporations is added to taxable income. Relief is given for the WHT suffered on bank accounts, treasury bills, and bonds issue to the extent of the CIT due.

### Rental income
Rental income should be deducted from the accounting result to reach the taxable result. Moreover, expenses related to property that is rented out should be added back to the accounting result to reach the taxable result.

A built property tax is paid on rental income at progressive rates ranging between 4% and 14%.

### Royalties income
Royalties received by a holding company from Lebanese companies for patents and the like are taxed at a rate of 10%. Royalties received by holding companies from abroad are exempt from tax.

Royalties received by other than holding companies are taxed as ordinary income at 15%.

### Unrealised exchange gains/losses
Unrealised exchange gains and losses are not treated differently from any other gain or loss for tax purposes, i.e. unrealised exchange gains are subject to CIT at 15% and unrealised exchange losses are deductible for CIT purposes.

### Foreign income

Income from any source, domestic or foreign, received by a corporation within Lebanon is subject to CIT. The scope of tax covers the activities carried out inside and outside Lebanon, which are administered or managed from Lebanon.

## Deductions

### Depreciation

Depreciation of property, plant, and equipment (at rates fixed by ministerial decree) is deductible. The depreciation method to be used is the straight line method. If a depreciation rate that is higher than the low rate is adopted, the Ministry of Finance should be notified. The allowable depreciation rates are as follows:

| Assets | Low rate (%) | High rate (%) |
|---|---|---|
| Buildings (commercial, touristic, and services) | 2 | 5 |
| Buildings (industrial and artisanal) | 3 | 10 |
| Buildings and constructions (commercial or industrial) | 6 | 20 |
| Freehold improvements and decorations | 6 | 25 |
| Technical installations and industrial equipments | 8 | 25 |
| Computer hardware and software | 20 | 50 |
| Vehicles (cars) | 10 | 25 |
| Vehicles (transport of goods / buses) | 6 | 20 |
| Sea transport | 5 | 10 |
| Air transport | 20 | 25 |
| Office equipment and furniture | 8 | 25 |
| Glasswares and silverwares (hotels, restaurants, etc.) | Inventory @ Y/E | Inventory @ Y/E |
| Gas cylinders | 8 | 20 |

### Organisation and start-up expenses

Organisation and start-up expenses are amortised over three to five years for tax purposes.

### Bad debts

Bad debts are deductible if all means for collection of the debt have been exhausted.

Provisions for bad debts are deductible if a debtor has been declared bankrupt. Surplus provisions are added to profits.

### Charitable contributions

Charitable contributions are deductible if made to approved charitable, social, cultural, or sporting institutions, within certain limits.

### Gifts

Gifts given by the company in cash are non-deductible.

Gifts given by the company in-kind to customers when the amount of each gift exceeds LBP 1 million per person per year and when the total amount of gifts in-kind exceeds 1% of the turnover are non-deductible.

### *Fines and penalties*
Fines and penalties are not deductible in Lebanon.

### *Taxes*
Taxes and duties incurred in the course of business (except CIT) are deductible.

Taxes due to foreign governments on income earned in Lebanon are non-deductible.

Exceptional taxes and fines are non-deductible.

### *Other significant items*
Other deductible expenses include:

- Cost of goods sold.
- Cost of services rendered.
- Rent of business premises or, if the premises are owned by the taxpayer, their depreciation.
- Salaries, wages, and other employee benefits, including end-of-service indemnities.
- General business expenses, including insurance premiums.
- Interest on business loans, under certain conditions.
- Reserves for severance payments, pensions, and disability payments. Surplus provisions are added to profits.
- Advertising and publicity expenses, within certain limits.
- Travel, telephone, and vehicle expenses, within certain limits.
- Entertainment expenses that are properly supported.
- Board remuneration against services performed.
- Accrued expenses as long as their occurrence is certain.
- Employees' life insurance premiums are deductible as long as they are included in the employees' benefits subject to payroll tax.

Other non-deductible expenses include:

- Interest paid on the taxpayer's capital.
- With the exception of normal maintenance expenses, costs that increase the value of the property, plant, or equipment (such costs should be capitalised and depreciated in accordance with the fiscal depreciation rates).
- Losses or share-in-costs resulting from enterprises, offices, and branches situated outside Lebanon.
- Representation allowances in excess of 10% of an employee's basic salary, as well as unjustifiable and unreasonable salaries.
- Personal expenses, such as payments deducted by an employer or partner for the management of the business and for certain business expenses incurred by the employer or partner.
- Appropriations made to board members that do not comprise remuneration for work done.
- Provisions, other than those specifically allowed by law. Examples of non-deductible provisions include provisions for bad debts, provisions for slow moving items, and provisions for bonuses, contingencies, and charges.

### *Net operating and capital losses*
Tax losses may be carried forward for up to three years after the year in which they were originally incurred. The carryback of losses is not available.

Capital losses may be used to offset taxable profits of the current year but may not be carried forward.

### *Payments to foreign affiliates*
Payments to foreign affiliates are generally subject to WHT.

Based on guidance issued by the Ministry of Finance, recharges from the head office located abroad (including advertising) are deductible up to a certain limit, calculated as follows:

> (Assets of the branch in Lebanon/Consolidated assets) x Central administrative expenses.

However, a ceiling of 3% of the branch's revenues is applied.

## *Group taxation*

There is no group taxation in Lebanon.

### *Transfer pricing*
In Lebanon, there are no clear and detailed transfer pricing or general anti-avoidance rules. However, even in the absence of clear transfer pricing rules, exchanges or transactions made between related parties should be done on an arm's-length basis.

The tax administration has the right to reassess related party transactions and adjust their value in order to reflect the taxable amount related to the period under study.

### *Thin capitalisation*
In Lebanon, there are no clear or detailed thin capitalisation rules.

## *Tax credits and incentives*

### *Holding companies*
Lebanese holding companies are exempt from CIT and from WHT on dividends. However, they are subject to a tax on their paid-up capital and reserves. In any given tax year, total tax payments on paid-up capital and reserves are capped at LBP 5 million.

Interest, management fees, and royalties received by holding companies from abroad are exempt from CIT.

Holding companies are subject to a 10% tax on interest received from loans shorter than three years extended to companies operating in Lebanon. Management fees received by the holding company from companies operating in Lebanon are subject to a 5% tax. Capital gains on financial assets in Lebanese companies held for less than two years are subject to a 10% tax. Royalties received from Lebanese companies for patents and the like are taxed at a rate of 10%.

### *Offshore companies*
Offshore companies are exempt from CIT and from the WHT on dividends, and are instead subject to a lump-sum annual tax of LBP 1 million. Contracts related to offshore activities outside Lebanon are exempt from Lebanese stamp duty.

Offshore companies are required to be registered as SAL companies and, with a few exceptions, are subject to the same regulations as a SAL company. The business objectives of an offshore company are limited.

### *Permanent exemptions from CIT*

Companies and organisations that are granted an indefinite exemption from CIT include the following:

- Educational institutions.
- Hospitals, orphanages, asylums, and other shelters that admit patients free of charge.
- Shipping, sea, and air transport associations (subject to certain restrictions).
- Farmers, provided they do not display farm produce and cattle outlets or sell products and meat after conversion tax.
- Syndicates and other types of professional associations.
- Miscellaneous non-profit organisations and co-operatives.
- Holding companies and offshore companies.
- Public sector bodies that do not compete with private institutions.

### *Reinvestment incentives*

Industrial companies using operating profit to finance certain capital investments are exempt from up to 50% of their CIT liabilities for a period of up to four years, provided that such exemptions do not exceed the original investments made. In areas designated 'development zones', 75% of a company's tax liabilities may be exempt.

In order to take advantage of this regulation, investments should consist of capital expenditures designed to increase a company's manufacturing capacity or of investments in housing facilities for the company's staff and other employees.

## *Withholding taxes*

### *WHT on interest*

The income, revenues, and interest earned from accounts opened at Lebanese banks and from treasury bonds are subject to a 5% WHT that is non-refundable and cannot be carried forward. This WHT is considered as an advance payment on the current CIT due to the extent of that amount and acts as a minimum tax in situations where the tax due is lower than the tax on interest paid.

### *Non-resident WHT*

Revenues earned by non-residents in Lebanon are subject to an effective WHT of 2.25% on revenue from the sale of materials and equipment, and 7.5% on the revenue in the case of sale of services.

### *Movable capital WHT*

A 10% WHT is levied on income derived from movable capital generated in Lebanon. Taxable income is comprised of the following:

- Distributed dividends, interest, and income from shares.
- Directors' and shareholders' fees.
- Distribution of reserves or profits.
- Interest from loans to corporations.

### *WHT on dividends*

Tax is withheld from dividends paid to shareholders/partners at a rate of 10%. The dividend distribution tax rate may be reduced to 5% under specific conditions.

Double taxation treaties (DTT) provide the following WHT benefits. Note that treaty rates do not override lower non-treaty rates. Treaty members may take advantage of the non-treaty rates.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Non-treaty | 10 | 10 | 7.5 |
| Treaty: | | | |
| Algeria | 15 | 10 | 10 |
| Armenia | 5/10 (1) | 8 | 5 |
| Bahrain | 0 (2) | 0 (2) | 0 (2) |
| Belarus | 7.5 | 5 | 5 |
| Bulgaria | 5 | 7 | 5 |
| Cyprus | 5 | 5 | 0 (2) |
| Czech Republic | 5 | 0 (2) | 5/10 (3) |
| Egypt | 10 | 10 | 5 |
| France | 0 (2) | 0 (2) | 0 (2) |
| Iran | 5 | 5 | 5 |
| Jordan | 10 | 10 | 10 |
| Kuwait | 0 (2) | 0 (2) | 5 |
| Malaysia | 5 | 10 | 8 |
| Malta | 5 (4) | 0 (2) | 5 |
| Morocco | 5/10 (5) | 10 | 5/10 (7) |
| Pakistan | 10 | 10 | 7.5 |
| Poland | 5 | 5 | 5 |
| Qatar | 0 (2) | 0 (2) | 0 (2) |
| Romania | 5 | 5 | 5 |
| Russia | 10 | 5 | 5 |
| Senegal | 10 | 10 | 10 |
| Sultanate of Oman | 5/10 (6) | 10 | 10 |
| Syria | 5 | 10 | 18 |
| Tunisia | 5 | 5 | 5 |
| Turkey | 10/15 (8) | 10 | 10 |
| UAE | 0 (2) | 0 (2) | 5 |
| Ukraine | 5/15 (9) | 10 | 10 |
| Yemen | 10 | 5 | 7.5 |

Notes

1. Shall not exceed:
   - 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the equity capital of the company paying the dividends.
   - 10% of the gross amount of the dividends in all other cases.
2. Dividends, interest, or royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State.
3. Shall not exceed:
   - 5% of the gross amount of royalties paid for the use of, or the right to use, any industrial, commercial, or scientific equipment.

- 10% of the gross amount of royalties paid for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including cinematograph films and films or tapes for radio or television broadcasting any software, patent, trademark, design or model, plan, secret formula, or process, or for information concerning industrial, commercial, or scientific experience.

4. Where the dividends are paid by a company which is:
   - A resident of Lebanon to a resident of Malta who is the beneficial owner thereof, the Lebanese tax so charged shall not exceed 5% of the gross amount of the dividends.
   - A resident of Malta to a resident of Lebanon who is the beneficial owner thereof, the Malta tax on the gross amount of the dividends shall not exceed that chargeable on the profits out of which the dividends are paid.
5. Shall not exceed:
   - 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the equity capital of the company paying the dividends.
   - 10% of the gross amount of the dividends in all other cases.
6. Shall not exceed:
   - 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 20% of the equity capital of the company paying the dividends.
   - 10% of the gross amount of the dividends in all other cases.
7. Shall not exceed:
   - 10% of the gross amount of royalties paid for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including cinematograph films and films or tapes for radio or television broadcasting.
   - 5% of the gross amount of royalties paid in other cases.
8. Shall not exceed:
   - 10% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 15% of the equity capital of the company paying the dividends.
   - 15% of the gross amount of the dividends in all other cases.
9. Shall not exceed:
   - 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 20% of the equity capital of the company paying the dividends.
   - 15% of the gross amount of the dividends in all other cases.

## *Tax administration*

### *Returns*

Taxes on business income in any given year are based on the profits of the previous financial year. Lebanon's fiscal year runs from January to December and is based on the Gregorian calendar. With the special permission of the local tax authorities, companies may, however, use their own accounting year.

Tax returns by artificial persons (entities) must be filed by 31 March of the year following the year of income. Tax returns by capital companies must be filed by 31 May of the year following the year of income.

Submission deadlines of annual declarations for institutions that are exempt from income tax (other than companies) are as follows:

- Before 1 February for institutions adopting the cash basis accounting.
- Before 1 April for institutions adopting the accrual basis accounting and for representative offices that represent non-corporate entities.
- Before 1 June for representative offices that represent corporations.

If taxpayers fail to submit a tax return, realisation penalties will be due.

### *Payment of tax*

The same deadlines for tax returns apply for tax payments.

If taxpayers fail to make payment, late payment penalties will be due.

### *Topics of focus for tax authorities*

Lately, several topics have been of interest to the tax authorities in Lebanon, including transfer pricing, payments of royalties, and management fees to non-resident parties, provisions, and employee compensation.

### *Audit cycle*

The most common ways for the tax authorities to select companies for tax audits are the size of the company, the type of business, and certain risk assessment measures.

Tax audits typically cover a single type of tax.

In a typical situation, a tax audit is likely to take less than one year from first information request to substantive resolution.

### *Statute of limitations*

The tax administration has four years to collect its rights. The period is calculated from the end of year that follows the current business year.

The taxable person may request the refund of excess tax within four years starting from the end of the year where the refund right was created.

The tax administration can exceed the statute of limitations in cases where a profit or revenue has been proven by a court order, arbitration, or inheritance clearance. The extension is limited till the end of the calendar year following the end of the year in which the tax administration was notified of such event.

Under the statute of limitations, a company should keep its accounting books and documentation for ten years.



## *Other issues*

### *Foreign ownership of real estate restrictions*

- Up to 3,000 square metres does not require Council of Ministers approval.
- Exploitation and normal lease right extending for a period of more than ten years cannot be attained without obtaining approval.
- Real estate owned by foreigners, for which approval has been obtained, cannot exceed, over all of the Lebanese territory, 3% of the total area of Lebanon. In each province, the total area owned should not exceed 3% of its area. With respect to Beirut, the total area owned should not exceed 10% of its area.
- The approval is nullified if not acted upon during a period of one year.
- When approval is granted, the building on the real estate should be constructed within a period of five years (renewable once by the Council of Ministers).

### *Choice of business entity*

Lebanon’s commercial law provides for a range of business entities available to both local and foreign investors. These consist of the following:

- Sole proprietorships.
- General partnerships.
- Limited partnerships.
- Joint-stock companies (SAL).

- Limited liability companies (SARL).
- Holding companies.
- Offshore companies.
- Representative offices.

Legal structures commonly used by foreigners in conducting business in Lebanon are SALs, SARLs, and branch offices.

**Joint-stock companies (Société anonyme libanaise or SAL)**
Lebanese joint-stock companies are permitted to engage in all kinds of business activity. Shareholders of a SAL have no liability beyond their actual capital subscriptions.

With a small number of exceptions (such as real estate companies and banks), there are no limits on the amount of capital that can be held by foreign investors.

The management of a SAL is entrusted to a board of directors with a minimum of three and a maximum of 12 members. The majority of board members must be Lebanese, but the chairman may be a foreign national.

- Certain types of businesses such as banks and insurance companies are required to incorporate as joint-stock corporations. Minimum capital: LBP 30 million.
- Taxation: the applicable real profit tax rate is 15% in addition to a WHT on dividends of 10%, reduced to 5% in certain cases, mainly if the shares are listed.

**Limited liability companies (Société à responsabilité limitée or SARL)**
Members of a limited liability company are partners, and the company's capital is divided into parts rather than shares. Partners are liable only to the extent of their parts, and individual partners' claims on the company's capital are fixed in the partnership deed.

All partners may be foreigners, with the exception of companies seeking to engage in commercial representation.

Limited liability companies may not be active in certain sectors of the economy, such as in insurance, banking, fund management, or air transportation.

The transfer of parts in a limited liability company is subject to the consent of partners representing at least three-quarters of the capital. Existing partners enjoy priority in the purchase of parts offered for transfer.

- A limited liability company is managed by one or several directors (managers) who may or may not be selected from among the partners. Minimum capital: LBP 5 million.
- Taxation: the applicable real profit tax rate is 15% in addition to a WHT on dividends of 10%.

### *Intellectual property*
The law in Lebanon does not contain a clear definition of author's rights. It protects all products of the human intellect whether written, pictorial, sculptural, scriptural, or oral regardless of its value, importance, destination, or form of expression.

The law provides patent protection for inventions and plant varieties and a sui generis protection for layout designs of integrated circuits. Furthermore, the law provides protection for undisclosed information. According to an assessment conducted by the World Intellectual Property Organization (WIPO) in July 2002, the Patent law is in complete conformity with the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). It was also pointed out that the provisions of the Plant Varieties exceed the minimum requirements of the TRIPS Agreement.

The law does not explicitly protect notorious trademarks and geographical indications. However, those are provided protection via Lebanon's membership to the Paris Convention. Moreover, Geographical indications are provided protection under the provisions of the new Law on Customs, the Law on Fraud Control, and the Criminal Law.

The copyright protection originally available to literary and artistic works is now extended to computer software, video films, and all kind of audio-visual works. The law provides stiffer penalties for offenders and better compensation to the persons whose rights have been infringed. The manner in which the copyright is breached has also been extended.

# Libya

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## Significant developments

The new Income Tax Law (Law 7 of 2010) became effective on 28 April 2010. The new Executive Regulations, which support the law, are still to be issued, and the previous Executive Regulations (Law 11 of 2004) remain effective. If conflict exists between the new law and the old Executive Regulations, the new law will prevail.

Libya over recent years has been in the process of negotiating and signing a number of double tax treaties. Libya has ratified treaties with Egypt, France, India, Malta, Pakistan, United Kingdom, Sudan, Slovakia, and Maghreb Union. Treaties with Italy, Croatia, Ukraine, Austria, Bosnia, Holland, Spain, Belgium, Russia, Turkey, Syria, Singapore, South Korea, and Belarus are being negotiated.

## Taxes on corporate income

Tax is imposed annually on the same basis for Libyan controlled corporate entities, foreign controlled corporate entities, and branches of foreign companies.

Tax is levied on taxable profits at a flat rate of 20%.

Libya has no provincial income tax laws.

### Surtaxes

There is a flat rate of Jehad Tax assessed at 4% on taxable corporate profits.

Jehad Tax was established by Law 44 of 1970. The purpose of the tax is to further the Muslim cause, in a peaceful manner throughout the world.

## Corporate residence

Corporate residence is not specifically dealt with in the laws of Libya. The tax authorities will seek to assess any income derived from services provided in Libya.

Double tax treaties being signed introduce the concept of permanent establishment. However, general law requires that any foreign entity seeking to provide services in Libya should obtain a business licence which necessitates in registering as a legal entity. Historically unregistered foreign entities have provided services in Libya but this is not in line with the law and is becoming difficult to do so.

## Other taxes

### Value-added tax (VAT)
In Libya, there is no VAT.

### Property taxes
Libya has no specific property taxes.

### Custom duties / Import tariffs
Customs duties were abolished in 2005, except for tobacco and tobacco products. Production and Consumption Taxes were then introduced to protect local industry.

A service fee of 10% on the value on all imports also exists. There are various exemptions to this service fee specifically under Investment Law and within the oil sector.

Other dues and taxes on importation are estimated at 0.5%. Initially a temporary import licence is issued for six months that can be extended to a maximum of three years. A guarantee or a deposit can be provided by the importer to the Customs Department.

### Excise taxes
Libya has no excise taxes.



### Transfer taxes
Libya has no transfer taxes.

### Stamp duty
Stamp Duty Law (Law 12 of 2004, as amended by Law 8 of 2010) levies a schedule of duties and rates on various documents and transactions. The most relevant to corporate entities is Schedule 28, which prescribes the rate of duties on contracts for the provision of services or supply. The duty on main contracts is 1% and on subcontracts 0.1%. Note that there is a duty of 0.5% on all payments to the Tax Department as well.

## Branch income

Tax rates on branch profits are the same as on corporate profits. However, the Income Tax Law allows the Tax Department to assess income tax on branches of foreign companies as a percentage of turnover via the 'deemed profit' basis of assessment. Tax is therefore payable even where tax losses are declared.

The level of deemed profit applied to turnover varies according to the branch's type of business activity. This ranges from 10% - 15% for civil works and contracting (turnkey projects), 15% - 25% for oil service, and between 25% - 40% in the case of design / consulting engineers. A deemed profit of between 5% - 7% is also assessed on local supply. The deemed profit percentage applied to any year will be higher than the profit percentage declared in the annual tax return since the deemed profit basis is applied during the course of a tax audit and is effectively a revenue generating exercise for the tax authorities. Historically tax audits have not resulted in credits or reimbursements.

## Income determination

For any Libyan registered entity, income arising both in Libya and abroad (i.e. worldwide) is assessable in Libya.

No specific rules apply on income determination for the following categories:

- Interest income.
- Partnership income.
- Rent / royalties income.
- Foreign income.

Income Tax Law allows entities to account on an accrual basis.

### Inventory valuation
The Commercial Code allows for inventory to be valued at the lower of cost and net realisable value.

### Capital gains
Any chargeable gains on the sale of capital assets are taxed as ordinary income. For entities assessed on a deemed profit basis, capital gains should be added to the deemed taxable income.

### Inter-company dividends
Libyan taxation laws do not contain any special provisions regarding inter-company dividends.

### Stock dividends
Stock dividends are not specifically dealt with in Libyan taxation laws. The current practice is for dividend distributions not to be taxed.

## Deductions

Taxable income is determined after deducting all expenditure and costs incurred in the realisation of the gross income *(for more details on the deemed profit basis of assessment on branches of foreign companies, see the Branch income section)*.

For any entity (not a foreign branch) seeking to be assessed on an add-back basis, it should ensure, in accordance with Stamp Duty Law, that the majority of its costs can be supported by tax registered documents, i.e. declared payrolls and registered contracts and invoices.

### Depreciation
Depreciation should be calculated in accordance with the Executive Regulations of the law.

| Assets | Depreciation rate (%) |
|---|---|
| **Buildings** | |
| Building in which machines are fixed | 3 |
| Building without fixed machines | 2 |
| **Means of Transport** | |
| Passenger | 20 |

| Assets | Depreciation rate (%) |
|---|---|
| Cargo and freight | 10 |
| Ships | 4 |
| Fishing boats | 4 |
| Aeroplanes | 8 |
| **Furniture** | |
| Office, ship, and domestic furniture | 10 |
| Hotel, restaurant, cafes, and hospital furniture | 20 |
| Work camps outside of cities | 20 |
| Food utensils and furnishings for restaurants, hotels, and the like | 25 |
| **Machines** | |
| Office machines | 10 |
| Electric generators | 20 |
| Computers and accessories | 10 |
| Software | 10 |
| Other machines | 15 |

### *Interest expenses*
No specific rules apply for the deduction of interest expenses.

### *Accrued expenses*
Accrued expenses are permitted if this is the accounting basis chosen.

### *Charitable contributions*
Donations to charities recognised by the state are permitted, up to 2% of net income.

### *Contingent liabilities*
General provisions for contingent liabilities are not permitted and are added back to the accounting profit.

### *Fines and penalties*
No specific rules apply for the deduction of fines and penalties.

### *Goodwill*
Purchased goodwill can be amortised on a straight line basis over five years.

### *Organisation and start-up expenditure*
Organisational and start-up expenditure can be capitalised and amortised over five years on a straight line basis.

### *Net operating losses*
Losses may be carried forward and deducted from future profits, for up to five years. The Income Tax Law has no provision for the carry back of losses.

### *Payments to foreign affiliates*
No specific rules apply for the deduction of payments to foreign affiliates.

## *Group taxation*

There is no recognition of a group for taxation purposes.

No rules exist in general law for the following categories:

- Transfer pricing.
- Treatment of inter-company items.
- Thin capitalisation.
- Related party transactions.

## *Tax credits and incentives*

Exemptions to corporate income tax exist most notably under the Investment Law. The Tourism Investment Law allows a ten year corporate income tax holiday from the commencement of project operations. General projects registered under the Investment Law are permitted a five year corporate income tax holiday with a possibility to extend for a further three years.

Exemptions also exist for strategic infrastructure projects. Such exemptions must be awarded by the General People's Committee (GPC), which is the legislative body, either by ratifying the relevant contract, which includes a tax exemption clause, or by the issuance of a separate law.

Investment law also provides exemptions for customs duties and stamp duty. The exemptions which exist are bestowed on subcontractors to the relevant projects.

Petroleum Law provides exemption to customs duties on oilfield specific equipment and materials which is also provided to oil service companies.

## *Withholding taxes*

Libyan law has no withholding taxes. Generally, for unregistered foreign entities seeking to register a contract with the tax authorities, income tax will be assessed (and must be settled) on a deemed profit basis at the time of registration. It may be possible to negotiate a withholding tax in preference to the aforementioned general procedure for a significant contract where there is greater uncertainty as to the estimated contract value.

## *Tax administration*

### *Returns*

The tax year is generally a calendar year, although assessments can be made on the basis of a company's own year-end, provided permission is granted in advance from the Tax Department, and the company then adheres consistently to the same date. All corporate entities must make an annual filing within four months of its year-end or one month within its audit report, whichever is earlier.

### *Payment of tax*

Corporate income tax is payable on a quarterly basis (10 March, 10 June, 10 September, and 10 December) normally commencing the first quarter date after an assessment has been issued.

### *Statute of limitations*

The statute of limitations for income tax purposes is seven years.

### *Late payment penalties*

A late payment penalty is assessed on the tax due at the rate of 1% to a maximum of 12%. In addition, the remaining quarterly payments are due immediately for failing to make an instalment on time.

The law also imposes the following penalties:

- A fine of not less than three times the amount of unpaid tax due shall be applied to any person who fails to pay tax by the due date.
- Without prejudice to any harsher penalty, a fine of not less than four times the amount of tax due and unpaid will be applied to any person who, with intent to evade all or part of the tax, commits any of the following acts or abets, agrees, or aids a person who commits such an act:
  - the making of false statements in declarations submitted under this law
  - the preparation of false accounts, books and records, reports, or budgets
  - the use of fraudulent means to conceal or attempt to conceal taxable amounts due under this law.

## *Other issues*

### *Statutory Books*

Business entities operating in Libya are required by Libyan Law to maintain a General Ledger and a General Journal (i.e. the Statutory Books).

Before use, these must be stamped as registered with the Revenue Authorities and the Commercial Court. It should be noted that a Ledger or Journal will not be registered if it already contains accounting entries (i.e. one cannot register existing books of account).

Similarly, transactions pre-dating the date the books are registered will be disallowed. In theory, transactions should be entered daily, but in practice, most companies write up their statutory records on the basis of monthly transactions summaries.

The Tax Inspector will always request production of the Statutory Books at the commencement of a tax audit. If these are not available, a perfunctory audit of the English (or other language) books of account will be made, and it is likely that there will be a punitive increase in taxable income as a consequence.

Please note that a new Commercial Code is being considered which may allow approved computer based ledgers to be used instead of the traditional manual ledgers. At this juncture, uncertainty exists as to who would provide such approval and on what basis.

# Liechtenstein

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## Significant developments

On 1 January 2011, a completely new tax law entered into force. As a result, the following important changes have been implemented:

- In principal, a profit tax of 12.5% for all corporations, foundations, and establishments.
- A standardized deduction of interest on equity (4% for 2011), which reduces the effective tax rate depending on the equity financing.
- Tax-exemption of dividends arising from participations in domestic or foreign legal persons, irrespective of the capital ownership percentage and the holding period.
- Tax-exemption of capital gains from the sale or liquidation of participations in domestic or legal foreign persons.
- Indefinite loss carryforward period.
- Tax deduction of 80% of the income from intellectual property rights from patents, trademarks, models, and utility models, provided that they are protected by entry in a domestic, foreign, or international register. This is only applicable to intellectual property rights created or acquired as of 1 January 2011.
- Group taxation scheme for subsidiaries directly or indirectly controlled with more than 50% of the voting rights and more than 50% of the rights pertaining to the nominal capital.
- Abolition of old privileged taxation schemes for holding and domicile companies after 2013.
- Low taxation of 1,200 Swiss francs (CHF) for Private Vehicle Solution (PVS), which are corporations, foundations, and establishments finally held by individuals that only engage the administration of their own assets and do not carry out any economic activities.
- Abolition of 4% withholding tax (coupon tax), excluding reserves accumulated prior to 1 January 2011 (old reserves).

*For more detailed information, please refer to the following sections.*

## Taxes on corporate income

In principle, all corporations, foundations, and establishments are subject to a profit tax at a flat rate of 12.5%. Resident companies are subject to unlimited tax liability on worldwide income. Non-resident companies are subject to limited tax liability for income from properties or branches within Liechtenstein.

### Minimum tax

All legal entities are subject to an annual minimum tax of CHF 1,200. This tax can be fully credited to the profit tax.

## Corporate residence

A company is considered to be resident in Liechtenstein if its registered seat (address) or place of effective management is within Liechtenstein.

Companies, who have neither a domicile nor effective place of management in Liechtenstein, as well as special asset dedications without legal personality, are subject to limited tax liability for the following income:

- Corporate income from the cultivation of domestic real estate used for agriculture and forestry.
- Rental and lease income from real estate situated within Liechtenstein.
- Taxable net corporate income of permanent establishments (PEs) situated in Liechtenstein.

### Permanent establishment (PE)

Please note that Liechtenstein has only a few double tax treaties *(see the Withholding taxes section)*. However, Liechtenstein is in the process to negotiate various new double tax treaties and has included PE definitions according to the Organisation for Economic Co-operation and Development (OECD) model treaty.

## Other taxes



### Value-added tax (VAT)

Liechtenstein has adopted the VAT law of Switzerland, having its own administration in Vaduz.

The general VAT rate is 8%. A reduced rate of 2.5% is applicable to deliveries of food, drugs, newspapers, magazines, and books. Furthermore, lodging/accommodation is taxed at a reduced rate of 3.8%. Note that various services are VAT-exempt (e.g. health, social security, education, banking, insurance).

Any person who, irrespective of legal form, carries on a business is liable for VAT. Any person liable for VAT that is involved in domestic entrepreneurial activity with a taxable turnover which is less than CHF 100,000 within a financial year can be exempted from taxation. Special regulations apply for non-profit institutions as well as for non-profit sport or cultures clubs. Reverse charge is applicable for services and certain deliveries from an entity domiciled abroad.

### Stamp duty

According to the customs union treaty of 1923 between Switzerland and Liechtenstein, the Swiss stamp duty tax law of 27 June 1927 is applicable in Liechtenstein. The stamp duty law includes the stamp duty tax and the security transfer tax.

#### Stamp duty tax

Upon the formation of legal entities whose capital is divided into shares (e.g. company limited by shares, limited liability company, establishment with capital divided into shares) the stamp duty amounts to 1% of the nominal value or the higher amount effectively paid (above par). The first CHF 1 million is tax exempt.

The same duty also becomes due when the capital is increased or when the shareholders make contributions without increasing the capital. Stamp duty is also due on bonds (0.6 per million to 1.2 per million) and money market certificates (0.6 per million).

Various exemptions should also be considered.

**Security transfer tax**
Security transfer tax is due on all transactions of qualifying securities, if a security dealer is involved. The tax amounts to 0.15% for domestic securities (Switzerland and Liechtenstein) and 0.3 % for foreign securities.

In particular, banks and financial intermediaries are liable for settlement. Furthermore, legal entities with qualifying securities with a book value of more than CHF 10 million also qualify as security dealers.

### *Formation tax (Gründungsabgabe)*
Unless Swiss stamp duty law applies, a formation tax in the amount of 1% of the statutory nominal capital is levied upon the formation or relocation of legal companies in Liechtenstein (e.g. foundations) as well as for capital increases.

The general tax rate of 1% is reduced to 0.5 % for amounts greater than CHF 5 million and to 0.3 % for amounts greater than CHF 10 million. The first CHF 1 million is tax exempt.

Foundations are subject to the formation tax with a tax rate of 0.2%.

### *Tax on insurance premiums*
Liechtenstein levies a tax on certain insurance premiums. The tax rate amounts to 5% of the cash premium (for life insurance 2.5%). Cash premiums in foreign currency have to be converted to Swiss francs at the time the tax claims arise.

Various exemptions should also be considered.

### *Real estate profit tax*
Capital gains from the sale of real estate, or equivalent actions with the same result, are subject to a separately assessed real estate profit tax. The taxable gain is generally the difference between proceeds of the sale and the original purchase price of the property plus any capital expenditure incurred. The basic tax rate is between approximately 2% and 14%, depending on the amount of taxable real estate gain. The transfer of the economic ownership of real estate (e.g. via the sale of the majority of the shares in a real estate company) triggers real estate tax as well.

### *Capital tax*
As of 1 January 2011, annual capital tax has been abolished.

### *Excise taxes*
Several excise taxes apply in Liechtenstein (e.g. petroleum tax, tobacco tax, car tax, CO2 tax, beer tax, salt tax, taxation of distilled spirits).

## *Branch income*

The same principles applicable to corporations also apply for branch income, provided that transactions with the head office or other branches are at arm’s length.

Liechtenstein taxation is imposed on the profit attributable to branch and on the capital invested in the branch. The minimum tax of CHF 1,200 is also applicable.

There is no withholding tax (WHT) on profit transfer to the head office.

## *Income determination*

### *Inventory valuation*

Inventories must be stated at the lower of cost or market. Cost is generally determined by the first in first out (FIFO) or by the average cost method. The tax authorities permit a general reserve against stock contingencies of up to one-third of the inventory cost or market value at the balance sheet date without inquiry into its justification, provided a detailed record of inventory is available for review by the tax authorities. The need for a reserve in excess of this amount (e.g. for obsolescence, slow-moving-stocks) must be substantiated to the satisfaction of the tax authorities.

### *Dividends/capital gains (from shares)/liquidation proceeds*

Dividend income, capital gains derived from the sale of shares, and liquidation proceeds are tax-exempt.

### *Foreign income*

Resident corporations operating locally are generally taxed on their worldwide income. However, income from foreign real estate and PEs situated abroad is exempt from taxation in Liechtenstein.



## *Deductions*

### *Depreciation and amortisation*

Depreciation of tangible fixed assets and amortisation of intangible assets is allowed to the extent it is 'commercially justified'. For tax purposes, either the straight-line (depreciation based on the acquisition value) or the declining-balance method (depreciation based on the book value) may be used. Depreciation and amortisation not recorded in statutory accounts are not deductible for tax purposes.

A special (higher) rate of depreciation may be allowed for assets used only for short periods or for assets for which a rapid decrease in value can be proved.

The depreciation/amortisation rate per annum of various property types are provided below. Note that these depreciation rates relate to write-downs on the book value. If the write-down is performed on the acquisition value, then the rates enumerated below should be reduced by half.

| Property type | Rate per annum (%) |
|---|---|
| **Immovable assets** | |
| Real estate (dwelling houses, offices, shops, restaurant and hotel buildings, industrial buildings, factories, warehouses, and parking spaces) | 5 |
| **Movable assets** | |
| Mobile structures, technical installations (air conditioning plant, gas and electricity mains for industrial purposes), elevators, investments in foreign real estate, high rack warehouses, and airplanes | 15 |
| Office furniture and machines, workshop, and storeroom equipment | 20 |

| Property type | Rate per annum (%) |
|---|---|
| Furniture used for the hotel and restaurant trade | 25 |
| Machines and accessories for production purposes, vending machines, telephone installations, and operating applications | 30 |
| Machinery used in more than one shift or used under heavy conditions, motor vehicles | 35 |
| Information technology (hardware and software), office furniture and machines, workshop and storeroom equipment, hotel and restaurant cookery, cutlery, and linen | 50 |
| Officially approved installations and equipment against water pollution, energy-saving equipment, and installations using solar energy | 50 |
| **Intangible assets** | |
| Goodwill, patent, licence, and other rights of use | 40 |

### *Equity interest deduction*

The equity interest deduction is a standardised deduction for interest on equity based on the multiplication of the 'modified' equity by the interest rate (according to the annual finance law). For 2011, the equity interest rate is 4 %.

To determine the modified equity, the following terms have to be considered:

- Paid-in capital and open reserves plus taxed hidden reserves:
  - Deduction of own shares.
  - Deduction of participations/shares.
  - Deduction of foreign real estate.
  - Deduction of assets belonging to foreign PEs.
  - Deduction of non-operating related assets.
- Equity increases and decreases, based on the capital at the beginning of the business year.

| | Example 1 | Example 2 | Example 3 | Example 4 | Example 5 | Example 6 |
|---|---|---|---|---|---|---|
| Modified equity | 1,000,000 | 500,000 | 500,000 | 1,000,000 | 1,000,000 | 1,000,000 |
| Loans | 0 | 500,000 | 500,000 | 0 | 0 | 0 |
| Profit | 100,000 | 100,000 | 200,000 | 1,000,000,000 | 30,000 | 60,000 |
| Interest on loans (4%) | 0 | -20,000 | -20,000 | 0 | 0 | 0 |
| | | | | | | |
| Profit | 100,000 | 80,000 | 180,000 | 1,000,000,000 | 30,000 | 60,000 |
| Interest on equity (4%) | -40,000 | -20,000 | -20,000 | -40,000 | -40,000 | -40,000 |
| Taxable profit | 60,000 | 60,000 | 160,000 | 999,960,000 | -10,000 | 20,000 |
| Profit tax rate | 12.50% | 12.50% | 12.50% | 12.50% | 12.50% | 12.50% |
| Tax burden | 7,500 | 7,500 | 20,000 | 124,995,000 | 0 | 2,500 |
| **Effective tax rate** | **7.50%** | **9.38%** | **11.11%** | **12.50%** | **0.00%** | **4.17%** |

### *Deduction for income from intellectual property (IP)*

A deduction of 80% is allowed on the net IP income which was created or acquired after 1 January 2011. IP, in the sense of the tax law, consists of patents, trademarks, models, and utility models. This tax rule was approved by the European Free Trade Association (EFTA) Supervising Authority on 1 June 2011.

***Taxes***
Taxes are not deductable in Liechtenstein.

***Net operating losses***
A loss can be carried forward and offset against the profits for future years. There is no limitation of loss carryforwards as well as loss offsetting. Losses cannot be carried back.

***Payments to foreign affiliates***
Interest, royalties and licenses, and other fees to foreign affiliates are allowed as deductions to the extent that they meet the arm's-length test (i.e. equivalent to charges that would be made by an unrelated third party).

For interest payments between affiliated companies or between shareholders and companies, Liechtenstein tax authorities publish safe harbour rules annually (i.e. generally accepted interest).

## *Group taxation*

Resident and non-resident corporations have the possibility to opt for group taxation if they meet the legal requirements (such as more than 50% of capital and 50% of voting rights). The ultimate group leader must either be a corporation domiciled in Liechtenstein or with the effective place of management in Liechtenstein.



In order to form multi-level group structures, sub-groups may also be built. The same rules are applicable for the group leader of the sup-group as for the primary group leader.

The group leader can decide, for each company which fulfils the conditions, which company will be included in the group or not.

Losses of group members can be offset against profits of the (sub) group leader within the same year. The offsetting is only possible under the following conditions:

- Only losses incurred after the option for group taxation can be considered.
- Losses need to be calculated according to Liechtenstein profit calculation rules.

The losses are allocated to the (sub) group leader according to the direct participation quota of the (sub) group leader to the group member whose losses should be offset. If the losses cannot be used at the level of the (sub) group leader, they can be allocated to other group members. However, the minimum tax is applicable for each group member.

Losses which have been attributed to the (sub) group leader must be adjusted in the following cases:

- Losses can be offset against profits on the level of the group member.
- Exit of group member from the group.
- Reduction of participation quota of a group member.
- Depreciation is made on a participation due to losses.

The (sub) group leader must provide evidence annually that no adjustment needs to be made.

### *Transfer pricing*
Liechtenstein does not have specific transfer pricing rules apart from the rule that intra-group transactions are carried out at arm's-length terms.

### *Thin capitalisation rules*
Liechtenstein does not have thin capitalisation rules.

## *Tax credits and incentives*

As of 1 January 2011, tax privileges for certain legal structures, such as domiciliary and holding companies, have been abolished. Companies which benefited from such privileges will continue to be taxed accordingly thru 2013, unless they opt for the ordinary taxation scheme. These companies also have to pay the minimum tax of CHF 1,200 annually.

The following tax incentives are applicable as of 1 January 2011:

- Profit tax exemption for corporations which have an irrevocable charitable, cultural, or ideal purpose without commercial activity.
- Profit tax exemption of dividend income and capital gains on shares/participations (especially interesting for holding companies).
- Notional interest deduction on equity.
- Private vehicle solution.

### *Private vehicle solution (Privatvermögensstrukturen or PVS)*
The new law of Liechtenstein offers tax privileges for PVSs. A PVS has no economic activity. The purpose of a PVS is to acquire, hold, administrate, and sell financial instruments according to the assets management law as well as cash and bank accounts. Participations may only be held if it can be proved that the shareholders or beneficiaries have no influence on the administration of this company.

The articles of the PVS must contain a clause that the regulations for PVS are applicable. Exemptions of this rule are applicable for legal entities which existed before the introduction of the new tax law as of 1 January 2011.

The investors of a PVS must be individuals who administrate their own assets or structures acting in the interest of individuals.

The company or the audit company needs to confirm, upon formation or after major changes, that the conditions for the PVS structure are fulfilled. This is supervised by the tax authority or a neutral certified accountant.

A PVS only pays the minimum tax of CHF 1,200 annually.

This tax scheme was qualified as in conformity with the provisions on state aid set out in article 61 of the Agreement on the European Economic Area by the EFTA Surveillance Authority (ESA).

## Withholding taxes

### Coupon (withholding) tax

Until the end of 2010, Liechtenstein had a coupon tax of 4% on dividend payments and certain interest payments. The coupon tax was abolished with the new tax law as from the beginning of 2011. This means that no coupon tax is due on new reserves incurred after the end of 2010 or on interest payments. However, the coupon tax still applies with regard to old reserves (reserves existing on 1 January 2011). The tax base for calculation of the coupon tax on old reserves is the taxable capital dated 31 December 2010 (i.e. equity according to commercial balance sheet, adjusted with taxed hidden reserves). With regards to future distributions, old reserves have priority.

#### Transitional rule

Distributions of old reserves in 2011 and 2012 will be taxed at a reduced rate of 2%. Companies can either distribute during this time frame or opt for the taxation of the old reserves without effective distribution.

Distributions of old reserves as of 2013 are taxed at the ordinary rate of 4%.

The transitional rule is not applicable for liquidations of ordinary taxed companies terminated before 30 June 2011.

### Tax treaties

Currently, a comprehensive double taxation treaty on income is in effect with Austria, Luxembourg, and a limited one with Switzerland.

Recently Liechtenstein initiated double taxation treaties with San Marino, Uruguay, and Hong Kong. Furthermore, various tax information exchange agreements (TIEAs) have been concluded.

The Governments of Liechtenstein and the United Kingdom signed a Memorandum of Understanding (MOU) relating to cooperation in tax matters, which includes the Liechtenstein disclosures facility (LDF). According to these regulations, financial intermediaries in Liechtenstein are required to show that their UK costumers have been declaring their Liechtenstein investments to HM Revenue and Customs (HMRC). Disclosure can be made between 1 September 2009 and 31 March 2015 and benefiting from favourable rules. In certain circumstances, even accounts or assets outside of Liechtenstein can be transferred in order to take advantage of the terms of the LDF.

## Tax administration

### Returns

Companies resident in Liechtenstein or with PEs in Liechtenstein must file a tax return by 1 July of the calendar year following the fiscal year-end.

The tax assessment issued by the tax administration is based on the company's tax return, including the attachments and the financial statements filed.

### Payment of tax

Companies must pay tax within 30 days of receipt of the assessment. The defaults charge rate is 5%.

## *Other issues*

### *Restructurings*

Restructurings (e.g. change of corporate form, merger, spin-off) can be carried out tax neutrally, if certain conditions are met.

# Lithuania

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## Significant developments

The following recent amendments have been made to the Law on Corporate Income Tax (CIT) and the Law on Value-Added Tax (VAT):

- Application of the reduced CIT rate (5%) for profit from agricultural activities was extended for an unlimited period.
- A part of profit attributed to payments for board and supervisory board members was recognised as an allowable deduction for 2010 and later tax periods.
- Expenses for the benefit of employees were recognised as allowable deductions for 2010 and later tax periods, provided that such benefit is subject to personal income tax (the benefit is treated as taxable or non-taxable income).
- The annual CIT return must be submitted to the Tax Authorities by the first day of the sixth month after the end of the financial year. The deadline for CIT payment was not changed (i.e. CIT must be paid by the first day of the tenth month after the end of financial year).
- The application of reduced VAT rates for heating (9%) and medicine compensated by the state (5%) was extended until 31 December 2011.
- The VAT rate of 9% was introduced for hotel and special accommodation services to be applicable until 31 December 2011.
- The application of the reduced VAT rate of 9% for books and non-periodical publications was extended for an unlimited period.



## Taxes on corporate income

The standard corporate income tax (CIT) rate is 15%. It was reduced from 20% to 15% as of 1 January 2010.

Generally, CIT is applied on taxable income received by a Lithuanian tax resident from its local and worldwide activities. Taxable income is calculated by reducing general income of a certain tax period with deductible expenses and non-taxable income.

Income of a tax resident company is not subject to taxation in Lithuania if it was received from activities through a permanent establishment (PE) in a foreign country which is in the European Economic Area (EEA) or which has a double tax treaty (DTT) with Lithuania and if the income was subject to taxation there.

Furthermore, CIT may be reduced or even not applied if foreign-sourced income received not through a PE is taxed with a withholding tax (WHT) in a foreign country and this country has a DTT with Lithuania.

Non-resident companies are generally taxed on Lithuania-sourced income received through a local PE and reduced by deductible expenses or on income subject to WHT in Lithuania.

### *Reduced CIT rate for small companies*
Entities with fewer than ten employees and less than 500,000 Lithuanian litas (LTL) (approximately EUR 145,000) in gross annual revenues can benefit from a reduced CIT rate of 5%.

### *CIT regime for certain maritime activities*
The rate of CIT on certain maritime activities is 15%, with the base set by reference to the functional capacity of the ship. This fixed CIT may be applied to maritime entities that fulfill certain conditions indicated in the law. An election must be made to the tax authorities to apply this regime.

### *Local taxes*
There is no local or municipal CIT.

## *Corporate residence*

A company is resident in Lithuania if it incorporates there or its activities create a PE for tax purposes.

### *Permanent establishment (PE)*
According to local legislation, a foreign company is deemed to have a PE in Lithuania when:

- it permanently carries out commercial activities in Lithuania in whole or in part
- it carries out its activities through a dependent representative (agent)
- it uses a building site or construction, assembly, or equipment objects, or
- it uses equipment, including drilling installations and ships, for exploration or extraction of natural resources.

DTTs may establish different rules of PE recognition. According to domestic law, where there is a DTT, the provisions of the treaty take precedence.

A PE must be registered as a taxpayer with the tax authorities in the territory where its activities are carried out. Its profits are subject to CIT at the rate of 15%.

## *Other taxes*

### *Value-added tax (VAT)*
The standard VAT rate is 21%.

A reduced rate of 9% applies to:

- books and non-periodicals
- supply of heating of residential premises and the supply of hot water to residential premises as well as heating of cold water (applicable thru 31 December 2011), and
- hotel and special accommodation services (applicable thru 31 December 2011).

A reduced rate of 5% applies to compensated pharmaceuticals and medical aid devices (applicable thru 31 December 2011).

The compensational rate for farmers is 6%.

In general, supplies of goods and services made by a taxable person performing its economic activity for a consideration within the territory of Lithuania, as well as imports of goods, are subject to VAT.

**Exempt with credit (zero-rated)**

Goods and services that are exempt with credit (zero-rated) include, but are not limited to, the following:

- Supply of goods exported outside of the European Union.
- Goods acquired by non-EU resident passengers in Lithuania and carried out from the European Union.
- Goods and services for vessels and aircraft.
- Transportation and any directly linked ancillary services related to export of goods and any directly linked ancillary services related to the import of goods when the value of these services shall be included in the customs value of the goods.
- Transportation of imported goods carried to a VAT exemption warehouse or temporarily stored under customs' supervision, placed in a free economic zone or free warehouse, put under customs warehousing procedure, processed under customs' supervision, temporarily imported for processing without levying customs duties, temporarily imported without implicitly levying customs duties, or put under internal or external transit procedure.
- Issuance of International Road Transportation (TIR) and Admission Temporaire/ Temporary Admission (ATA) transportation documents.
- Insurance and certain financial services directly related to export of goods from the European Union.
- Supply of goods to sponsorship or charity recipients registered in Lithuania and listed in the Lithuanian law on charity and sponsorship, if the goods are exported by the recipients as sponsorship or charity to non-EU organisations which may be recipients of sponsorship or charity under the law.
- Supply of maintenance and processing services for movable property supplied to non-taxable persons established outside Lithuania that have no fixed establishment within the country, provided that the property was temporarily imported for maintenance, repair, processing, etc. in the European Union and will be carried out from the European Union after supply of these services.
- Services of disclosed agents participating in certain transactions of supply of goods or services to local taxable and non-taxable persons where zero-rated VAT is applied and transactions of supply of goods or services where the supply of goods or services is considered carried out outside the European Union.
- Supply of goods to VAT payers registered in another EU member state when these goods are carried out from Lithuania to another EU member state.
- Supply of new means of transport supplied to any person when new vehicles are carried out from Lithuania to another EU member state.
- Supply of goods subject to excise duty when they are supplied to a company not registered for VAT purposes and the goods are carried out from Lithuania to another EU member state.
- Supply of goods in certain cases related to international trade.

In order to apply zero-rated VAT on goods carried out from Lithuania, VAT payers must hold supporting documents as evidence that these goods were actually exported from the European Union or carried out from Lithuania to another EU member state.

**Exempt without credit**

Goods and services that are exempt without credit include, but are not limited to, the following:

- Personal or public health care services, under certain conditions.
- Supply of human organs, blood, human milk, and dental prostheses supplied by dentists or dental technicians.
- Transportation of ill, wounded, or other persons requiring medical care by special means of transport.
- Social services supplied by institutions for children and young people, nursing homes for the elderly, and/or by care or guardianship institutions for disabled or by other non-profit entities.
- Education and training services.
- Cultural and sports services rendered by non-profit entities.
- Services provided by political parties, trade unions, and other non-profit membership based legal entities to their members when these services correspond to that set out in the articles of association and are provided free-of-charge, except for membership fees.
- Services provided by religious communities, other communities, and centres to their members if these services correspond to the purposes of these communities set out in their canons, statutes, and other documents and are provided free-of-charge, except for donations.
- Postal services and directly related goods supplied by government-listed universal postal services providers, except for individually negotiated postal services.
- Radio and TV broadcasting services provided by non-profit legal entities.
- All types of insurance and re-insurance services and related services rendered by insurance and re-insurance agents.
- Financial services meeting certain requirements.
- Lotteries and gambling.
- Postage stamps and other government-listed special signs available for sale against their nominal value (this provision shall be applied only to the postage stamps which can be used as a confirmation of payment for postal services in Lithuania).
- Letting of residential premises (except for accommodation services provided by hotels, motels, camping, and other accommodation services or letting of residential premises not indicated above when the letting period does not exceed two months).
- Letting or sale of immovable property, other than residential premises (certain exceptions apply).
- Supply of goods where the VAT payer has not deducted any proportion of the VAT on purchases and/or importation thereof (certain conditions apply).

Intra-Community acquisitions (i.e. acquisitions of goods from other EU member states) are VAT-exempt provided that:

- the supply of such goods in Lithuania would be VAT-exempt or zero-rated or the import of such goods would be VAT-exempt
- the purchaser who is a foreign taxable person would be able to refund this VAT, and
- triangular transactions meet certain criteria.

As of 2010, supply of a business or parts thereof is treated as being out of scope of VAT (under certain conditions). As of 2011, this exemption applies both to sale and to contribution in kind.

**Option to tax**
Option to tax is applicable to:

- lease of immovable property
- sale or other transfer of old immovable property (i.e. used for more than 24 months), and
- financial services meeting certain requirements.

Option to tax may be exercised only if the customer is a taxable person registered for VAT purposes. If a VAT payer decides to use the option to tax, it is valid for at least 24 months.

### *State dues (stamp taxes)*
State dues are payable on activities of state institutions, such as the issuance of documents having legal force and other deeds.

### *Land tax*
Lithuanian and foreign entities are subject to land tax collected by the municipalities for the land they own in Lithuania. Roads for general use and forestland are exempt. The annual tax rate is 1.5% of the taxable value, which is determined according to the rules established by the government. The assessment and payment terms are set forth by the municipalities, which are also entitled to grant land tax incentives.



### *Land lease tax*
State-owned land that is leased for Lithuanian and foreign companies is subject to land lease tax at a rate established by the municipalities. The minimum tax rate set by the government is 0.1%, and the maximum rate is 4% of the value of the land.

### *Real estate tax*
Real estate tax at a rate ranging from 0.3% up to 1% is levied on the value of real estate owned by individuals and used for commercial purposes or owned by legal entities (with certain exemptions). Municipal councils establish a specific tax rate for real estate situated in their territories annually.

### *Excise taxes*
Excise duty is imposed on the following goods produced in or imported into Lithuania: ethyl alcohol and alcoholic drinks, including beer and wine; processed tobacco, including cigarettes, cigars, cigarillos, and smoking tobacco; energy-related products, including petrol, kerosene, gasoline, fuel oil, natural gas, and their substitutes and additives; coal, coke, and lignite; and electricity (as of 1 January 2010). The tax rate depends on the type and quantity of goods.

### *Customs duties*
EU customs law is applicable in full.

EU customs law, also known as the Community Customs Code, compiles the rules, arrangements, and procedures applicable to goods traded between the European Community and non-member countries. The Community Customs Code indicates an obligation on a person to pay the amount of the import or export duties which apply to specific goods under the Community provisions in force. The application of the EU customs law means that:

- trade between Lithuania and other EU countries is customs-free
- imports from non-EU countries are subject to EU customs tariffs, and
- numerous free trade agreements concluded between EU and non-EU countries apply to Lithuania.

### *Environmental tax*
Environmental tax is imposed on pollutants discharged into the environment, a few specified products (e.g. tyres, batteries), and certain types of packaging.

### *Tax on natural resources*
A tax on natural resources is payable on the value of extracted natural resources.

## *Branch income*

A branch of a foreign company is defined as a structural subunit of a foreign company, which has an establishment in Lithuania and is entitled to engage in commercial activities in Lithuania as well as conclude contracts and undertake obligations according to the power of attorney issued to the branch by its founder. A branch does not have the status of a legal person. It is taxed in the same manner as a PE *(see the Taxes on corporate income section).*

## *Income determination*

### *Inventory valuation*
Under domestic accounting legislation, stock used in the production and included in the cost of produced products is valued in the financial statements by the first in first out (FIFO) method. The last in first out (LIFO), weighted-average, progressive-average, actual-price, or another method that corresponds to the stocks' movement can also be used. However, the method used must be disclosed in the notes to the annual accounts, and, among other things, the note must report the profit that would have been calculated if the FIFO method of valuation had been used. For CIT purposes, usage of another method than FIFO should be approved by the tax authorities.

### *Capital gains*
Capital gains are taxed as part of the corporate profit of the enterprise.

Capital gains are treated as non-taxable income when they are derived from the transfer of shares in a company incorporated in the European Economic Area (EEA) or in a country with which Lithuania has a valid DTT and that pays CIT or an equivalent tax. This holds true if the Lithuanian holding company holds more than 25% of voting shares for a continuous period of (i) at least two years or (ii) at least three years when the shares were transferred in one of the established forms of reorganisation. Certain restrictions apply.

### *Dividend income*
The receiving company does not include the dividends received from other entities in its taxable income.

### *Exemptions from taxable income*

The following types of income are exempt from CIT:

- Insurance indemnity not in excess of the value of lost property or other losses or damages, the refunded part of insurance premiums in excess of the premiums deducted from income in accordance with the procedure established, and the part of insurance indemnity in excess of the premiums deducted from income in accordance with the procedure established.
- Proceeds of a bankrupt company received from sale of its property.
- The balance of the formation fund of an insurance company as prescribed by the law on insurance.
- Investment income of investment companies with variable capital and closed-end investment companies acting in accordance with the law on collective investment undertakings, except for dividends and other distributable profits.
- Income derived by health care institutions for their services that are financed from the funds of the Compulsory Health Insurance fund.
- Income derived from revaluation of fixed assets and liabilities as established by laws and regulations, except for income derived from the revaluation of derivative financial instruments acquired for hedging purposes.
- Default interest except for that received from foreign companies registered or otherwise organised in blacklisted territories or residents of such territories *(see Blacklisted territories in the Deductions section)*.
- All or part of the profit gained from legal entities of unlimited civil liability that are payers of CIT and with income that is subject to CIT under the law or to a similar tax under respective statutes of foreign countries, with certain exceptions.
- Fees collected by seaports and airports, charges for air traffic navigation services, and funds collected from the lease of seaport-owned land.
- Results arising from adjustments made for the previous tax periods as prescribed by the law on accounting.
- Indemnification for damages received by the company, with certain exceptions.
- Compensation received according to the Lithuanian programmes of the EU financial support relating to taking fishing ships for scrap.
- Life insurance payments received by insurance companies, provided the term of the life insurance policy is valid for not less than ten years or at the date of the receipt of the insurance benefit the recipient has reached the pension age in accordance with the additional law on pensions. Additionally, insurance investment income of insurance companies, except for dividends and other distributable profit, are exempt along with investment insurance income of insurance companies received according to the contracts of life insurance occupational pensions concluded in accordance with the law on accumulation of occupational pensions.
- Direct and other compensational allowances, which are received by units performing agricultural activities to maintain their level of income, which meet the requirements established in the laws and other legal acts of Lithuania.

### *Foreign income*

Income is not subject to taxation in Lithuania if it was received from activities through a PE in a foreign country which is in the EEA or which has a DTT with Lithuania and if the income was subject to taxation there. Since such income is not subject to taxation in Lithuania, costs related to the income cannot be deducted from income that is subject to taxation in Lithuania.

## *Deductions*

Allowable deductions include all the usual costs that an entity actually incurs for the purpose of earning income or receiving economic benefit unless the law on CIT provides otherwise.

Limited deductible expenses include the following:

- Depreciation or amortisation expenses of fixed assets: for tax purposes assets cannot be depreciated faster than indicated in the CIT law *(see below)*.
- Maintenance, repair, and reconstruction expenses of tangible fixed assets: if the repair or reconstruction increase the service period and improve the qualities (useful characteristics of the fixed assets), the value of repair or reconstruction shall be added to the acquisition value of the tangible fixed assets.
- Business travel expenses: deductible with restrictions.
- Advertising and representation expenses: 75% of representation expenses are deductible.
- Natural losses: deduction limited to not more than 1% of turnover.
- Taxes: deductible with restrictions *(see below)*.
- Bad debts: deductible only if proved and specific criteria met, provisions are non-deductible.
- Contributions and expenses for the benefit of employees: deductible with restrictions.
- Special provisions of credit institutions and insurance companies: calculated according to the methods established by the Bank of Lithuania and the Commission of Insurance Supervision.
- Sponsorship: the double amount deductible (i.e. 200% deduction is available) but only if provided to registered recipients and only up to 40% of taxable result before deduction of sponsorship and utilisation of tax losses carried forward.
- Membership fees, contributions, and premiums: deductible with restrictions.
- Losses of previous tax periods: losses can be carried forward for indefinite period if certain requirements are met *(see below)*.

Non-deductible expenses include the following:

- VAT payable to the budget and CIT *(see below)*.
- Default interest (forfeit), fines, and late interest paid to the state budget as well as other sanctions imposed for violations of laws and regulations of Lithuania.
- Interest or any other indemnity paid due to non-performance of contractual obligations by related parties.
- Amount of the limited deductible expenses in excess of the established limits.
- Expenses attributed to allowable deductions more than 18 months past, although the payments for goods or services supplied by the entities registered or otherwise organised in blacklisted territories *(see below)* have not been made.
- Sponsorship and gifts that do not correspond to the requirements of CIT law.
- Payments to blacklisted territories *(see below)* if they are not verified and payments are not subject to withholding tax (WHT).
- Indemnification for damages inflicted by the entity.
- Dividends or otherwise distributed profits.
- Other expenses not related to the deriving of income and not attributed to operating activities of the entity as well as the expenses that are not considered allowable deductions under the law.
- Amounts resulting from adjustments and corrections of errors of previous tax periods.

- Expenses related to revaluation of fixed assets and securities.
- Deductible or limited deductible expenses attributed to non-taxable income.
- Expenses related to income from certain international maritime activities, if a maritime entity chose to apply a fixed CIT.

### *Depreciation*
Tangible and intangible assets may be depreciated using a directly proportional (straight-line) depreciation method, a production depreciation method, or a double-declining-balance depreciation method. Depreciation may not exceed maximum rates established by the law. For certain typical assets depreciation rates relevant for tax purposes are shown in the chart below:

| Asset | Depreciation period (years) | Annual depreciation rate (%) |
|---|---|---|
| New buildings used for business activities | 8 | 12.5 |
| Residential buildings | 20 | 5 |
| Plant and machinery | 5 | 20 |
| Trucks (not older than 5 years) | 4 | 25 |
| Computer and communications equipment | 3 | 33.3 |
| Software | 3 | 33.3 |

### *Taxes*
All taxes, fees, and other compulsory payments to the state budget are deductible for CIT purposes, except VAT paid to the budget and CIT. Note that VAT can be treated as deductible for CIT purposes if it is input or paid import VAT which is non-refundable for VAT purposes and this input or paid import VAT is calculated on deductible expenses.



### *Net operating losses*
Operating losses may be carried forward for an indefinite period, provided that certain requirements are met.

Current year operating losses incurred after 1 January 2010 can be transferred to another legal entity of the group if certain conditions are met.

Losses incurred due to the transfer of securities and/or derivative financial instruments may be carried forward for five years.

No carryback of losses is available in Lithuania.

### *Payments to foreign affiliates*
Payments to foreign affiliates (e.g. interest, royalties, management fees, fees for other services) are deductible for tax purposes if the payment serves a business purpose, provides a benefit to the payer, is at arm's length, and is substantiated by sufficient documentation. Payments to foreign affiliates may also be subject to various withholding taxes. Certain payments to affiliates located in tax haven (blacklisted) countries are subject to 15% WHT rate.

### *Blacklisted territories*
A blacklisted territory is a foreign country or territory that is included on a list of offshore territories established by the Minister of Finance that meets at least two of the following criteria:

- Similar tax rate in such territory is below 75% of that set in the Lithuanian CIT law.
- In such territory, different rules for levying a similar tax are applied, depending on the country where the parent company (controlling entity) is registered or otherwise organised.
- In such territory, different rules for levying a similar tax are applied, depending on the country where the business is conducted.
- The company (the controlled taxable entity) has entered into agreement with the tax administrator of that territory with regard to the application of a tax rate or tax base.
- There is no effective exchange of information in such territory.
- There is no financial and administrative transparency in such territory, the tax administration rules are not quite clear, and the application thereof is not communicated to tax administrators of other countries.

A list of 58 offshore territories has been published. With certain exceptions specified in the law, all payments to offshore companies or their branches for any work or services, commodities, interest on funding, insurance premiums, guarantees, etc. are non-deductible for CIT purposes unless the Lithuanian entity provides evidence to the state tax authorities that:

- the payments are related to usual activities of the paying and the receiving business entities
- the receiving foreign business entity manages the property necessary to carry out such usual activities, and
- there is a connection between the payment and the economically grounded business operation.

## *Group taxation*

Group taxation legislation and regimes are not available in Lithuania. Each Lithuanian entity is regarded as a separate taxpayer and may not deduct tax losses accumulated from previous tax periods at the level of any other group entity.

However, recent amendments to CIT law allowed transfer of current year operating tax losses incurred as of 1 January 2010 to an entity of the same group of companies if certain requirements are met.

### *Transfer pricing*

All transactions between associated parties must be performed at arm's length. The tax authorities have a right to adjust transaction prices if they do not conform to market prices.

The Lithuanian rules refer to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations established by Organisation for Economic Co-operation and Development (OECD) to the extent that they do not contradict with the domestic rules.

According to the Lithuanian transfer pricing regulations, companies may apply the following methods, although traditional methods should be given preference:

- Comparable uncontrolled price method.
- Resale price method.
- 'Cost plus' method.
- Profit split method.

- Transactional net margin method.

All entities with an annual revenue exceeding LTL 10 million (EUR 2.9 million), as well as all banks, insurance companies, and credit institutions are required to prepare transfer pricing documentation in a specifically prescribed form. The documentation may be in a foreign language, but upon request has to be translated to Lithuanian.

### *Thin capitalisation*

The Lithuanian thin capitalization rules apply in respect to borrowings from related parties as well as borrowings from third parties guaranteed by related parties. The debt to equity ratio is 4:1. The above provisions do not apply if a Lithuanian company can prove that the same loan under the same conditions would have been granted by a non-related entity.

## *Tax credits and incentives*

### *Investment project incentive*

Entities involved in an investment project are able to reduce their taxable profits by up to 50% of the actually incurred acquisition costs of long-term assets meeting certain requirements. Please note that depreciation (amortisation) expenses of such assets shall be deducted in a common manner.

Taxable profits can be reduced by such costs incurred from 2009 to 2013.

The costs exceeding the above mentioned 50% limit can be carried forward for four years.

There are certain criteria defining what could be considered an investment project. The project should be precisely described to meet the criteria allowing it to use the tax relief, and the tax authorities should be properly notified about the project.

### *Tax relief for research and development (R&D)*

Expenses, except for fixed assets’ depreciation (amortisation) expenses, incurred for R&D purposes can be deducted three times in the tax period when they are incurred, provided that R&D works performed are related to ordinary business activities.

A company applying tax relief for R&D has to prepare R&D documentation. This documentation has to cover the performed project, substantiate conformity with certain tax requirements, and specify the amount of expenses for R&D activities.

### *Free economic zones*

Entities that invest in Lithuanian free economic zones are entitled to partial or complete CIT relief (depending on the investment amount), relief of tax on real estate, and 50% relief of land lease tax.

### *Foreign tax credit*

A company may reduce tax payable on certain foreign-sourced income in Lithuania by taxes paid on that income in a foreign country if that Lithuanian company has received appropriate notice from that foreign country. The tax credit may not exceed CIT rate payable in Lithuania.

## Withholding taxes

### Domestic legislation

Income of a foreign entity in Lithuania not derived through a PE is deemed to be Lithuanian-source income and is subject to WHT at the following rates:

- Interest on any type of debt obligations, including securities: 10%.
- Proceeds from the sale, transfer (with title), or lease of immovable property located in Lithuania: 15%.
- Income derived from sports activities or performers' activities: 15%.
- Income from distributed profits: 15%.
- Royalties: 10%.
- Annual payments (tantiems) to the members of the board or supervisory board: 15%.
- Indemnities received for the infringement of copyrights or neighbouring rights: 10%.

WHT on royalties paid to related parties meeting requirements of the EC Interest and Royalty Directive is 10% until 30 June 2011. As of 1 July 2011, the rate will be reduced to 0%.

As of 1 January 2010, Lithuanian WHT on interest paid to the EU entities or DTT tax residents is 0%.

WHT is not applied on government securities issued on international financial markets, interest accumulated and paid on deposits, and interest on subordinated loans which meet the criteria established by legal acts adopted by the Bank of Lithuania.

Dividends distributed by a resident company to another resident company are subject to a 15% CIT, which is withheld by a distributing company.

The dividends are exempt from WHT if the recipient company has held not less than 10% of the voting shares in the distributing company for at least a 12-month period and the distributing entity is subject to 5% or 15% Lithuanian CIT rate. However, this relief is not applied if the foreign entity (recipient) is registered or otherwise organised in blacklisted territories *(see Blacklisted territories in the Deductions section),* as specified by the Ministry of Finance. Please note that the requirement of the 12-month holding period does not necessarily have to be fulfilled on the day of dividend distribution.

The receiving company may reduce its payable CIT for that period when dividends were received by the amount of CIT withheld from the received dividends. Any excess credit may be offset with other taxes payable.

Dividends distributed by a foreign entity are subject to a 15% WHT which is to be paid by the receiving Lithuanian entity.

Dividends are exempt from WHT if the distributing foreign entity is established in the EEA and related profit is properly taxed in the domiciled country.

The dividends are exempt from WHT if the recipient company has held not less than 10% of the voting shares in the distributing company for at least a 12-month period and the receiving entity is subject to 5% or 15% Lithuanian CIT rate. This participation exemption satisfies the requirements of the EC Parent-Subsidiary Directive. The exemption also applies to dividends paid by non-EU foreign companies, except those registered or organised in blacklisted territories.

### *Tax treaties*
Where a treaty for the avoidance of double taxation and prevention of fiscal infringement with the country in question contradicts the local regulations, the treaty provisions prevail. Lithuania has now signed 48 DTTs with foreign countries.

Reduction of, or exemption from, WHT under a DTT may be obtained if a special residence certificate (Form DAS–1) is completed and approved by the tax authorities before a taxable payment is transferred. If a payment that would have been subject to a tax treaty has already been made and WHT at the local rate was withheld, it is possible to obtain an appropriate refund (reduction) by completing a special claim for a refund of the Lithuanian tax withheld at source (Form DAS–2) and obtaining the approval of the tax authorities.

In addition, the tax authorities may require completion of a special certificate giving information about income received and taxes paid in Lithuania (Form DAS–3).

## *Tax administration*

### *Returns*
#### CIT
CIT returns must be submitted by the first day of the tenth month of the following tax period (1 October for companies using the calendar year).

If CIT is calculated based on activity results for the previous year, the advance CIT return for the first nine months of the tax period is to be submitted by the last day of the first month (usually January) of the tax period. The return for the remaining months of the tax period is to be submitted by the last day of the tenth month (usually October) of the tax period. If the taxpayer has chosen to pay the advance amount based on the projected amount of CIT for the current year, the return must be submitted not later than the last day of the first month of the tax period.

#### WHT on payments other than dividends
A tax-withholding entity must submit to the tax authorities a special form of a return reporting the amounts paid and taxes withheld during the calendar month no later than 15 days after the end of the month in which the amounts were paid.

#### WHT on dividends
A tax-withholding entity must submit to the tax authorities a special form of a return reporting the dividends paid and tax withheld within ten calendar days after the end of the month of the dividend payment.

### *Payment of tax*
#### CIT
Based on the activity results for the previous year, the advance amount of CIT for the first nine months of the tax period is calculated based on the actual CIT amount for the tax period before the previous tax period. For example, the CIT for the first nine months of 2011 would be calculated based on the appropriate portion of the actual amount of CIT for 2009. The advance amount for the remainder of the tax period is based on the actual amount of CIT for the previous period, for example, tax for the last three months of 2011 would be based on the appropriate portion of the actual amount of CIT for 2010. Thus, the advance CIT amount for each quarter would be equal to one-fourth of the actual tax amount calculated for the tax periods discussed.

The taxpayer may choose to pay the advance amount based on the projected amount of CIT calculated for the current year. The advance tax (one-fourth of the advance CIT) must be paid no later than the last day of the respective quarter, and for the last quarter by the 25th day of the last month of the quarter.

If the amount of tax indicated in the return exceeds the amount actually paid during the tax period, the taxpayer is obliged to transfer the additional amount no later than the return submission deadline. Overpaid tax is refunded in accordance with the law on tax administration.

### WHT on payments other than dividends

WHT is to be calculated, withheld, and remitted by a Lithuanian company or a PE of a foreign company no later than the return submission deadline.

### WHT on dividends

WHT is to be calculated, withheld, and remitted by a Lithuanian company that pays dividends within ten calendar days after the end of the month of the payment.

# Luxembourg

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## Significant developments

### New tax measures for 2011

On 28 January 2011, the Luxembourg tax authorities issued a Circular (L.I.R. n° 164/2) describing the tax treatment for Luxembourg entities that are mainly engaged in intra-group lending activities financed by borrowings. The Circular prescribes certain conditions which have to be fulfilled by Luxembourg entities to obtain a written confirmation from the income tax authorities. The requirements include a certain level of substance in Luxembourg as well as a minimum level of equity at risk. In addition, the arm's-length margin earned in on-lending activities should be determined and documented by way of a transfer pricing study.

On 8 April 2011, the Luxembourg tax authorities issued a second Circular (L.I.R. n°164/2bis) clarifying the application of Circular L.I.R 164/2 of 28 January 2011. This Circular explains that, as of 1 January 2012, the income tax authorities will no longer be bound by confirmation obtained before 28 January 2011 in relation to existing intra-group lending activities financed with borrowings falling within the scope of Circular L.I.R. 164/2.

On 2 December 2010, the Luxembourg Parliament enacted a new bill that introduced the following tax measures that are applicable as of 1 January 2011:

- The special amortisation applicable to energy-saving investments or environmentally friendly investments has increased by 20% (i.e. 80% instead of 60%).
- The investment tax credit granted on additional investments in depreciable tangible assets other than buildings, livestock, and mineral and fossil deposits has increased to 13% (instead of 12%).
- The investment tax credit on global investments has increased to 7% (instead of 6%) for the first portion of investment not exceeding 150,000 euros (EUR) and to 3% (instead of 2%) for the portion exceeding EUR 150,000.
- The contribution to the employment fund has increased from 4% to 5%. As a result, the corporate income tax (CIT) rate remains unchanged, but the combined tax rate (i.e. the applicable rate for Luxembourg City) increased from 28.59% to 28.80%.
- A EUR 1,500 minimal CIT (increased to EUR 1,575 by the 5% contribution to the employment fund) has been introduced for fully taxable resident entities which (i) do not require a business license or the approval of a supervisory authority and (ii) own financial assets, transferable securities, and cash at bank (i.e. accounts no. 23, 50, or 51 of the Standard Chart of Accounts) exceeding 90% of their total balance sheet. For tax consolidated entities, this measure will only apply once (at the level of the head of the tax consolidation).
- Severance payouts or 'golden handshakes' are deductible for CIT and municipal business tax purposes, up to EUR 300,000.

On 16 December 2010, the Luxembourg Parliament also enacted a new law implementing the Undertakings for Collective Investment of Transferable Securities (UCITS) IV Directive that introduced the following tax measures that are applicable as of 1 January 2011:

- Where a foreign Undertakings for Collective Investment (UCI) is managed by a Luxembourg-based management company (or where the UCI's place of effective management is located in Luxembourg), the UCI will not be deemed to be domiciled in Luxembourg and therefore not be subject to any tax in Luxembourg.
- Non-resident investors are no longer subject to Luxembourg capital gains tax on the disposal of shares in a Luxembourg Société d'Investissement à Capital Variable (SICAV).
- New exemptions from subscription tax are available for exchange traded funds, and an extension of exemption is available for funds dedicated to multi-employer pension vehicles or to several employers providing pension benefits to their employees.

### *Exchange of information*
As of May 2011, Luxembourg has signed 28 double tax treaties (DTTs) or amendments to comply with Organisation for Economic Co-operation and Development (OECD) principles on exchange of information.

The country is on the OECD 'white' list having 'substantially implemented the internationally agreed tax standards'.

### *Value-added tax (VAT)*
As of January 2011, the Luxembourg VAT law has implemented the second phase of the so-called 'VAT package'. The sole change relates to the place of taxation of services in respect of admission to cultural, artistic, sporting, scientific, educational, entertainment, or similar events, such as fairs and exhibitions, and of ancillary services related to the admission, supplied to a taxable person. These services will be deemed to be located at the place where those events actually take place.

As of 2011, a Standard Audit File for Tax (SAF-T), which is a file containing reliable accounting data, has been implemented by the VAT Authorities. This specific file will have to be used by a taxable person to transfer information to Luxembourg VAT Authorities during a VAT audit. Only specific taxable persons having a significant number of transactions and registered under a 'normal filing regime' with a turnover exceeding EUR 112,000 are firstly concerned. On the other hand, some entities, notably those subject to the supervision of the Commission de Surveillance du Secteur Financier (CSSF) and insurance/reinsurance companies, will not be subject to these SAF-T obligations.

A law proposal regarding the creation of VAT suspensive regimes was issued in March 2011. Once adopted, the law should allow the implementation of VAT warehouses in which transactions (e.g. the entry in the regime, the packaging, the warehousing) made on goods placed under this regime would temporally benefit from a VAT exemption. VAT would only become due at the exit of the goods from these regimes. This law, once adopted, should increase the attractiveness of Luxembourg as a strategic logistic place.

## *Taxes on corporate income*

Luxembourg taxes its corporate residents on their worldwide income and non-residents only on Luxembourg-source income.

Businesses with taxable income lower than EUR 15,000 are subject to CIT at a rate of 20%. The CIT rate is currently 21% for companies with taxable income in excess of EUR 15,000.

The CIT does not apply to tax transparent entities (e.g. general or limited partnerships or European Economic Interest Grouping).

As of tax year 2011, EUR 1,500 minimal CIT (increased to EUR 1,575 by the 5% contribution to the employment fund) has been introduced for fully taxable resident entities which (i) do not require a business license or the approval of a supervisory authority and (ii) own financial assets, transferable securities, and cash at bank (i.e. accounts no. 23, 50, or 51 of the Standard Chart of Accounts) exceeding 90% of their total balance sheet. For tax consolidated entities, this measure will only apply once (at the level of the head of the tax consolidation).

### *End of the Holding 1929 tax regime*

The phasing-out period for Holding 1929 companies ended on 31 December 2010. Hence, all remaining Holding 1929 companies (i.e. those not converted by a decision of the Board of Directors) have been automatically converted into fully taxable entities as of 1 January 2011 by effect of the law.

### *Solidarity tax*

A 5% solidarity tax is also imposed on the CIT amount (4% prior to 1 January 2011).

Taking into account the solidarity tax, the aggregate CIT rate in 2011 is 22.05% for companies with taxable income in excess of EUR 15,000.

### *Municipal business tax on income*

Municipal business tax is levied by the communes and varies from municipality to municipality. The municipal business tax for Luxembourg City is 6.75%.

The effective combined CIT rate (i.e. CIT, solidarity tax, and municipal business tax) for Luxembourg City in 2011 is 28.80%.

## *Corporate residence*

Based on domestic law, a company is considered to be resident in Luxembourg if either its registered office or place of central administration is located in Luxembourg. The registered office is designated as such in the company's articles of incorporation.

The place of central administration is generally understood to mean the place where the company is managed and controlled. While this term is not legally defined, the location of the company's major establishment is determined by facts and circumstances, including the following:

- The place where meetings of the board of directors are held.
- The place where shareholders meetings are held.
- The place where the company's officers make their decisions.
- The place where the company's books and records are kept.
- The place where other, similar factors evidencing management control occur.

## Other taxes

### Value-added tax (VAT)

Proceeds of sales and services, which are deemed to take place in Luxembourg, are subject to VAT at the standard rate of 15% (lowest standard VAT rate in the European Union (EU)) or, on certain transactions, at 12% (e.g. wine, advertising pamphlets), 6% (e.g. supply of gas or electricity), or 3% (e.g. food except alcohol beverages, pharmaceutical products, books, radio and television broadcasting services except adult entertainment). Some transactions, such as export and related transport, are zero-rated.

Taxpayers whose activities are subject to VAT are entitled to offset against their VAT payable the amount of such tax charged to them by their suppliers or reverse charged (i.e. self-accounted) by them on import or acquisitions of goods or services from abroad.

Banking, financial, insurance, and reinsurance generally are exempt activities. The VAT paid on costs made for these transactions cannot be recovered except when related to services performed for persons established outside the European Union. VAT on expenses made in the context of 'passive' holding activities, which are considered as outside the scope of VAT, are not recoverable.

### Excise duties

In addition to VAT, some products are subject to specific excise duties. In Luxembourg, these products are electricity, mineral oils, manufactured tobacco, and alcohol.

Excise duties are not based on the sale price of the products but on the quantity. Excise duty becomes chargeable at the time, and in the EU member state, of release for consumption. Release for consumption occurs in any of the following instances:

- The departure of excise goods from a duty suspension arrangement.
- The holding of excise goods outside a duty suspension arrangement where excise duty has not been levied pursuant to the applicable provisions of Community law and national legislation.
- The production of excise goods outside a duty suspension arrangement.
- The importation of excise goods, including irregular importation, unless the excise goods are placed, immediately upon importation, under a duty suspension arrangement.

### Customs duties/import tariffs

Based on a European Regulation, goods entering within the territory of the European Union could be subject to customs duties/import tariffs. Rates applying for determining customs duties/import tariffs are based on the nature and on the quantity of the products.

### Net wealth tax

Both Luxembourg resident companies and Luxembourg branches of non-resident companies are subject to net wealth tax levied at a rate of 0.5% on their net wealth, based on prescribed valuation methods. In general, assets are taken into account at market value (except for real estate, which is subject to a special regime). Shareholdings qualifying for the participation exemption *(see Dividend income in the Income determination section)* generally are exempt from net wealth tax.

Resident companies and Luxembourg branches of non-resident companies may claim a reduction of their net wealth tax liability by making an allocation to a special reserve before the closing of the tax year following the year for which the net wealth tax reduction is claimed. To this end, an amount corresponding to five times the net wealth tax that should have become payable must be kept in this special reserve for the five years following the year in which it was allocated. The reduction, however, may not be higher than the taxpayer's CIT liability, before tax credits, for that same year.

### *Subscription tax*

Investment funds are subject to subscription tax (at various rates) on their total net assets evaluated at the last day of each quarter. Institutional funds and monetary funds are subject to an annual rate of 0.01% and the other funds to an annual rate of 0.05%. Funds of institutional funds and monetary institutional funds are exempt from subscription tax.

As of 1 January 2011, new exemptions from subscription tax are available for exchange traded funds, and an extension of exemption is available for funds dedicated to multi-employer pension vehicles or to several employers providing pension benefits to their employees.

Where a foreign Undertakings for Collective Investment (UCI) is managed by a Luxembourg-based management company (or where the UCI's place of effective management is located in Luxembourg), the UCI will not be deemed to be domiciled in Luxembourg and therefore not be subject to any tax in Luxembourg.



Non-resident investors are no longer subject to Luxembourg capital gains tax on the disposal of shares in a Luxembourg Société d'Investissement à Capital Variable (SICAV).

### *General registration taxes*

General registration taxes (inclusive of the transcription tax described below) are levied at 7% on the market value of real estate purchased or transferred (10% in the commune of Luxembourg City for some categories of properties) and 1% on mortgages on real estate. The taxes are deductible for CIT purposes.

Note that a fixed registration duty of EUR 75 is levied on certain transactions involving Luxembourg entities (i.e. incorporation, amendment to the articles of association, and transfer of seat to Luxembourg).

For Luxembourg real estate assets, contribution made to a company remunerated by shares are subject to a proportional registration duty of 0.6% (0.9% for Luxembourg City for some categories of properties) and a transcription tax of 0.5%. Contribution remunerated by means other than shares remain subject to a proportional registration duty of 6% (9% for some categories of properties located in Luxembourg City) and a transcription tax of 1%. Transfers made within the framework of a corporate reorganisation may be exempt from any proportional registration duty under certain conditions.

### *Commune (municipalities) real estate tax*

Communes (municipalities) levy an annual real estate tax, the basis of which is the unitary value of real estate, which represents its estimated value in 1941. The basic rate varies from 0.7% to 1% of the unitary value, according to the category of property, and is multiplied by a coefficient, which varies with communes and different types of property. For commercial properties, the coefficient in Luxembourg City is 750%, which should be applied to 1% of the unitary value. The real estate tax is deductible for CIT purposes.

## Branch income

Branch income generally is taxed at CIT rates. However, the municipal business tax generally only applies if the branch is carrying on commercial activity within Luxembourg.

## Income determination

### Inventory valuation

Inventories generally are valued at the lower of actual or market cost. There is no statutory specified method. In general, the first in first out (FIFO), the last in first out (LIFO), and the weighted-average costs methods of inventory valuation are acceptable for income tax purposes, provided the method is in accordance with the facts.

### Dividend income

Dividends received by a Luxembourg resident company (or by a domestic permanent establishment (PE) of a non-resident company in certain cases) should, in principle, be subject to CIT.

#### Participation exemption regime

Dividends received may be tax exempt in Luxembourg, according to the so-called 'participation exemption' regime, if the conditions described below are satisfied:

- The distributing company is:
  - a collective entity falling within the scope of article 2 of the amended version of the EU Council directive of 23 July 1990 (90/435/EEC), hereafter the 'Parent Subsidiary Directive'
  - a Luxembourg resident joint-stock company, which is fully taxable and does not take one of the forms listed in the appendix to paragraph 10 of article 166 of the Luxembourg Income Tax Law (LITL), or
  - a non-resident joint-stock company that is fully liable (in its state of residence) to a tax corresponding to the Luxembourg CIT (i.e. as a general rule, it is required that the foreign tax is compulsorily levied at an effective rate of at least 10.5%, on a basis similar to the Luxembourg one).
- The beneficiary company is:
  - a Luxembourg resident collective entity, which is fully taxable and takes one of the forms listed in the appendix to paragraph 10 of article 166 LITL
  - a Luxembourg resident joint-stock company, which is fully taxable and does not take one of the forms listed in the above-mentioned appendix
  - a domestic PE of a collective entity falling within the scope of article 2 of the amended version of the Parent-Subsidiary Directive
  - a domestic PE of a joint-stock company that is resident in a country with which Luxembourg has concluded a DTT, or
  - a domestic PE of a joint-stock company or of a cooperative society, which is a resident of a European Economic Area (EEA) member state (other than an EU member state).
- At the date on which the income is made available, the beneficiary has been holding or undertakes to hold, directly (or through a tax transparent entity - *see Transparent entities below*), for an uninterrupted period of at least 12 months, a participation in

the share capital of the subsidiary of at least 10% or with an acquisition price of at least EUR 1.2 million.

### *Capital gains*

Capital gains (and losses) generally are taxed as ordinary income (or losses). It is possible to defer the taxation of gains on certain fixed assets where the gain is used to acquire replacement items. Under certain conditions, exempted capital gains and hidden reserves may be unrealised in a merger or another form of reorganisation of resident companies or other EU companies.

In general, capital gains on the disposal of qualifying shareholdings held by entities eligible to the participation exemption regime are tax exempt, provided (i) the shareholding constitutes at least 10% of total ownership or an acquisition price of at least EUR 6 million and (ii) the disposing company has held or intends to hold the qualifying shareholding for at least 12 months.

A recapture system exists wherein the capital gain realised will become taxable up to the amount of the aggregate expenses and write-downs in relation to the participation deducted during the year of realisation of the exempt capital gain and in previous years.

The purpose of the system is to avoid a taxation vacuum, which could result if the deductibility of expenses and write-downs connected to the participation was allowed, while the income arising from the participation is tax exempt. This system should, in principle, remain tax neutral as the company should have available carryforward losses for an equivalent amount (unless previously used to offset other taxable income).



#### Taxation of non-resident corporate investors on gains upon disposal of shares

In principle, should a non-resident corporate investor (non-treaty protected) derive income from the disposal of an important participation (i.e. representing at least 10% of the share capital) in a Luxembourg company within six months of its acquisition, said capital gain will be subject to CIT in Luxembourg unless a tax treaty provides otherwise.

As of 1 January 2011, non-resident investors will no longer be subject to the aforementioned capital gains tax upon disposal of shares in a Luxembourg SICAV.

### *Transparent entities*

From a Luxembourg tax perspective, a transparent entity is seen as having no legal personality distinct from that of its partners (those transparent entities are commonly referred to as ‘partnerships’) for CIT and net wealth tax purposes, although it may be regarded as a separate legal entity from a civil/corporate law point of view. Provided that the partnership carries out a commercial activity, however, it will be liable to municipal business tax on its own.

### *Foreign income*

A Luxembourg tax resident company is liable for CIT on its worldwide income, whether derived from Luxembourg or from foreign sources. Luxembourg does not apply a territorial basis for taxation. Foreign-source income is therefore taxable in Luxembourg, unless a DTT provides for an exemption.

Dividends from foreign subsidiaries are taxed when received, except where exempt as mentioned above. Profits of a foreign branch which are not exempt by means of a DTT may, however, benefit from a foreign tax credit. Any foreign taxes paid in excess of the tax credit are deductible as expenses. Luxembourg is, however, using the exemption method in most of its DTTs.

## Deductions

### Depreciation

Depreciation rates must be consistent with economic reality. The depreciation must be calculated on the total acquisition cost, bearing in mind the normal life of the asset and the estimated residual value. Depreciation normally is calculated using the straight-line method. However, the declining-balance method is permitted for fixed assets, other than buildings and intangible assets. The depreciation rate may not, however, exceed three times the rate applicable according to the straight-line method, or 30% (four times the applicable rate in the case of assets used exclusively for scientific and technical research, or 40%).

It is permissible to change from the declining-balance method to the straight-line method, but the converse is not allowed. Tax depreciation must be reflected in the financial accounts prepared for commercial purposes.

In the event of a sale of a depreciated asset, the net book value at the moment of the disposal must be compared with the sale price of that asset. If this comparison indicates a profit, corresponding income tax may be due unless the sale price is reinvested in eligible assets. Capital losses are deductible.

Under certain conditions, fixed assets with a value of less than EUR 870 or an economic life that is not in excess of one year can be expensed fully in the year of acquisition. Special accelerated depreciation on 80% (60% prior to 1 January 2011) of the cost of fixed assets is available for assets that protect the national environment, save energy in Luxembourg, or permit the development of workplaces for handicapped workers, under certain conditions.

### Shareholdings

Expenses linked to a shareholding qualifying for the participation exemption, including write-downs in the value of the shareholding booked as a consequence of a dividend distribution, are not deductible up to the amount of the exempt dividend. Recapture rules may apply in the event of disposal of the shareholding. Basically, the effect of this rule is that capital gains realised will become taxable up to the amount of the aggregate expenses and write-downs in relation to the participation, deducted during the year of disposal and the previous years. The qualifying shareholding is exempt from net wealth tax.

### Charitable contributions

Gifts for scientific, charitable, or public purposes and to institutions in the general interest are deductible, subject to a maximum of 20% of the net income or up to an amount of EUR 1 million (the minimum being EUR 120) with a possibility to spread the deduction over two years.

### Severance payouts or 'golden handshakes'

As of 1 January 2011, severance payouts or 'golden handshakes' are deductible for CIT and municipal business tax purposes, up to EUR 300,000.

### *Taxes*
Several taxes are deductible in determining income subject to CIT, including the registration duties and real estate tax. Also, certain taxes are credited against the computed amount of income tax owed, including taxes withheld from Luxembourg dividend income, tax withheld abroad from dividend and interest income received by a Luxembourg corporation (subject to limitations), and investment tax credits *(see the Tax credits and incentives section)*.

The main non-deductible taxes are CIT, municipal business tax, net wealth tax as well as interest and penalties for late payment of said taxes.

### *Net operating losses*
Net operating losses can be carried forward for an unlimited period but cannot be carried back.

### *Payments to foreign affiliates*
Royalties, management service fees, and interest charges paid to foreign affiliates by a Luxembourg company are deductible items, provided they are equal to what the company would pay an unrelated entity for comparable services.

## *Group taxation*



Luxembourg permits tax unity. Generally, the conditions to qualify for tax unity include that:

- each company is a fully taxable company that is resident in Luxembourg (the top entity may be a Luxembourg PE of a fully taxable non-resident company)
- at least 95% of each subsidiary's capital is directly or indirectly held by the parent company
- each company's fiscal year starts and ends on the same date, and
- tax unity is requested jointly by the top company and each subsidiary that becomes member of the group.

Tax unity lasts for a five-year period, and taxable income/loss is computed on the consolidated result. Tax losses that occurred before the consolidation period may be offset only against tax profits of the company that incurred the loss. Tax losses that are sustained by a group member during the consolidation period are offset against the tax profits of the other group members. Tax losses arising during the consolidation period that exist after the consolidation period are attributed to the parent company.

### *Transfer pricing*
Luxembourg largely follows the transfer pricing guidelines issued by the OECD in the absence of detailed transfer pricing regulations in Luxembourg. LITL has prescribed the general transfer pricing provisions in Article 56 LITL, which requires that transactions between related parties are carried out in line with the arm's-length principle. This article provides that where there is a transfer of profit possibly due to the fact that a Luxembourg taxpayer has a special economic relationship with a non-resident taxpayer, then the tax authorities may determine the financial result regardless of the reported profit. The concept of a special economic relationship can be described as any economic relationship that differs from a regular/commercial economic relationship between two parties. The special economic relationship goes beyond the related party definition as stated in article 9 of the OECD Model Convention.

Furthermore, Article 164(3) LITL characterises certain transactions as a hidden distribution of profits where a direct or indirect shareholder receives an advantage from a company that said shareholder would not have received if there had not been a shareholding relationship. The hidden distribution of profits in Luxembourg is included in the profit of the taxpayer and subject to tax at the prevailing statutory rate of corporation tax. In addition, it may be subject to 15% withholding tax (WHT) on the gross amount received, except in case a reduced rate applies under the provisions of the relevant DTT or the EC Parent-Subsidiary Directive.

Transfer pricing documentation is prepared based on OECD transfer pricing guidelines and EU transfer pricing documentation guidelines. Transfer pricing documentation is neither required at the time of the transaction nor at the filing of the tax return. During the course of a tax assessment, the tax authorities may request documentation from the taxpayer to evidence the reasonableness of an intra-group pricing arrangement. There are no transfer pricing methods prescribed for determining the arm's-length standard, and the taxpayers and the tax authorities largely follow the transfer pricing methods prescribed in the OECD transfer pricing guidelines.

In terms of the burden of proof, the tax authorities have to prove that there is an erosion of the taxable base in Luxembourg, whereas the taxpayer has to prove that the inter-company transactions did not result in a reduction or cancellation of taxes. The statute of limitations is generally five years from the end of the year in which the tax liability arises. This period may be extended if a deferred payment is granted. In case of tax evasion or fraud, the statute of limitations can be extended up to ten years. There are no specific penalties in relation to transfer pricing in Luxembourg, but the penalty regime under the corporate tax will be applicable.

Although Luxembourg has no formal procedure for applying Advance Pricing Arrangements (APA), the income tax authorities are quite flexible in this area. There have been a few cases in Luxembourg where bilateral APAs have been concluded, although in general, unilateral advanced tax agreements are obtained on an individual basis. Recently, the tax authorities have increased their focus on transfer pricing. As a result, two Circulars describing the tax treatment for intra-group financing transactions have been issued by the Luxembourg tax authorities.

According to the Circular of 28 January 2011 (L.I.R. n° 164/2), the internationally acceptable arm's-length principle should be applied for the determination of the compensation for Luxembourg companies which are principally engaged in on-lending transactions. The remuneration of the related entities should be determined based on the functions performed, assets utilized, and risks born by the Luxembourg company. A written confirmation from the tax authorities can be obtained if the Luxembourg company meets the substance and equity at risk requirements with regard to the on-lending activity. In respect of the equity at risk requirement, the Luxembourg company must be at risk for an amount equal to the lesser of 1% of the nominal value of the loan or EUR 2 million. In addition, the arm's-length price has to be determined by way of a transfer pricing analysis.

On 8 April 2011, the Luxembourg tax authorities issued a second Circular (L.I.R. n°164/2bis) clarifying the application of Circular L.I.R 164/2 of 28 January 2011. This Circular explains that, as of 1 January 2012, the income tax authorities will no longer be bound by confirmation obtained before 28 January 2011 in relation to existing intra-group lending activities financed with borrowings falling within the scope of Circular L.I.R. 164/2.

### Thin capitalisation
No thin capitalisation ratio is specifically provided by the Luxembourg tax law.

In practice, the tax authorities apply an 85:15 debt-to-equity ratio for the intra-group financing of participations. Should the 85:15 ratio not be complied with by the taxpayer, the surplus of interest could be requalified by the tax authorities as a hidden distribution of profits which would be non-deductible and potentially subject to a 15% WHT.

## Tax credits and incentives

### Inbound and capital investment incentives
Luxembourg tax law provides for various incentives, with specific requirements, in the areas of risk-capital, audiovisual activities, and environmental protection as well as for research and development (R&D), professional training, and recruitment of unemployed persons.

The most commonly used incentives are the investment tax credits. Luxembourg tax law provides for two types of investment tax credits.

First, a tax credit is available which amounts to 13% of the increase in investment in tangible depreciable assets made during the tax year. The increase in investment over a given tax year is computed as the difference between the current value of all qualifying assets and the reference value allocated to the same type of assets.



Independently, the company may benefit from a 7% tax credit on the first EUR 150,000 of qualifying new investments, and a 3% tax credit on the amount of new investments exceeding EUR 150,000 in tangible depreciable assets as well as investments in sanitary and central heating installation in hotel buildings and investments in buildings used for social activities. The above 7% and 3% rates are increased to 8% and 4% for investments eligible for special depreciation (i.e. investments favouring the protection of the environment, the realisation of energy savings, or the creation of employment for handicapped workers). However, certain investments are excluded from the credit calculation, including investments in real property, intangible assets, and vehicles (unless specifically stated by the law).

Domestic law requires that investments be physically operated in Luxembourg in order to be eligible for the incentive, unless the investment consists in shipping vessels operating in international waters. In addition, the tax benefit of the tax credit is limited to investments that are made within a Luxembourg business establishment and that are intended to be used permanently in Luxembourg.

Further to the European Court of Justice’s decision dated 22 December 2010 (Tankredeerei, C-287/10), the Luxembourg Tax Authorities issued a Circular letter dated 31 March 2011, confirming that the investment tax credit must be granted to any investment used within the EU and EEA member states. Although Luxembourg domestic tax law has not yet been amended accordingly, the application of investment tax credit may be requested for the current tax year, as well as for tax years already assessed but still subject to the introduction of a claim.

### Intellectual property (IP) regime

An IP regime is applicable to qualifying IP rights acquired or developed after 31 December 2007. This regime provides for an 80% tax exemption of the net income deriving from the use and the right to use qualifying IP rights, under certain conditions. Qualifying IP rights include patents, trademarks, design, domain names, models, and software copyrights.

An 80% deduction of net deemed income is available also under certain conditions for self-developed patents, which are used internally by the taxpayer.

The net capital gain realised upon disposal of the qualifying IP rights also benefits from the 80% exemption.

Finally, qualifying IP rights may be fully tax exempt for net wealth tax purposes under certain conditions.

### R&D incentives

Luxembourg entities involved in innovative and R&D activities can benefit from financial support in addition to the specific IP tax regime and general tax incentives.

Innovation loans may be granted by the Société Nationale de Crédit et d'Investissement and may carry a fixed interest rate lower than the market rate. Financial support may also be granted in the form of cash grants or interest subsidies.

R&D projects or programmes receive financial support up to a maximum eligibility (percentage of costs eligible for the incentives) depending on the size of the beneficiary (private research companies or organisations) as follows:

- Large (25% to 100% depending on the investment).
- Mid-size (35% to 100%).
- Small (45% to 100%).

These incentives are available for:

- experimental development
- experimental development and cooperation
- industrial research
- industrial research and cooperation, or
- fundamental research.

Innovation in process and organisation and investment in innovation pools can benefit from financial support of between 15% and 35% (50% for public research companies).

Promotion and development of innovation pools can benefit from financial support of up to 50% for private organizations or 75% for public research companies.

Research regarding technical feasibility can benefit from financial support of up to 40% or 50% if prior to experimental development and up to 65% or 75% if prior to experimental research.

### *Other incentives by entity*

#### Investment funds

Investment funds resident in Luxembourg generally are exempt from CIT, municipal business tax, and WHT on dividends. These investment funds are subject to the previously described subscription tax and to the general registration duty regime.

#### Financial participation company (Soparfi)

A Soparfi (Société de Participation Financière) is neither a specific type of company nor a special tax regime. It is rather used to refer to resident companies that hold and manage the shareholdings of subsidiaries. A Soparfi is subject to CIT, municipal business tax, and net wealth tax, but it does benefit from Luxembourg's DTTs, EU Directives (e.g. Parent-Subsidiary directive), the domestic participation exemption on dividends received, and capital gains on qualifying participations.

#### Private wealth management company (Société de gestion du Patrimoine Familial or SPF)

The SPF has been tailored to enter the private sphere of individuals for the purpose of wealth management. Its corporate objective is restricted to the acquisition, holding, management, and disposal of financial assets, to the exclusion of any commercial activity. As a general rule, an SPF is exempt from Luxembourg taxation on income and wealth tax in Luxembourg. A yearly subscription tax of 0.25% is due on the basis of paid-up capital, share premium, and excessive debts. Subscription tax, however, is capped at EUR 125,000. No WHT applies on dividends distributed by an SPF. Non-resident investors are not taxed in Luxembourg on dividends paid by a SPF or on capital gains realised on shares in a SPF.



#### Securitisation companies (SC)

SCs are subject to normal corporate taxation. A securitisation company is a company which carries out securitisation activities or which participates in securitisation transactions. Securitisation companies are taxed based on their net accounting profit (i.e. gross accounting profits minus expenses). However, the commitment to remunerate the security holders (both capital and debt) issued by the securitisation company qualifies as interest on debt even if paid as return on equity. Securitisation companies are not subject to net wealth tax in Luxembourg.

#### Venture capital vehicle (Société d'Investissement en Capital à Risques or SICAR)

The SICAR benefits from an attractive tax regime. SICARs are notably exempt from net wealth tax. Incorporated under a corporate form, the SICAR is subject to income tax at the normal rate with the benefit of an exemption on income and gains (e.g. dividends, capital gains, liquidation proceeds, interest) from transferable securities qualifying as risk capital as well as income arising from investments in liquid assets pending their investment in risk capital for a maximum of 12 months. In addition, it can benefit from the European directives and DTTs. Under the form of a limited partnership, the SICAR is treated as a tax transparent entity, and investors are taxed according to the rules of their country of residence. SICARs treated as tax transparent entities do not benefit from the European directives and DTTs. The SICAR mainly targets qualified or informed investors (i.e. 'professional' investors).

#### Financial services companies

Banks, securities depositaries, insurance, and reinsurance companies as well as other financial service companies may benefit from preferential regulations when establishing their taxable basis for CIT (e.g. provision for the neutralisation of unrealised exchange gains, general banking risk provision, provision for guarantee of deposits, mathematical reserves, and/or catastrophe reserves).

**Shipping companies**
Luxembourg-resident shipping companies are not subject to municipal business tax and can benefit from investment tax credits and accelerated depreciation (even for used assets).

## *Withholding taxes*

Dividends paid by a Luxembourg fully taxable company to its 'corporate' shareholders resident in a treaty country, which hold or commit themselves to hold a participation of at least 10% in the Luxembourg company (or shares with an acquisition price of at least EUR 1.2 million) for an uninterrupted period of at least 12 months, may be exempt from WHT *(see Note 1 below for more details)*.

The following taxes are withheld on payments made. The WHT due on dividends paid to residents of a treaty country cannot exceed the non-treaty rate.

| | Dividends (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Portfolio** | **Substantial holdings (1)** | **Interest (%) (2)** | **Royalties (%) (3)** |
| Resident corporations | 15 | 0 | 0 | 0 |
| Resident individuals | 15 | 15 | 10 (4) | 0 |
| Non-resident corporations and individuals: | | | | |
| Non-treaty | 15 | 0/15 | 0 | 0 |
| Treaty (1, 5): | | | | |
| Armenia | 15 | 0/5 (21) | 0 | 0 |
| Austria | 15 | 0/5 (6) | 0 | 0 |
| Azerbaijan | 10 | 0/5 (7) | 0 | 0 |
| Bahrain | 10 | 0 (26) | 0 | 0 |
| Belgium | 15 | 0/10 (8) | 0 | 0 |
| Brazil | 25 | 0/15 (9) | 0 | 0 |
| Bulgaria | 15 | 0/5 (6) | 0 | 0 |
| Canada | 15 | 0/5 (19) | 0 | 0 |
| China, P.R(10) | 10 | 0/5 (6) | 0 | 0 |
| Czech Republic | 15 | 0/5 (6) | 0 | 0 |
| Denmark | 15 | 0/5 (6) | 0 | 0 |
| Estonia | 15 | 0/5 (6) | 0 | 0 |
| Finland | 15 | 0/5 (12) | 0 | 0 |
| France | 15 | 0/5 (12) | 0 | 0 |
| Georgia | 10 | 0/5 (22) | 0 | 0 |
| Germany | 15 | 0/10 (20) | 0 | 0 |
| Greece | 7.5 | 0/7.5 | 0 | 0 |
| Hungary | 15 | 0/5 (6) | 0 | 0 |
| Hong Kong | 10 | 0 (10) | 0 | 0 |
| Iceland | 15 | 0/5 (6) | 0 | 0 |
| India | 10 | 0 | 0 | 0 |
| Indonesia | 15 | 0/10 (6) | 0 | 0 |

| | Dividends (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Portfolio** | **Substantial holdings (1)** | **Interest (%) (2)** | **Royalties (%) (3)** |
| Ireland, Rep. of | 15 | 0/5 (20) | 0 | 0 |
| Israël | 15 | 0/5 (21) | 0 | 0 |
| Italy | 15 | 0 | 0 | 0 |
| Japan | 15 | 0/5 (15) | 0 | 0 |
| Korea, Rep. of | 15 | 0/10 (6) | 0 | 0 |
| Latvia | 10 | 0/5 (6) | 0 | 0 |
| Liechtenstein | 15 | 0/5 (25) | 0 | 0 |
| Lithuania | 15 | 0/5 (6) | 0 | 0 |
| Malaysia | 10 | 0/5 (16) | 0 | 0 |
| Malta | 15 | 0/5 (6) | 0 | 0 |
| Mauritius | 10 | 0/5 (9) | 0 | 0 |
| Mexico | 15 | 0/5 (9) | 0 | 0 |
| Moldavia | 10 | 0/5 (23) | 0 | 0 |
| Monaco | 15 | 0/5 (21) | 0 | 0 |
| Mongolia | 15 | 0/5 (16) | 0 | 0 |
| Morocco | 15 | 0/10 (6) | 0 | 0 |
| Netherlands | 15 | 0/2.5 (6) | 0 | 0 |
| Norway | 15 | 0/5 (6) | 0 | 0 |
| Poland | 15 | 0/5 (6) | 0 | 0 |
| Portugal | 15 | 0/15 | 0 | 0 |
| Qatar | 10 | 0/5 (24) | 0 | 0 |
| Romania | 15 | 0/5 (6) | 0 | 0 |
| Russia | 15 | 0/10 (17) | 0 | 0 |
| San Marino | 15 | 0 (26) | 0 | 0 |
| Singapore | 10 | 0/5 (18) | 0 | 0 |
| Slovak Republic | 15 | 0/5 (6) | 0 | 0 |
| Slovenia | 15 | 0/5 (6) | 0 | 0 |
| South Africa | 15 | 0/5 (6) | 0 | 0 |
| Spain | 15 | 0/5 (6) | 0 | 0 |
| Sweden | 15 | 0 (26) | 0 | 0 |
| Switzerland | 15 | 0/5 (6) | 0 | 0 |
| Thailand | 15 | 0/5 (6) | 0 | 0 |
| Trinidad and Tobago | 10 | 0/5 (9) | 0 | 0 |
| Tunisia | 10 | 0/10 | 0 | 0 |
| Turkey | 20 | 0/5 (6) | 0 | 0 |
| United Arab Emirates | 10 | 0/5 (9) | 0 | 0 |
| United Kingdom | 15 | 0/5 (14) | 0 | 0 |
| United States | 15 | 0/5 (13) | 0 | 0 |
| Uzbekistan | 15 | 0/5 (6) | 0 | 0 |
| Vietnam | 15 | 0/5/10 (11) | 0 | 0 |

Notes

These notes are not extensive. The full text of the DTT should be checked for a comprehensive view on the conditions of application of reduced rates.

1. Under Luxembourg domestic law, no WHT is levied on dividends paid by a Luxembourg qualifying subsidiary to an entity which is:

- a collective entity falling within the scope of article 2 of the amended version of the Parent - Subsidiary Directive
- a Luxembourg resident joint-stock company, which is fully taxable and does not take one of the forms listed in the appendix to paragraph 10 of article 166 of the Luxembourg income tax law
- a PE of a collective entity falling under the previous categories
- a collective entity that is resident in a country with which Luxembourg has concluded a DTT and which is fully liable to a tax corresponding to the Luxembourg CIT, or a domestic PE of such an entity
- a Swiss resident joint-stock company that is subject to Swiss CIT without benefiting from any exemption
- a joint-stock company or a cooperative society which is resident in a EEA member state (other than a EU member state) and is fully liable to a tax corresponding to the Luxembourg CIT, or
- a PE of a joint-stock company or of a cooperative society which is resident in a EEA member state (other than a EU member state), and
- at the date on which the income is made available, the beneficiary has been holding or undertakes to hold, directly, for an uninterrupted period of at least 12 months, a participation of at least 10%, or with an acquisition price of at least EUR 1.2 million in the share capital of the income debtor.

Qualifying shareholders need to be fully taxable collective entities subject in their country of residence to a tax similar to that imposed by Luxembourg. As a general rule, this requirement is met if the foreign tax is compulsorily levied at an effective rate of at least 10.5%, on a basis similar to the Luxembourg one.

2. Interest paid to non-residents generally is not subject to WHT in Luxembourg. However, interest that represents a right to profit participation on a bond may be assimilated t a dividend and subject to WHT. Further analysis should be made to determine the applicable reduced rate on the basis of the treaty (i.e. pursuant to dividend or interest clause). The WHT that may be due as a consequence of the EU Savings Directive (Council Directive 2003/48/EC dated 3 June 2003) is not mentioned.
3. Royalties paid to non-residents are not subject to WHT in Luxembourg, whether the companies are associated or not.
4. A WHT of 10% is withheld on defined interest income paid by a Luxembourg paying agent to resident individuals. Interest indirectly cashed through investment funds are out of the scope of this WHT.
5. DTTs have been concluded with Albania, Argentina (limited scope), Barbados, Cyprus, Kazakhstan, Kuwait, Kirghizstan, Lebanon, Macedonia, Pakistan, Panama, Serbia and Montenegro, Syria, and Ukraine, but are not yet in force.
6. The recipient company holds at least 25% of the Luxembourg company's capital. In some rare cases, a holding period requirement may have to be met as well (e.g. Spain, Switzerland).
7. The recipient company owns at least 30% of the company's capital and the equivalent of an acquisition price of USD 300,000.
8. The recipient company owns a 25% investment or the equivalent of an acquisition price of EUR 6,197,338. The investments may be held by several Belgian companies, provided one owns at least 50% of the shares of each of the others. The investment must be held since the beginning of the financial year of the recipient of the dividends.
9. The recipient company holds at least 10% of the Luxembourg company's capital.
10. No WHT is levied if the recipient company holds at least 10% of the Luxembourg company's capital or a participation with an acquisition price of a least EUR 1.2 million.
11. The rate of 5% of WHT on the gross amount of the dividends applies where the effective recipient company owns directly or indirectly at least 50% of the share capital of the paying company or has contributed more than USD 10 million or the equivalent in Luxembourg or in Vietnamese currency, in the capital of the company paying the dividends; the rate of 10% of WHT on the gross amount of the dividends applies where the beneficial owner is a company which holds directly or indirectly at least 25% but less than 50% of the capital of the company paying the dividends and has contributed not more than USD 10 million, or the equivalent in Luxembourg or Vietnamese currency, in the capital of the company paying the dividends.
12. The recipient company owns directly or indirectly 25% of the company's capital. Indirect participation includes the holding through several treaty resident companies located in the same country provided one owns more than 50% of the shares of each of the others.
13. A 5% WHT is levied on dividend distributions where the beneficial owner is a company which holds at least 10% of the voting rights of the paying company. No WHT is levied when the US company has held, during an uninterrupted period of two years, a direct shareholding of at least 25% of the voting power of the paying company and certain conditions regarding the nature of activities performed by the distributing company are met.
14. The recipient company owns directly or indirectly 25% of the company's voting rights. Indirect participation includes the holding through several treaty resident companies located in the same country provided one owns more than 50% of the voting rights of each of the others.
15. The recipient company holds at least 25% of the Luxembourg company's voting shares during the period of six months immediately before the end of the accounting period in which the distribution of profits takes place.
16. The dividends are taxable at a rate of 5% if the beneficial owner is a company that holds directly at least 10% of the capital of the company paying the dividends. No WHT is levied when the beneficiary company has held during the 12 preceding months a direct shareholding of at least 25% of the capital of the paying company. The holding period must be met before the date of distribution of the dividend. Furthermore, certain conditions regarding the nature of activities performed by the company must be met.

17. The recipient company holds at least 30% of the Luxembourg company's capital and the acquisition price reaches at least EUR 75,000 (or equivalent).
18. The recipient company holds at least 10% of the Luxembourg company's capital. Dividends paid to the government of Singapore are exempt.
19. The beneficial owner is a company (other than a partnership) which controls directly or indirectly at least 10% of the voting power in the company paying the dividends.
20. The recipient company holds at least 25% of the Luxembourg company's voting shares (Germany/Luxembourg) or company's voting power (Ireland/Luxembourg).
21. The rate of 5% of WHT on the gross amount of dividends applies where the recipient company holds at least 10% of the Luxembourg company's capital.
22. The rate of WHT is 5% if the beneficial owner is a company that holds directly at least 10% of the capital of the company paying the dividends and made an investment in the capital of the paying company of more than EUR 100,000 or the equivalent in Georgian currency. No WHT is levied when the beneficiary company holds directly at least 50% of the capital of the company paying the dividends and made an investment in the capital of the paying company of more than EUR 2 million or the equivalent in Georgian currency.
23. The recipient company holds at least 20% of the Luxembourg company's capital.
24. No WHT is levied when the beneficiary company holds at least 10% of the company paying the dividends. The rate of 5% of WHT on the gross amount of dividends applies where the beneficial owner is an individual who holds directly at least 10% of the company paying the dividends and was a resident of the other contracting state for the 48-month period immediately preceding the year in which the dividends are paid.
25. No WHT is levied when the beneficiary of the dividend is a joint stock company, which has held directly a participation of at least 10% (or with an acquisition price of at least EUR 1.2 million) of the distributing company's share capital, for an uninterrupted period of at least 12 months. The rate of 5% of WHT applies if said participation has been held for less than 12 months.
26. No WHT is levied when the recipient company holds at least 10% of the Luxembourg company's capital. A holding period requirement has to be met for Sweden and San Marino.

## *Tax administration*



### *Returns*

Companies must file their tax returns by 31 May of each year following the calendar year during which the income was earned.

Assessments are issued after the end of the tax year and normally can be finalised within five years, although the delay may extend to ten years if the declaration is found to be incomplete or inexact, with or without the intention of fraud. Once issued, the tax assessment notice is in principle final (unless new facts come to light).

A self-assessment procedure applies to Luxembourg resident companies. Tax assessments are issued by the tax authorities immediately upon receipt of the tax return, based on the taxable profit reported by the company. The tax authorities may then reassess or request more information on the return within the period of five years that follows the reception of the tax return.

### *Payment of tax*

Quarterly tax advances must be paid. These payments are fixed by the tax administration on the basis of the tax assessed for the preceding year or on the basis of the estimate for the first year. This estimate is given by the company pursuant to the request of the Luxembourg tax authorities.

Tax must be paid by the end of the month that follows the month of reception by the company of its tax assessment.

# Macau

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## Significant developments

### Tax incentives for the tax year 2011

On 15 December 2010, the Legislative Assembly approved certain tax incentives proposed in the Budget for the financial year 2011. The key tax incentives include the following:

- The tax free income threshold for complementary (corporate) tax will continue to be increased from 32,000 Macanese patacas (MOP) to MOP 200,000 for income derived in the tax year 2010. Taxable income between MOP 200,000 and MOP 300,000 is taxed at 9%, and taxable income over MOP 300,000 is taxed at 12%.
- The standard MOP 3,500 reduction in property tax liabilities will continue to be available in the tax year 2011 for both self-use and rental properties.
- Restaurants will continue to be exempt from tourism tax in the tax year 2011.
- Insurance policies written or renewed in the tax year 2011 and banking transactions in the tax year 2011 will continue to be exempt from stamp duty.
- Admission tickets for performances, exhibitions, and entertainment programs will continue to be exempt from stamp duty in the tax year 2011.
- Commercial and industrial operations will continue to be exempt from the annual industrial tax in the tax year 2011.

### Revision of the Macau Property Tax Law

The Legislative Assembly approved certain amendments to the Macau Property Tax Law on 16 February 2011. The amendments became effective on 8 March 2011 and are applicable to benefits derived from properties for the tax year 2010 retrospectively.

Under the revised Law, the property tax rate for leased properties has been reduced from 16% to 10% on the actual rental income. For self-use properties, the property tax rate has been reduced from 10% to 6% on the official rateable value. The surcharge of 5% that was previously levied on the property tax payable on such properties has been abolished.

The annual deduction of 10% of the official rateable value to cover repair and maintenance expenses is automatically available for self-use properties under the revised Law. However, approval by the Macau Finance Bureau (MFB) is still required for a maximum deduction of 10% of the rental income derived for leased properties.

### Revision of the Macau Stamp Duty Law

Effective as of 4 May 2011, the 0.5% stamp duty on intermediate transfer of immovable properties, so called ‘confirmor sale’, has been annulled.

The revision of the Macau Stamp Duty Law was intended to curb speculation activities in the real estate market. Under the revised Law, all property transfer, whether it be intermediate, final, or sale of uncompleted properties, will be subject to Macau Stamp Duty at a progressive rate scale ranging from 1% to 3%, thereby increasing the transactional costs of speculative property activities.

### *First Protocol to the People's Republic of China/Macau avoidance of double taxation arrangement (DTA)*

The Central Government of the People's Republic of China (the PRC) and the Government of the Macau Special Administrative Region (SAR) signed the Protocol (Protocol) to the PRC/Macau DTA on 15 July 2009. The Protocol became effective on 15 September 2010 and is applicable to income arising as of 1 January 2011.

The PRC/Macau DTA was signed in 2003. Some of the provisions of the PRC/Macau DTA are less favourable than those of the PRC/Hong Kong DTA. Under the Protocol, the treaty-based rates for withholding tax (WHT) on dividends, interest, and royalty have been reduced. Further, the criteria for determination of a service permanent establishment (PE) and certain criteria for capital gains exemption under the PRC/Macau DTA have been clarified. In summary, the Protocol has brought the PRC/Macau DTA broadly in line with the PRC/Hong Kong DTA. This has no doubt increased the competitiveness of the Macau SAR and provided added incentives for Macau companies to do business or invest in the People's Republic of China. Nevertheless, as Macau adopts a worldwide taxation system in its domestic tax regime, consideration should be given as to whether the use of a Macau company as a holding company for investments in the People's Republic of China is favourable from a tax perspective.

### *Second Protocol to the PRC/Macau DTA*

The Central Government of the PRC and the Government of the Macau SAR signed the Second Protocol (Second Protocol) to the PRC/Macau DTA on 26 April 2011. The Second Protocol is aimed at amending Article 26 of the PRC/Macau DTA to implement the standards on transparency and exchange of information developed by the Organisation for Economic Co-operation and Development (OECD), which are endorsed by the G20 members.



### *The Republic of Cape Verde/Macau DTA*

The Government of the Macau SAR and the Government of the Republic of Cape Verde signed a DTA on 15 November 2010 to promote trade relations between the two jurisdictions. The DTA will become effective upon completion of the necessary ratification procedures by the respective jurisdictions. The DTA includes a tax information exchange clause that implements the internationally agreed standards developed by the OECD.

### *The Republic of Mozambique/Macau DTA*

The ratification procedures for the DTA signed between the Government of the Macau SAR and the Government of the Republic of Mozambique have been completed, and the DTA became effective on 11 January 2011.

### *Tax information exchange agreements signed with the Nordic countries*

On 29 April 2011, the Government of the Macau SAR signed tax information exchange agreements (TIEAs) with the Nordic countries, which include the Kingdom of Denmark, the Faroe Islands, the Republic of Finland, Greenland, Iceland, the Kingdom of Norway, and the Kingdom of Sweden. Together with the five comprehensive tax arrangement/agreements that Macau has signed with the PRC, Portugal, the Republic of Mozambique, Belgium, and the Republic of Cape Verde respectively, Macau has enlarged the network of agreements to implement the internationally agreed standards on transparency and exchange of information for tax purposes through the signing of a total of 12 DTAs or TIEAs to date.

The TIEAs will become effective upon completion of the necessary ratification procedures by the respective jurisdictions.

### *Pending legislation*

Please note this information is current as of 1 June 2011. Typically, pending legislation is announced in June or July. Please visit the WWTS website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

## *Taxes on corporate income*

Complementary tax is imposed on the worldwide income earned by Macau registered entities, irrespective of where their residence or headquarters are situated and irrespective of the nature of the income. The exception to the foregoing is rental income from leasing of immovable properties located in Macau, which is taxed separately under the Property Tax Regime.

Generally, if a foreign entity is engaged in commercial/industrial activities and/or rendering services in Macau, the resultant gain from such commercial/industrial activities and/or services rendered will be subject to complementary tax.

According to the Macau Complementary Tax Law, complementary tax is imposed on a progressive rate scale ranging from 3% to 9% for taxable profits below or equal to MOP 300,000 and 12% for taxable profits over MOP 300,000. Taxable profits below MOP 32,000 are exempt from tax.

According to the Budget for the financial year 2011, which has already been approved by the Legislative Assembly (2011 Approved Budget), the tax-free income threshold for complementary tax has been increased from MOP 32,000 to MOP 200,000 for income derived in the tax year 2010 (the next MOP 100,000 of taxable income is taxed at 9%, and taxable income in excess of MOP 300,000 is taxed at 12%). Such increase in the tax-free income threshold has been granted since the tax year 2007. While it is generally believed that the direction of the Macau government policy will remain stable at least for several years, the changes in tax-free income threshold and the tax brackets beyond the tax year 2010 are subject to approval by the Legislative Assembly on an annual basis, unless such amendments are written into the relevant tax laws.

### *Types of taxpayers and associated tax bases*

#### Group A taxpayers

Taxpayer entities whose registered capital reached MOP 1 million, or whose average taxable profits reached MOP 500,000, per year in three consecutive years will automatically become Group A taxpayers in the tax year following the year in which the notification is issued by the Macau Finance Bureau. A taxpayer entity can also elect to become a Group A taxpayer by filing a Group A declaration form. Profits of Group A taxpayers are assessed based on the actual accounting income after making necessary tax adjustments.

#### Group B taxpayers

Group B taxpayers refer to any individual or any other form of companies not mentioned above and those taxpayers that do not keep detailed accounting records.

Profits of Group B taxpayers are assessed on a deemed basis if the reported income is below the internal parameters set by the MFB for taxpayers in similar industries.

## Corporate residence

Corporate residence is generally determined by reference to the place of establishment. The exception to the foregoing is a Macau offshore company or a Macau offshore financial institution that is established under Law 58/99/M. Such a Macau offshore company or financial institution is not considered as a Macau tax resident in the context of the comprehensive tax arrangement/agreements entered into between the Macau SAR and the PRC, Portugal, and the Republic of Mozambique respectively. A Macau tax resident entity is subject to complementary tax on its worldwide income.

### Permanent establishment (PE)

There is no specific definition of PE in the Macau Complementary Tax Law. Technically speaking, there are two major criteria for determining whether a foreign entity should be subject to complementary tax, and the key phrases are 'engaging in commercial/industrial activities' and/or 'rendering services in Macau'. These phrases are again not defined. Generally, if a foreign entity is engaged in commercial/industrial activities and/or rendering services in Macau, the resultant gain from such commercial/industrial activities and/or services rendered will be subject to complementary tax.

## Other taxes



### Value-added tax (VAT)

There is no VAT regime in Macau.

### Property tax

Property tax is imposed annually on the owner of buildings situated in Macau. This is first payable after acquiring a property or upon the expiry of the property tax exemption period, if applicable. Different exemption periods are granted, depending on the location of the property. Additional exemption periods may apply in special cases.

For leased properties, property tax is charged at 10% (16% prior to the tax year 2010) on the actual rental income, and by application, a maximum deduction based on 10% of the rental income derived to cover repair and maintenance expenses incurred will be granted, if approved by the MFB.

For self-use properties, property tax is charged at 6% (10% prior to the tax year 2010) on the official rateable value as established by the appointed committee of the MFB. A deduction of 10% of the official rateable value to cover repair and maintenance expenses will be automatically granted for self-use property. If the property is not occupied, the owner can apply for an exemption from property tax, the approval of which is entirely at the discretion of the MFB.

According to the 2011 Approved Budget, there is a standard MOP 3,500 reduction in the property tax liabilities assessed in the tax year 2011 for both self-used and rental properties.

Effective from 8 March 2011, the surcharge of 5% that was previously levied on property tax payable has been abolished.

# Macau

### *Annual industrial tax*
The annual industrial tax has been exempted for the tax year 2011 and has been exempted on an annual basis by the Macau Government since 2002.

Under the Industrial Tax Code, all commercial or industrial operations carried out in Macau are subject to industrial tax at the beginning of each year. The amount of the tax is dependent upon the nature of the business. The table below is an illustration of the tax amounts applicable to certain types of businesses in Macau.

| Type of business | Tax (MOP) |
|---|---|
| Commercial banks | 80,000 |
| Construction companies | 500 |
| Hotels | 500 |
| Insurance companies | 500 |
| Textile companies | 500 |

### *Special gaming tax*
Special gaming tax is levied at 35% on the gross gaming revenue derived by gaming concessionaires authorised to carry on the operation of games of chance in the Macau SAR under Law 16/2001.

### *Tourism tax*
Tourism tax is imposed at the rate of 5% on bill of services, excluding telecommunication and laundry services, and service charges of up to 10%, rendered in Macau by establishments such as hotels, guest houses, dancing halls, night clubs, massage/sauna parlours, gymnasium, karaoke, and the like. Such tax is generally borne by consumers.

Restaurants are exempt from tourism tax in the tax year 2011 and have been exempt, via an exemption published on an annual basis by the Macau Government, since 2002.

### *Consumption tax (excise duty)*
Consumption tax is imposed only on tobacco and spirits entering into Macau.

There are two methods for determining the amount of consumption tax payable, by quantity or by value. The former method of assessment is based on the weight or volume of goods and the latter is based on the price of the goods imported into Macau. The rate of consumption tax varies depending on the classification of the imported goods.

### *Customs duties/import tariffs*
Apart from consumption tax imposed on tobacco and spirits entering into Macau, there are no customs duties/import tariffs in Macau.

### *Motor vehicle tax*
Motor vehicle tax is imposed on the sale of new motor vehicles to consumers and the importation of new motor vehicles for self-use. Exemptions are available to certain persons and organisations and for certain specific usages. Generally, motor vehicle tax is levied based on the listed selling prices as registered with the MFB. The rate of motor vehicle tax varies depending on the type of motor vehicle and its value.

### Stamp duty
Stamp duty is payable on certain types of documents and stampable transactions at a small fixed amount or at rates ranging from 0.1% to 10% on the value represented by the documents and transactions.

The charge to stamp duty has been extended to property transfers and the irrevocable transfer of certain assets. Stamp duty at progressive rates ranging from 1% to 3% is payable on transfer of immovable property with a surcharge of 5% on the duty payable, resulting in effective stamp duty rates of 1.05% to 3.15%. The irrevocable transfer of certain assets without consideration is subject to a 5% stamp duty.

Insurance policies written or renewed and banking transactions have been exempt from stamp duty since 2005. This exemption will continue to be available in the tax year 2011.

Admission tickets for performances, exhibitions, and any kind of entertainment programmes has been exempted from stamp tax for the tax year 2011. This exemption, if extended, will be published by the Macau Government on an annual basis.

### Land rent
According to the 2011 Approved Budget, land rent below MOP 100 shall not be collected by the MFB in the tax year 2011. However, any such amount already collected shall not be refunded.

## Branch income



Branch income is subject to tax at the same rate as that for corporations. The taxable income is ascertained based on branch accounts.

## Income determination

The paragraphs below describe the tax acceptable treatments under the prevailing Complementary Tax Law and are for reference only.

### Inventory valuation
Inventory should be stated at actual cost, and conformity between book and tax reporting is required. Market selling price or replacement cost is allowed only in special circumstances, and prior approval of the Director of the MFB is required for adoption of such inventory valuation methods. The write-down of inventory values is not permitted.

### Capital gains
Gains or losses from the realisation of capital assets of a corporate taxpayer are treated as current revenue or expense items for complementary tax purposes.

### Dividend income
Dividends from all sources are subject to complementary tax in the hands of a recipient incorporated in Macau unless the dividends were paid out of profits that have been taxed at the corporate level in Macau. Where dividend to shareholders is paid out of profits of a Macau entity that have not been taxed in Macau, complementary tax will technically be charged on the dividend distribution to the shareholders, except for distribution of tax exempt profits of approved offshore institutions, where complementary tax, in practice, has not been charged by the MFB to date.

### *Foreign income*
Companies incorporated in Macau are subject to complementary tax on worldwide income, wherever received or credited. Currently, double taxation relief is available under the respective avoidance of double taxation agreements/arrangement that Macau has with Portugal, the People's Republic of China, and the Republic of Mozambique.

## *Deductions*

Please note that the assessor is empowered to disallow any business expenses (e.g. entertainment, travelling) where the amount incurred is considered to be excessive.

### *Depreciation*
An initial allowance of 20% is granted on buildings. The rates of tax depreciation are detailed in Decree-Law No.4/90/M, dated 5 March 1990. The Decree-Law prescribes the maximum annual tax depreciation rates and the number of years of asset life for different asset classes under the straight-line method. For illustration, the maximum depreciation rates and the maximum useful life currently applicable to the general types of assets are set out below.

| Assets | Maximum annual percentage rate (%) | Maximum number of years |
|---|---|---|
| Industrial buildings | 4 | 50 |
| Office and residential buildings | 2 | 100 |
| Machinery and installations, air conditioning, elevators, equipment | 10 to 20 | 20 to 10 |
| Tools | 20 to 33.3 | 10 to 6 |
| Laboratory, telex and interior telephone equipment, furniture, filing systems, typewriters, and accounting machines | 16.66 to 25 | 12 to 8 |
| Computer hardware | 25 | 8 |
| Office installations | 14.29 | 14 |
| Trucks | 14.29 | 14 |
| Automobiles | 20 | 10 |
| Intangible assets, pre-operating expenses incurred prior to commencement of business | 33.33 | 6 |
| Deferred expenses arising in connection with increases in share capital, changes in form of business enterprises, issuance of debentures, marketing and other studies, and financial expenses incurred for the acquisition or own production of fixed assets prior to completion | 33.33 | 6 |
| Patents | 10 | 20 |
| Manufacturing licences, concessionary agreements, and similar rights | * | * |
| Trademark | * | * |

* At the discretion of the authorities.

In the case of commercial and industrial buildings, depreciation is not allowed for the value attributable to the cost of the freehold land. Where the value of the freehold land cannot be determined from the total cost of land and buildings, a portion equal to 20%

is deemed to be attributable to the land value for the purpose of determining the value of buildings to be depreciated.

Depreciation can be claimed either on a prorated basis in accordance with the prescribed annual rates for assets that are not acquired at the beginning of the financial year or on an annual basis.

The cost of repairs and maintenance exceeding 10% of the acquisition cost of the asset in a given year is deemed to be an expense of a capital nature and should be capitalised and depreciated over the remaining life of the asset.

### *Bad debts*
The amount provided against doubtful trade receivables is an allowable tax deduction, but the provision cannot exceed 2% of the total receivables, except in the case of banks, where the minimum provisions required under the local banking regulations are fully tax-deductible.

Debts considered uncollectible may be written off only when adequate proof can be shown, usually by way of bankruptcy court proceedings.

### *Charitable contributions*
A deduction of up to 0.2% of the company's turnover is allowable for donations to charitable organisations recognised by the tax authority.

### *Pension expenses*
The employer's contribution to the staff provident fund legally registered in Macau is fully tax-deductible up to 15% of the employees' basic salary.



### *Fine and penalties*
Tax fines are not deductible.

### *Other significant items*
- An amount provided against stock obsolescence of up to 3% of the total stock value at year-end is allowed as a tax deduction.
- Losses arising from insurable risks are not allowable as a tax deduction.
- Staff social welfare expenses paid for the benefit of employees, for example canteens and libraries, are fully tax-deductible.

### *Net operating losses*
Agreed tax losses can be carried forward for three consecutive years for Group A taxpayers. Group B taxpayers are not allowed to carry their tax losses forward to future years. Tax losses cannot be carried back in Macau.

### *Payments to foreign affiliates*
The regulations make no specific mention of royalties, interest, and service fees paid to foreign affiliates. The MFB generally monitors the deductibility of such payments. Payments to foreign service providers for consulting services or construction-related services are not deductible if such consulting contracts are not properly registered in Macau.

## *Group taxation*

There is no provision for group taxation in Macau.

### Transfer pricing
There is no transfer pricing provision in the Macau tax regime.

### Thin capitalisation
There is no thin capitalisation provision in the Macau tax regime.

## Tax credits and incentives

### Capital investment incentives
A 50% reduction in complementary tax and stamp duty on certain transactions, as well as exemptions from annual industrial tax and property tax (up to periods prescribed by the MFB), are allowable for taxpayers in the manufacturing industry (as defined in the Decree Law) whose capital investment is aimed at the introduction of new products or high technology, improvement of productivity, and increase in exports of goods to new markets.

Where profits are retained in reserves and reinvested in installation of new equipment within the following three financial years, the reinvested reserves can be deducted from taxable profits, provided that the reinvested reserves are attributable to profits earned from normal business operations and the investment is considered to be beneficial for the economic development of Macau.

### Offshore services business incentives
Profits derived by approved offshore institutions from prescribed offshore service-related activities are exempt from all forms of taxes, such as complementary tax, annual industrial tax (currently exempt for all taxpayers), and stamp duties. By application, the executives, staff at a supervisory level, and/or specialised technicians who have obtained a residency permit in Macau are exempt from professional tax for three calendar years from the date the exemption application is approved.

### Incentives for owners of touristic facilities
Additional incentives such as an extended property tax exemption period, exemption from annual industrial tax, reduction in stamp duty, as well as acceleration of depreciation for complementary tax purposes are available to owners of facilities that qualify as touristic facilities.

### Foreign tax credit
There is no foreign tax credit provision in the Macau Complementary Tax Law. Foreign tax credit is only available under the relevant provisions of the comprehensive tax arrangement/agreements that the Macau SAR has entered into with the PRC, Portugal, and the Republic of Mozambique respectively.

## Withholding taxes

Currently, there is no provision in the Macau Complementary Tax Law for the withholding of taxes from payments made by domestic corporations to overseas companies.

## Tax administration

### Returns

The Macau tax year is on a calendar-year basis.

Assessments are made by the MFB upon review of the tax returns, which must be lodged before 31 March or 30 June of each year for Group B or Group A taxpayers, respectively.

### Payment of tax

A provisional tax payment calculated based on the declared taxable profit for a Group A taxpayer or final assessed profits for a Group B taxpayer is payable in two equal instalments in September and November. However, if the amount is not greater than MOP 3,000, payment will be requested in one lump sum amount in September. For Group A taxpayers, a final tax assessment will be issued upon the completion of tax assessment by the MFB.

### Statute of limitation

The statute of limitation period is five assessment years from the relevant year of assessment for both Group A and Group B taxpayers.

### Exchange of information

Law 20/2009 is the legislation that governs the exchange of information by the Macau SAR with other tax jurisdictions within the scope of bilateral tax treaties or arrangements. Its objective is to promote the transparency of the Macau tax administration and to demonstrate the Macau SAR's willingness to cooperate with treaty partners in combating tax avoidance or tax evasion activities.



The information to be exchanged under Law 20/2009 is strictly confined to information collected for tax purposes only, and includes the following:

- Information collected within the jurisdiction of the MFB.
- Information collected by the MFB from financial institutions that are governed by the Macau Financial System Act and offshore institutions that are governed by the Macau Offshore Law (the Institutions).

At present, the only bilateral tax arrangements/treaties entered into by the Macau SAR which have come into effect are with the PRC, Portugal, and the Republic of Mozambique. The bilateral tax treaties/tax information exchange agreements (TIEAs) entered into by the Macau SAR with Belgium, the Republic of Cape Verde, the Kingdom of Denmark, the Faroe Islands, the Republic of Finland, Greenland, Iceland, the Kingdom of Norway, and the Kingdom of Sweden will be effective upon completion of the necessary ratification procedures by the respective parties.

In response to the OECD's request for cooperation in combating tax avoidance or evasion activities, and to prevent the Macau SAR from being viewed as a tax haven, it is believed that more comprehensive tax arrangements/treaties or TIEAs will be signed between the Macau SAR and other tax jurisdictions in the near future.

As the information of a Macau taxpayer is becoming more transparent under comprehensive tax arrangements/treaties or TIEAs, it is important for Macau companies with cross-border transactions to perform periodic tax health checks to ensure that tax planning arrangements, if any, that have been put in place in the past, remain technically defensible. As Macau offshore companies continue to be a focus of investigations for many tax jurisdictions, it is important to ensure that such companies have adequate commercial substance in Macau and the companies' transfer pricing policies are supported by appropriate transfer pricing documentation and transfer pricing studies.

## *Other issues*

### *Choice of business entity*

An investor conducting business in Macau is obligated to set up a legal establishment, which could be in the form of a company or a branch.

There are two types of Macau companies: companies limited by shares and companies limited by quotas. The capital and corporate governance requirements for a company limited by shares are higher than a company limited by quotas, and in general, a company limited by quotas is used by investors that are not in regulated industries.

# Macedonia

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## Significant developments

The amendments of the Corporate Income Tax Law in 2010 and 2011 introduced significant developments in respect of corporate income tax (CIT). As of July 2010, the distribution of profit to resident legal persons is exempted from CIT. As of 16 April 2011, the understated revenues and 'hidden profit distributions' are subject to CIT on an annual basis. Most of the previous temporary differences for tax purposes, such as depreciation and long-term provisions, are not taxable. Thin capitalisation and transfer pricing regulations were amended as well.

The period for submission of VAT returns and payment of VAT was extended from the 15th day after the end of the VAT period to the 25th day. Furthermore, the new cap for mandatory VAT registration was set at 2 million denari (MKD) instead of MKD 1.3 million.

Under the amendments to the Customs Act, taxpayers may engage in customs procedures only as approved or licensed agents by the Customs Administration.



A procedure for education of the taxpayer was introduced in the Tax Administration Law as a transitory phase prior to imposing certain tax penalties by the Public Revenue Office.

## Taxes on corporate income

Generally, all resident and non-resident companies operating through a permanent establishment (PE) are liable to pay CIT in Macedonia.

Macedonian resident entities are taxed on their worldwide income. Non-resident entities are taxed on their Macedonian-source income. Non-business organisations (including governmental bodies) are taxed on income from their business activities.

The CIT rate is 10%.

There are two separate tax bases for CIT which are subject to filing of two separate tax returns.

The first tax base is the sum of taxable expenses and understated revenues decreased by any available tax credits and tax reliefs. In this case, tax is payable on an annual basis regardless of whether the corporate taxpayer incurs profit or loss.

The second tax base is the amount of dividends or other type of profit distributions by the taxpayer in monetary or non-monetary form. Under recent amendments, the definition of 'other type of profit distributions' was extended to cover also the increase of registered capital as a result of asset revaluation as well as payments from profit to shareholders, members of managing bodies, and employees, based on the taxpayer's decision.

As of July 2010, distribution of profit to resident legal persons is exempted from CIT. Therefore, only distributed profit to individuals (foreign or domestic residents) or to non-resident legal entities is taxable.

Taxpayers are obliged to cover the losses from previous years prior profit distribution. The distributed amount is taxed at the moment of payment. Upon each profit distribution, a corporate taxpayer is obliged to submit a tax return containing information for the dividend beneficiary and the year from which the profit to be distributed arises. If the profit arises prior to 2009, CIT is not payable.

Undistributed profit is tax exempt. Undistributed profit is determined in accordance with the accounting regulations and standards decreased by the amount of CIT paid on taxable expenses and understated revenue.

## *Corporate residence*

A company is resident in Macedonia for tax purposes if it is established or maintains its headquarters in the territory of Macedonia. Foreign legal entities with headquarters abroad are non-residents for tax purposes, but their Macedonian branches are liable for tax on any profit generated in the territory of Macedonia.

### *Permanent establishment (PE)*

Generally, a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on, either directly or through a dependent agent.

More specifically, the domestic law provides that a PE may include a place of management, a branch office, an office, a factory, a workshop, mining activities, or any other place of extraction of natural resources.

A building site or construction or installation project, as well as related supervision activities, may constitute a PE if it lasts longer than six months.

Furthermore, the provision of services, including consulting services with regard to one or several related projects, is deemed to give rise to a PE if such activities last longer than 90 continuous days within any 12-month period. According to recent amendments effective as of April 2011, if one or several persons establish a PE as per above, any other non-related project on which they are working on becomes part of the PE irrespective of its duration.

The amendments also prescribe that the PE should be registered as a corporate tax payer at the beginning of its activity in the country for the purposes of obtaining a tax number. However, this provision seems to contradict the Companies Law requirement, which states that if operating in Macedonia, the foreign companies are obliged to establish at least a branch in the country. Therefore, it should be further clarified whether tax registration of a PE shall be possible without establishment of a legal form as per the Macedonian Companies Law.

## Other taxes

### Value-added tax (VAT)

In general, the VAT regulations are in line with the provisions of the sixth European Union (EU) VAT directive.

The standard VAT rate is 18%. This rate applies to overall turnover and imports of goods and services. A lower rate of 5% applies to supplies of certain goods, including food, drinking water from public supply systems, computers and software, agricultural material and equipment, pharmaceutics and medical equipment, and publications such as books, pamphlets, newspapers, and other printed material, except for publications mainly used for advertising purposes.

As per recent amendments, all taxpayers whose total turnover exceeded MKD 2 million or whose total supplies, as projected at the beginning of the business activity, will exceed this amount, are liable to register for VAT purposes.

Residents that do not meet the criteria above may voluntarily register for VAT purposes at the beginning of each calendar year.

The standard VAT period is one calendar month. However, if the total turnover in the previous calendar year did not exceed MKD 25 million, the tax period is the calendar quarter. The tax period for voluntarily VAT registered taxpayers is the calendar year.

A taxpayer is obliged to submit a VAT return for each tax period within 25 days following the end of the relevant tax period.



### Customs duties

Customs duties generally apply to most products imported into Macedonia. The customs rates under the most favoured nation treatment for agricultural products in 2011 are up to 31%, whereas the customs rates for industrial products are below 23%.

Macedonia has signed trade agreements with Turkey, Ukraine, and European Free Trade Association (EFTA) member states. The country is a member state to the Central European Free Trade Agreement (CEFTA) and has signed a Stabilisation and Association Agreement with the European Community.

The import of industrial products with preferential origin is custom duty exempt as of 2011.

According to the Stabilization and Association Agreement 2001 between Macedonia and the European Union, generally, products with Macedonian origin can be exported into EU countries free of customs duties.

### Stamp taxes

Stamp taxes are not payable in Macedonia.

### Excise duties

Excise duties are levied with respect to a limited number of goods produced or imported in Macedonia. Petroleum products, alcohol and alcoholic beverages, tobacco products, and passenger motor vehicles are subject to an excise duty at a flat or percentage rate. The excise period is one calendar month, and excise duty is payable within 15 days as of the end of the calendar month. The excise duty for alcohol beverages and tobacco goods is levied by way of purchasing excise stamps.

The excise duty for petroleum products is payable per kilo/litre and ranges between MKD 0.1 and MKD 24.

Alcohol and alcoholic beverages are taxable per litre/percentage of alcohol. Some categories of alcoholic beverages (e.g. wine) are subject to no excise duty. Maximum excise duty payable is up to MKD 300 per litre pure alcohol.

The excise duty for tobacco products is combined and is calculated both per peace/kilo and as a percentage from the retail price as follows:

- MKD 1.35 per cigar and 0% from its retail price.
- MKD 0.10 per cigarette and 35% of from its retail price.
- MKD 1,350 per kilo smoking tobacco and 0% from its retail price.

The excise duty for passenger motor vehicles is calculated as a percentage of the market value or the custom value of the vehicle. It ranges from o% for vehicles valued up to EUR 3,000 to 18% for vehicles valued above EUR 30,000.

### *Property tax*
Property tax is paid on the ownership of real estate, including land (agricultural, construction, forest, and pastures) and buildings (residential buildings or flats, business buildings and business premises, administrative buildings and administrative premises, buildings and flats for rest and recreation, and other construction facilities, as well as installations constructed on the buildings or below and permanently attached to the buildings).

The person liable for property tax is the legal entity or the individual owner of the property. If the owner is not known or cannot be reached, the person liable for property tax is the user of the property. A property taxpayer may also be the taxpayer who usufructs the property; and if the property is owned by several persons, each of them is a property taxpayer proportionately for the portion owned. A property taxpayer is also the legal entity who uses real estate owned by the state and the municipality.

The property tax base is the market value of the real estate. The market value of the real estate is determined by a special municipal commission in accordance with the methodology prescribed by the Government.

Property tax rates are proportional and range from 0.10% to 0.20%. The rates may be determined on the basis of the type of the property. As an exception, property tax rates on agricultural land not used for agricultural production may be increased outside the above range (i.e. from three to five times in relation to the basic rates).

The amount of the rates is decided by the Municipal Councils.

### *Transfer tax*
The transfer of the right to ownership of real estate for or without compensation, as well as other means of acquiring real estate for or without compensation, between legal entities is subject to transfer tax.

The person liable for transfer tax is the seller of the real estate. As an exception, a taxpayer may also be the buyer of the real estate, if agreed in the sale and purchase agreement. When replacing real estate, the taxpayer is the party that replaces the real estate of greater value.

When selling real estate in bankruptcy and executive procedure, as well as when realising agreements on mortgage, the taxpayer may be the buyer of the real estate.

In the case of transfer of ownership of an ideal share in real estate, taxpayers are each of the owners separately.

The tax base is the market value of the real estate at the moment the tax liability arises.

When replacing real estate, the tax base is the difference between the market values of the real estate being replaced.

When selling real estate in bankruptcy and executive procedure, the tax base is the attained selling price.

The market value is determined by a special municipal commission in accordance to the methodology prescribed by the Government.

Tax rates are proportional and range from 2% to 4%. The tax rates are determined by the municipal councils by way of decision.

### *Garbage collection fee*

A garbage collection fee is payable for immovable property depending on the type of property and on the surface area used. It is calculated on the basis of a tariff. It is collected together with the bills for water usage.

Companies and individuals are liable for paying communal taxes for usage of certain rights and services (mainly for usage of the urban space in the municipalities, posting commercials, etc.).



## *Branch income*

Branch offices are registered in the Trade Registry. Branches are subject to CIT in accordance with the general statutory provisions. The foreign parent company is fully liable for the obligations of its established branch office in Macedonia.

A foreign company that is entitled to carry out commercial activities pursuant to its national legislation may establish a commercial representative office in Macedonia. Representative offices are not legal entities and may not carry out any commercial activities. Representative offices are not subject to CIT.

## *Income determination*

Capital gains, as well as income from dividends, interest, rent, and royalties are treated as ordinary income of the taxpayer and are included in its general taxable base in accordance with accounting rules and standards. Since the accounting profits of a company are not taxable until distributed to individuals and non-resident legal entities, such income is not subject to CIT before that time.

### *Inventory valuation*

As of 16 April 2011, the provisions in the tax legislation regarding inventory valuation were abolished. Prior to 16 April 2011, corporate taxpayers were restricted to value inventories for tax purposes in accordance to the weighted average price method.

## Deductions

### Tax base on taxable expenses and understated revenues
The CIT Law exhaustively lists the expenses which are not recognised for tax purposes and are part of the tax base on taxable expenses and understated revenues.

### Hidden profit distribution
Under the new amendments to the CIT Law effective as of 16 April 2011, hidden profit distributions are taxable as part of the tax base on taxable expenses and understated revenues. The following transactions with shareholders or their related parties are considered as hidden profit distribution subject to CIT:

- Sales of goods/services on terms below the market price.
- Purchase of goods/services on terms above the market price.
- Providing loans with an interest lower than the market one.
- Arrangements under which gains are realized by the shareholders or their related parties.

Unjustified shortages are also taxed as hidden profit distribution if not reimbursed from the salary of the authorised person.

Some of the transactions as per above may be regulated under the transfer pricing provisions in the CIT Law as well. It seems that the purpose of this provision was to tax the non-fair transactions with shareholders and their related parties which do not fall under the 'related-party' definition as per the CIT Law.

### Non-business-related expenses
Expenses which are not related to the business activity of the taxpayer are taxable.

### Depreciation
As of April 2011, corporate taxpayers can apply depreciation methods and rates as well as perform impairment of their fixed assets under applicable accounting standards without any tax consequences.

Prior to the amendments, the depreciation of intangible and tangible assets was not taxable up to the amount calculated on the acquisition value of such assets, by applying depreciation rates within the limits set by the law. Once determined, the depreciation method was used until the final depreciation of the asset or group of assets.

### Interest expenses
Interest paid on non-business related credits of the taxpayer as well as interest on credits for purchase of passenger vehicles, furniture, carpets, works of art, and decorative objects is a taxable expense. Interest on business-related credit is also taxable provided it falls under the thin capitalisation or transfer pricing rules *(see Thin capitalisation or Transfer pricing in the Group taxation section for more information)*.

### Compensation expenses
Employees' related expenditures (e.g. organised transportation to/from work, organised food (cantina), business trip allowance, field allowance, family separation allowance, one-off severance payment, retirement allowance, annual holiday allowance, anniversary awards) are taxable if paid over the amount prescribed by law and collective agreement.

Voluntary pension insurance contributions are taxable if their annual amount per employee exceeds four average monthly gross salaries paid out in the previous calendar year.

The monthly allowances and expenses to the managing board members are tax-deductible up to 50% of the average gross monthly salary paid out in the country in the previous year.

### Insurance expenses

Personal insurance premiums paid for members of the management board and the employees (if not paid out of their salary) are taxable expenses. Only the collective insurance of the employees for work related injuries is a non-taxable expense for corporate taxpayers.

### Representation expenses

Expenses for gifts, business dinners, recreation, and entertainment are taxable expense up to 90% of the annual amount borne by the taxpayer.

### Shortages and scrapping

Expenses for shortages and scrapping exceeding the standards for the particular industry or the particular taxpayer are taxable if not caused by vis major or an uncontrollable event.

### Impairment and write-off of receivables

Impairment of receivables is not taxable for banks, saving institutions, and insurance companies if impaired in accordance to the methods prescribed by law. As to other corporate taxpayers, impairment of receivables is a taxable expense if not based on an effective court decision or reported and confirmed as debts in liquidation or bankruptcy procedure. The taxpayers are entitled to a tax credit for the tax paid on collected impaired receivables in the year of collection.

Write-off of receivables is a taxable expense for all corporate taxpayers.

### Charitable contributions

Donations and sponsorships expenses are taxable if not pursuant to the manner, the conditions, and the procedure set forth in the Law on Donations and Sponsorships in Public Activities. If compliant with the law requirements as per above, donations are taxable if the annual amount borne by the taxpayer exceeds 5% of its overall revenue, whereas sponsorship expenses are taxable if above 3% of the overall revenue of the taxpayer.

### Fines, penalties, and taxes

Fines and tax penalties, penalty interest paid for public duties, expenses for enforced payments, and withholding tax (WHT) borne by the taxpayer on behalf of third parties are taxable.

### Net operating losses

Loss carryforwards are not specifically regulated in the Macedonian tax legislation. However, due to the concept of corporate income taxation of distributed profit, in essence, accounting losses could be carried forward indefinitely. This is because of the fact that profit can be distributed only if losses from previous years are covered.

Loss carrybacks are not allowed under the Macedonian tax legislation.

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### *Tax losses on taxable expenses and understated revenues*
According to the new amendments introduced in April 2011, tax losses arising from taxation of taxable expenses and understated revenues could be carried forward in the next consecutive five years. Such tax losses are recognised when the tax credit and reliefs exceed the amount of taxable expenses in the tax return on taxable expenses and understated revenues.

### *Payments to foreign affiliates*
There are no specific provisions in the tax legislation with regard to payments towards foreign affiliates.

## *Group taxation*

Tax consolidation provisions were abolished in Macedonia as of 1 January 2009.

### *Transfer pricing*
According to the amendments effective as of 16 April 2011, the transfer pricing provisions are extended to cover not only the expenses but also the revenues resulting from related party transactions.

The difference between the market price and the transfer price is a taxable expense in the tax return on taxable expenses and understated revenues. As of April 2011, the cost plus method in addition to the comparable uncontrolled price method would be applicable. No reference is made to other methods accepted by the Organisation for Economic Co-operation and Development (OECD).

The part of the interest paid on loans to related parties which exceeds or is below the interest payable between unrelated parties is considered taxable.

Penalty interest imposed between related parties shall be considered as a taxable expense.

Transfer pricing rules do not apply on expenses for interest under credits and penalty interest paid to related parties which are banks or financial institutions.

### *Thin capitalisation*
Significant changes were introduced in the thin capitalisation rules as of April 2011. According to the amendments, interest is taxable if the credit received from a non-resident shareholder who directly holds at least 25% of the capital in the company exceeds the amount of three times its share in the equity in the company during a tax period. Thin capitalisation rules will not apply to loans received from banks or other financial organisations. Also, thin capitalisation rules will not apply for newly established companies within the first three years of operation.

Prior the amendments, thin capitalisation rules applied to all taxpayers irrespective of the years of business operation and with regard to all shareholders who held at least 25% of the taxpayer's capital irrespective of their residence or type of business activity.

## Tax credits and incentives

### Foreign tax credit
The taxpayer is allowed a tax credit for the tax paid on foreign income abroad up to the amount of tax payable for that income in Macedonia. The WHT on dividends and CIT paid abroad could be credited against the corporate tax liability on profit distribution. The foreign WHT paid on other types of income except dividends could be credited against the corporate tax liability on taxable expenses and understated revenues.

### Technological industrial development zones
A taxpayer that is a registered user within a technological industrial development zone is exempt from profit tax payment for a period of ten years from the commencement of the performance of the activity in the zone under terms and conditions and according to a procedure determined with the Law on Technological Industrial Development Zones.

### Simplified tax regime for small companies
Companies that perform economic activity (except banking, financial, and insurance activities, and games of chance and entertainment games) and have not earned overall revenue from any source exceeding MKD 3 million on an annual level in any of the previous three years (including the year of assessment) may calculate and pay annual tax on total revenue in the amount of 1% of the amount of earned total revenue presented in the annual income statement for the calendar year.

## Withholding taxes



All domestic legal entities and domestic physical persons that are registered for carrying out an activity, as well as foreign legal entities or physical persons that are non-residents but have a PE in Macedonia, are obliged to withhold tax when paying certain types of income to a foreign legal person and to pay the tax withheld to a respective suspense account simultaneously with the payment of the income.

The WHT rate is 10% and is applied on the following forms of incomes payable abroad:

- Dividends.
- Interest.
- Royalties.
- Income from entertainment or sporting activities in Macedonia.
- Income from management, consulting, financial services, or services related to R&D.
- Income from insurance or reinsurance premiums.
- Income from telecommunications services between Macedonia and a foreign country.
- Income from the lease of immovable property in Macedonia.

As an exception, WHT is not applicable to the following forms of income:

- The after-tax profit of a PE transferred to its foreign headquarters.
- Interest from bonds issued or guaranteed by the government.
- Interest on deposits in banks located in Macedonia.
- Income from transactions in state securities on the international financial markets.

If a double taxation avoidance agreement is in place, WHT shall be payable in accordance with the treaty provisions. Taxpayers are obliged to obtain approval from the Macedonian tax authorities prior to applying the tax rates from the double tax treaty (DTT).

Macedonia has signed DTTs with the 37 countries listed in the chart below:

| Recipient | Dividend (%) | Interest (%) | Royalties (%) | Other income (%) |
|---|---|---|---|---|
| Albania | 10 | 10 | 10 | 0 |
| Austria (1) | 0/15 | 0 | 0 | 0 |
| Belgium (2, 9) | 10/15 | 15 | 10 | 0 |
| Belgium (1,4) | 5/15 | 10 | 10 | 0 |
| Belarus (2) | 5/15 | 10 | 10 | 0 |
| Bulgaria (2) | 5/15 | 10 | 10 | 0 |
| China | 10 | 10 | 10 | 0 |
| Croatia (2) | 5/15 | 10 | 10 | 0 |
| Czech Republic (2) | 5/15 | 0 | 10 | 0 |
| Denmark (2, 3) | 0/5/15 | 0 | 10 | 0 |
| Egypt (4) | 10 | 10 | 10 | 0 |
| Estonia (2) | 0/5 | 5 | 5 | 0 |
| Federal Republic of Yugoslavia (2, 5) | 5/15 | 10 | 10 | 0 |
| Finland (1) | 0/15 | 10 | 0 | 0 |
| France (1) | 0/15 | 0 | 0 | 0 |
| Germany (1) | 5/15 | 5 | 5 | 0 |
| Hungary (2) | 5/15 | 0 | 0 | 0 |
| Ireland ( 6) | 0/5/10 | 0 | 0 | 0 |
| Iran (4) | 10 | 10 | 10 | 0 |
| Italy (2) | 5/15 | 10 | 0 | 0 |
| Latvia (1, 4, 8) | 5/10 | 5 | 5/10 | 0 |
| Lithuania (1) | 0/10 | 10 | 10 | 0 |
| Moldova (2) | 5/10 | 5 | 10 | 0 |
| Morocco (4, 7) | 10 | 10 | 10 | 0 |
| Netherlands (1) | 0/15 | 0 | 0 | 0 |
| People's Republic of China – Taiwan | 5 | 10 | 10 | 0 |
| Poland (2) | 5/15 | 10 | 10 | 0 |
| Romania | 5 | 10 | 10 | 0 |
| Qatar | 0 | 0 | 5 | 0 |
| Russia | 10 | 10 | 10 | 0 |
| Slovakia | 5 | 10 | 10 | 0 |
| Slovenia (2) | 5/15 | 10 | 10 | 0 |
| Spain (1) | 5/15 | 5 | 5 | 0 |
| Sweden (2) | 0/15 | 10 | 0 | 0 |
| Switzerland (2) | 5/15 | 10 | 0 | 0 |
| Turkey (2) | 5/10 | 10 | 10 | 0 |
| Ukraine (2) | 5/15 | 10 | 10 | 0 |
| United Kingdom (10) | 0/5/15 | 0 | 0 | 0 |

Notes

1. The lower rate applies to dividends paid out to a foreign company, which controls at least 10% of the share capital of the payer of the dividends.

2. The lower rate applies to dividends paid out to a foreign company, which controls at least 25% of the share capital of the payer of the dividends.
3. The zero rate applies to dividends paid out to pension funds.
4. These DTTs are still not in force.
5. The DTT with Federal Republic of Yugoslavia now applies both to Serbia and Montenegro.
6. The zero rate applies to dividends paid out to recognised pension funds and to foreign companies which continuously control at least 25% of the share capital of the payer of the dividends for 12 months before the dividends payment. The 5% rate applies to dividends paid out to foreign company which controls at least 10% of the share capital of the payer of the dividends. The 10% rate applies to dividends paid out in all other cases.
7. Interest arising in the contracting state, borne and paid by its government or its central bank to the government or to the central bank of the other contracting state, shall be exempt from tax in the first mentioned state.
8. The tax rate of 10% for royalties payments applies only for utilisation or right to utilise cinematographic films and films or tapes for radio and television transmission. The 5% rate applies on all other cases.
9. The DTT concluded between the Socialist Federal Republic of Yugoslavia (SFRY) and Belgium is still applicable for Macedonia.
10. The zero rate applies to dividends paid out to pension schemes and to foreign companies which continuously control at least 25% of the share capital of the payer of the dividends for 12 months before the dividends payment. The 5% rate applies to dividends paid out to foreign company which controls at least 10% of the share capital of the payer of the dividends. The 15% rate applies to dividends paid out in all other cases.

## *Tax administration*

### *Returns*

The taxable period for which CIT is determined covers one calendar year.

Taxpayers are obligated to calculate and pay CIT on taxable expenses and understated revenues on the basis of a tax return on taxable expenses and understated revenues which must be submitted to the Public Revenue Office by the end of February the following year.



Taxpayers who distribute profit are obliged to calculate and pay CIT on the basis of a tax return on profit distribution, which should be submitted to the tax authorities up to the date of profit distribution.

Small taxpayers who fall under the simplified tax regime are obliged to calculate and pay the tax due on the basis of a tax return on overall income which should be submitted to the tax authorities up to 31 May the following year.

### *Payment of tax*

Corporate taxpayers are obliged to pay monthly CIT advance payments during the year within 15 days of the end of each month.

Monthly CIT advance payments are calculated as one-twelfth of the tax obligation on taxable expenses and understated revenues for the previous calendar year increased by the index of cumulative retail price growth as determined by the State Statistical Bureau.

The difference between the advance payments and the final CIT liability as determined in the tax return on taxable expenses and understated revenues should be paid within 30 days as of the dead-line for submission of the tax return on taxable expenses and understated revenues. Daily penalty interest of 0.03% is due on late tax payments.

In case the sum of monthly advance payments exceeds the final tax liability in the tax return on taxable expenses and understated revenues, the taxpayer may request for a refund of overpaid tax. The tax should be refunded within 60 days as of the date of submitting the request. If the taxpayer does not ask for a tax refund, the overpaid amounts will be considered as advance payment for the following period.

## *Other issues*

### *Choice of business entity*

The Macedonian Trade Companies Law provides for the following types of entities:

- General partnerships.
- Limited partnerships.
- Limited liability companies.
- Joint stock companies.
- Limited partnerships by shares.
- Foreign business entities may register a branch office or a representative office in Macedonia.

# Madagascar

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## Significant developments

The corporate tax rate decreased from 23% in 2010 to 22% in 2011.

## Taxes on corporate income

A corporate entity registered in Madagascar and having an annual turnover exceeding 20,000,000 Malagasy ariary (MGA) is subject to corporate income tax (CIT) at a rate of 22%. Note that the CIT rate was 23% in 2010.

The tax payable cannot be less than 5/1,000 of turnover plus a fixed amount of MGA 100,000 for taxable persons carrying on agricultural, artisan, transportation, industrial, hotel, or mining activities. The minimum tax cannot be less than 5/1,000 of turnover plus MGA 320,000 for other activities.

Revenue of foreign businesses that do not have a permanent establishment in Madagascar is subject to withholding income tax at a rate of 10% of any income realised in Madagascar.

## Corporate residence

Companies are considered resident in Madagascar if they are registered in Madagascar or have a legal existence in Madagascar. While there is no definition of permanent establishment in the Madagascar tax law, companies usually are required to have a legal existence when they carry out business in Madagascar or have revenue from ownership of assets in Madagascar.

## Other taxes

### Value-added tax (VAT)

VAT is applicable to all transactions realised in Madagascar by a VAT vendor. Services are considered to be performed in Madagascar if such services are used in Madagascar or invoiced to a taxpayer established in Madagascar.

Any corporate entity or individual person who realises an annual turnover exceeding MGA 200,000,000 is a VAT vendor. For a business realising annual revenue less than MGA 200,000,000, VAT vendor registration is an option.

A foreign company that has no PE in Madagascar but renders services to a Madagascar taxpayer must appoint a tax representative to collect and pay VAT on its behalf.

Otherwise, the beneficiary of the services must collect and pay VAT on behalf of the foreign supplier.

The VAT rate is 20%, and the VAT rate on export is 0%. VAT input is recoverable under certain conditions.

### *Registration fees*
Registration fees are applicable to transfers of title ownership (e.g. sales, donations) of movable and immovable assets, to transfers of interests, to share capital increases, and to lease agreements.

Registration fee rates are 0.5% to 6%, depending on the nature of the transaction.

### *Payroll tax*
Salary income taxes, called Impôt sur les Revenus Salariaux et Assimilés (IRSA), are levied at a rate of 22% on the total taxable remuneration of employees, including salaries, allowances, and benefits in kind. Employers are responsible for withholding and paying salary income taxes on behalf of employees.

### *Real estate ownership tax*
Real estate ownership tax is imposed annually at the rate of 5% to 10% on the rental value of the property. Land ownership is also taxable at a rate depending on the nature of the land.

### *Tax on insurance contracts*
All insurance or life annuity conventions concluded with a company, insurance firm, or with any other Madagascan or other insurer are subject to an annual tax on insurance contracts at a rate of 3% to 20% levied on the insurance premiums.

### *Social security contributions*
Employers must contribute to Caisse Nationale de Prévoyance Sociale, Madagascar's national social security fund, which includes pensions and accident insurance. The contribution is capped at 13% of eight times the legal minimum salary per employee.

### *Health contributions*
Employers must contribute to the health system assessment at a rate of 5% of the total amount of taxable remuneration of its employees.

### *Custom and import tax*
The importation of goods is subject to payment of custom and import tax payable to the custom office.

## *Branch income*

The tax on branch income is the same as for corporate income.

## *Income determination*

### *Inventory valuation*
There are no provisions for valuing inventories or determining inventory flows. The tax treatment will follow the accounting treatment.

### Capital gains
There is no provision for capital gains in Madagascar except for capital gains on the sale of real estate by an individual. Capital gains made by a company on the sale of assets and interests are considered as normal business income that is subject to normal income taxes.

### Inter-company dividends
Dividends received by a company are considered as business income subject to income tax. No withholding tax applies on payment of dividends.

### Stock dividend
Stock dividends are unusual, but they are considered as business income that is subject to income tax.

### Foreign income
Foreign income is considered as normal business income subject to income tax unless a tax treaty is established and indicates otherwise.

## Deductions

### Contingent liabilities
To be tax-deductible, provisions for doubtful debt must be subject to justification of existence of amicable or judicial settlement.



### Deductible wages
Salaries and wages that are not included in salary income taxes or not declared to Caisse Nationale de Prévoyance Sociale are not deductible.

### Depreciation
The amount of deductible depreciation should not exceed the amount that is calculated according to the rates of depreciation provided by the law:

- Industrial buildings: 5%.
- Plant and machinery: 10%.
- Mining exploration and development (licence): 33%.
- Transportation (car): 20%.
- Transportation (utility cars, vans, trucks): 25%.
- Computers: 25%.
- Electricity generators: 10%.

With the exception of buildings, it is also possible to practise a graduated depreciation. In this case, the annual depreciation corresponds to 30% of the net book value of the asset.

In case of loss, depreciation of assets can be deferred and carried forward to the next financial years until absorption.

### Fines and penalties
Fines and penalties are not deductible for income tax purposes.

### *Net operating losses*
Accumulated loss can be carried forward for the next five financial years following the period in which the loss occurs.

### *Payments to foreign affiliates*
For branches, the deductible amount of overhead that the head office can charge to the branch is limited to 1% of the turnover of the branch.

For interest on inter-company loans, only interest calculated on twice the amount of the share capital, at a rate practised by the Central Bank plus two points, is deductible.

### *Other significant items*
Third-party taxes borne by the company are not tax-deductible.

## *Group taxation*

There is no provision regarding group taxation in Madagascar.

## *Tax credits and incentives*

The following activities benefit from a special tax and /or customs regime.

### *Microfinance activity*
Microfinance benefits are available for entities specializing in lending money on the basis of small or medium scale value. Entities duly licensed to practise microfinance activities are exempt from income tax during the first five years. After this period, the microfinance company is subject to income tax at a rate of 22%.

### *Free zone (free trade zone)*
Free-zone law is available for industrial and other service providers that export all of their products. If eligible under the free-zone law, an income tax exemption is provided during the first two to five years and a reduced income tax of 10% thereafter. Exemption from customs duties on importation is also provided.

### *Big investment mining*
A mining company committing to invest more than USD 50,000,000 is considered a big investment mining company. The big investment mining law provides a minimum income tax exemption, a reduced income tax rate for the transformation entity (i.e. the entity in charge of processing the extracted minerals), exemption from custom and importation duties, and VAT reimbursement on locally purchased equipment and investments.

### *Petroleum code*
The petroleum code provides a custom and importation duties exemption for hydrocarbon research, exploration, and exploitation activities.

### *Leasing law*
The leasing law provides that leasing activities can benefit from income tax exemption and reduction of tax rate during the first four years.

## *Withholding taxes*

Withholding taxes (WHT) are levied as follow:

- Impôt sur les revenues des capitaux mobiliers (IRCM): WHT on interest of 22% is applicable on financial loan interest. However, interest paid to banks, financial institution, and foreign financial organisation is exempt.
- WHT of 22% is applicable on remuneration of a member of a board of directors or a single director.
- Income tax for non-resident entity: Management fees, royalties, technical and assistance fees, licence fees, equipment rental fees, and any income realised by foreign suppliers is subject to withholding income tax at a rate of 10%.

Madagascar has signed two tax treaties.

| Recipient | Loan interest | Royalties, management fees, services fees | Dividend |
|---|---|---|---|
| No tax treaty | 22% | 10% | 0% |
| France | 15% | 15% (max) | 15% (max) |
| Mauritius | 10% | 5% | 10% (max) |

## *Tax administration*

Corporate income tax is payable bi-monthly in provisional instalments. The balance is payable before 15 May each year for companies whose financial year ends at 31 December, and before 15 November each year for companies whose financial year ends at 30 June.

Withholding tax on foreign services is payable to the tax authorities within one month of the date of payment.

Withholding tax on interest and on payments to members of boards of directors are payable at 15 May or 15 November, depending on the financial year-end.

# Malawi

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## Significant developments

As of 1 July 2010, the date for payment of provisional tax changed; provisional tax for each quarter should be paid within 25 days after the end of the quarter. Previously, the tax was payable 30 days after the end of the quarter.

As of 1 July 2011, the following developments will go into effect:

- Minimum tax based on turnover has been introduced on loss making companies and companies with low profits as follows: 1% of turnover for annual turnover of 50 million Malawian kwachas (MWK) or less; 2% of turnover for annual turnover of more than MWK 50 million.
- Investment allowances for manufacturers has been reduced from 100% to 40% of the cost for new and unused plant and machinery and industrial buildings and from 40% to 20% for used assets.
- Additional 50% training allowance has been abolished. Previously, the cost of training a Malawian employee to obtain a degree, diploma, or a certificate in the field relevant to the employee's job would attract a 50% additional training allowance.
- The rate of transport allowance for transportation of exports has been reduced from 25% of the cost to 15%.
- Corporate tax at 30% has been introduced on income of companies operating in Export Processing Zones. Previously, these companies would enjoy both income tax and import duty exemption.

## Taxes on corporate income

Malawi does not have separate legislation for the determination of taxable income of different types of legal persons. Taxation of all income is included in the Taxation Act.

Section 11 of the Taxation Act defines income as the total amount in cash or otherwise, including any capital gain, received by or accrued to in any year or period of assessment from a source within or deemed to be within Malawi. The taxpayer's assessable income excludes any amount exempt from tax under this act.

### Income deemed to arise in Malawi

The liability for Malawi tax is based on the source of the income rather than residence of the person. Certain transactions may be deemed to be from a source within Malawi even if effected outside Malawi. Section 27 of the Taxation Act limits the income that may be deemed to have arisen in Malawi to the following:

- Remuneration for services rendered or work performed in Malawi.

- Remuneration for services rendered or work performed in or out of Malawi where the amount may be claimed as a tax-deductible expense by a permanent establishment (PE) in Malawi.
- Amounts incurred, claimed, or claimable in connection with a PE in Malawi.
- Realised exchange gains and losses arising in connection with a PE in Malawi or foreign exchange assets and liabilities held in Malawi.
- Capital gains and losses realised with respect to tangible property located in Malawi and interests in companies incorporated in Malawi.

### *Summary of tax rates*

| Entity | Income tax rate (%) |
|---|---|
| Locally incorporated companies (1) | 30 |
| Branches of companies not incorporated in Malawi | 35 |
| Companies in export processing zones (2) | 30 |
| Companies in priority industries (3) | |
| For a period not exceeding ten years | 0 |
| In all other cases for companies incorporated in Malawi | 15 |
| In all other cases for Malawi branches of external companies | 20 |

Notes

1. In the case of a mining company, an additional resource rent tax of 10% is levied on profits after tax if the company's rate of return exceeds 20%. The basis for calculating rate of return has not been defined.
2. Prior to 1 July 2011, these companies enjoyed an income tax exemption.
3. Priority industries have not been defined.



## *Corporate residence*

A corporate entity is considered a resident for tax purposes in Malawi if it has a PE in Malawi.

### *Permanent establishment (PE)*

The Taxation Act defines a PE as 'an office or other fixed place of business through which business activity is carried on'. This short definition is wide in scope. Care must be exercised when considering this definition in situations that may be affected by a double tax agreement (DTA). Each DTA contains a specific and far more detailed definition of what constitutes a PE.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is applicable on taxable goods and services. There are three classes of supplies for VAT: taxable supplies (at the rate of 16.5%), zero-rated supplies, and exempt supplies. A taxable person can claim input VAT on inputs used in making taxable supplies. A taxable person should complete VAT returns and make VAT payment, where applicable, on a monthly basis within 25 days after the end of the month.

### *Customs duties/Import tariffs*

Customs duty is applicable on goods imported into Malawi. The basis for calculating duty is cost, insurance, and freight (CIF). There are three types of import duties:

Customs duty, import excise, and import VAT. The rate of custom duty varies from product to product.

### *Excise duties*
Domestic excise is chargeable on certain goods manufactured in Malawi and on certain services such as alcoholic drinks, tobacco, and cell phone airtime. The rate of excise varies depending on the goods and services.

### *Turnover tax*
Turnover tax is applicable for businesses with a turnover between MWK 2 million and MWK 6 million. The turnover tax rate is 2% of turnover.

### *Resource rent tax for miners*
Miners pay resource rent tax of 10% on after tax profits if the rate of return exceeds 20%. This kind of tax has been introduced recently and details of operation are not clear. For example, no formula has been provided for calculating the rate of return.

### *Non-resident tax*
Non-resident tax is payable on income due to a non-resident at the rate of 15% of the gross income.

Any income payable to a person who is not resident in Malawi (who has not been in Malawi for an aggregate period of 183 days) arising from a source within Malawi is liable to a final tax of 15% of the gross of such income. Non-resident tax is applicable where the recipient of the income does not have a PE in Malawi from which the income emanated.

Non-resident tax should not be charged on income of residents of countries that have a standing DTA with Malawi. Currently, the following countries have a DTA with Malawi: United Kingdom, Denmark, The Netherlands, France, Norway, South Africa, Switzerland, and Sweden.

### *Fringe benefits tax (FBT)*
A fringe benefit is defined as any asset, service, or other benefit in kind provided by or on behalf of an employer to an employee, if such benefit includes an element of personal benefit to the employee. And, the employer providing such benefits is liable for payment of FBT. FBT is charged at the rate of 30% of the taxable figure.

Take note that a benefit need not be wholly for personal use in order to be considered for FBT.

Note as well that no benefit in cash, no matter what it is termed as, can be treated as a fringe benefit. All monies paid in cash (rather than in kind) should be considered for PAYE deduction.

However, subsistence allowances, given to employees working out of their duty station for instance, presumably to cater wholly, exclusively, and necessarily for the needs such as accommodation, meals, transport, etc. ought not be taxed. This applies also for reimbursement of expenses incurred in business.

Every employer shall register for FBT within the month in which one begins to provide fringe benefits.

The sums due as FBT shall be remitted to the Malawi Revenue Authority (MRA) in quarterly instalments not later than 14 days after the end of each quarter of a period of 12 months ending 30 June, and remittance should be accompanied with a duly completed FBT return in Form FBT 2.

Note that the value for FBT should not be included in the employee's certificate of gross emoluments.

**Assessment of housing fringe benefits**
The taxable value of a housing fringe benefit is the greatest of (i) 10% of salary where the house is unfurnished, (ii) 12% of salary if furnished, or (iii) the rental value.

Where the house occupied by the employee is owned by the employer, the taxable value is reduced by 50%.

**Motor vehicles**
FBT is applicable on motor vehicles allocated for use by members of staff and does not include pool cars or cars that are strictly commercial in nature.

The taxable value is 15% of the original cost of the vehicle.

**School fees (for children/dependants)**
50% of the cost to the employer for school fees is a taxable benefit, where payment is made directly to the educational institution. Education allowances payable to employees are not subject to FBT as the allowance is considered part of normal salary and taxable as such.



**Utilities, household items, vacations, travel, and domestic services**
The taxable value of utilities (e.g. electricity, water, and telephone expenses), household items, vacations, travel, and domestic services (e.g. gardener, cook, house boy, guard, nanny) is the entire cost to the employer. Except that for a house owned by the employer, the cost of gardener, security guard, and watchman shall not constitute a taxable benefit.

**Interest free loans and loans given at interest lower than the commercial rate**
Where an employer gives a loan to an employee, which is interest free or bears interest that is lower than the predetermined commercial rate, the difference between the interest offered and the commercial rate is a taxable benefit.

## *Branch income*

There is a 35% tax on taxable income of a branch of a foreign company. Locally incorporated companies pay tax at the rate of 30%.

No dividend withholding tax (WHT) is applicable on repatriation of profits.

## *Income determination*

### *Inventory valuation*
Inventory is stated at cost for tax purposes.

### Capital gains
The tax basis for capital gains is the cost of the asset adjusted by the applicable consumer price index (inflation index). Once determined, the taxable gain is subject to corporate tax at the rate applicable to the particular entity.

Capital gains arising from the disposal of personal and domestic assets not used in connection with trade are exempt from corporate tax.

Capital gains arising from the sale of shares traded on the Malawi Stock Exchange where they have been held for at least one year are also exempt from corporate tax.

### Rollover relief
If a business asset is sold and the taxpayer acquires a qualifying replacement asset, the taxpayer may claim rollover relief. This means that the taxpayer does not immediately pay the tax on the gain. Instead, the cost of the replacement asset is reduced by the amount of the gain. The taxpayer must declare this in the tax return.

A qualifying replacement asset is an asset similar to, or related in service or use to, the asset disposed of. The replacement asset must be acquired within 18 months of the disposal giving rise to the gain.

### Dividend income
Dividend income is exempt from corporate tax; however, dividends received from Malawi sources are subject to a 10% dividend WHT, which is a final tax. Note that although the word ‘final’ has not been defined, it is applied as meaning that dividend WHT suffered may not be offset against an income tax liability.

### Foreign exchange gains and losses
Foreign exchange gains realised on foreign currency assets or liabilities are taxable.

Foreign exchange losses realised on foreign currency assets or liabilities are tax deductible.

Unrealised gains and losses are carried forward until realised and then included in income or allowable expenditures. The maintenance of records that accurately track unrealised exchange rate adjustments from year to year is necessary to ensure correct tax computations.

### Tax-exempt income
The following are common examples of other tax-exempt income:

- The income of agricultural, mining, and commercial institutions or societies not operating for private pecuniary profit or gain of the members.
- The income of clubs, societies, and associations formed, organised, and operated solely or principally for social welfare or civic improvement or other similar purpose provided that the income of such bodies may not be divided among or used for the benefit of the members or shareholders.
- The income of ecclesiastical, charitable, and educational institutions of a public character.

### Foreign income
Generally, income whose source is not Malawi is not taxable in Malawi.

### Commissioner General's power to increase taxable income

The Commissioner General is empowered to increase the taxable income and liability of a taxpayer when of the opinion that the main purpose or one of the main purposes of a transaction was the avoidance or reduction of tax or where the main benefit that might have been expected to accrue from a transaction was the avoidance or reduction of tax.

## Deductions

Taxable income is calculated by deducting allowable items from assessable income. Section 28 of the Taxation Act defines tax-allowable deductions as any expenditures and losses (not being of a capital nature) wholly, exclusively, and necessarily incurred by the taxpayer for the purpose of trade or in the production of income.

### Capital allowances

Capital allowances (i.e. depreciation allowances) are applicable as stipulated in the Taxation Act at various rates.

Capital allowances, which are available to companies and individuals in business, are allowed as follows:

| | Allowances (%) | | |
|---|---|---|---|
| **Asset** | **Initial** | **Investment** | **Annual** |
| Industrial and farm buildings, hotels, and docks (1/2/3) | 10 | 40/20 | 5 |
| Staff housing (3) | 10 | – | 5 |
| Plant, machinery, and equipment (1/2/3/4) | 20 | 40/20 | 20/10 |
| Furniture and fittings (3) | 20 | – | 10 |
| Motor vehicles (3/4/5/6) | 20 | – | 20 |
| Commercial buildings (7) | – | – | 2.5 |
| Computers | 20 | | 40 |

Notes

1. The 40% investment allowance is available only on new and unused qualifying assets as indicated above, belonging to and used by a manufacturer or farmer (prior to 1 July 2011, the investment allowance was 100%). The rate for used qualifying assets is 20% (40% prior to 1 July 2011). The investment allowance is claimable only in the first year of use.
2. Where an investment allowance is claimed, the initial allowance is not allowed to be claimed on the same asset. The initial allowance is claimable only in the first year of use.
3. Annual allowances at the above rates are based on cost less investment and initial and annual allowances previously granted.
4. Investment allowance on plant and machinery excludes motor vehicles intended or adapted for use on roads.
5. A 20% annual allowance is standard, but the Commissioner General may vary the amount.
6. No initial allowance is granted on private motor vehicles. These include saloons, sedans, station wagons, and double cabin pickups. However, the restriction does not apply where the motor vehicle is used for hiring purposes.
7. The building must be newly constructed at a cost of no less than MWK 100 million.

On disposal, assets are subject to balancing charges (capital gains) or balancing allowances.

If an asset is subject to extensive use, such as machinery working double shifts, so that its expected economic life is reduced, the commissioner general may agree to increase the rates of annual allowances.

### Lease, patent, trademark, and copyright premium
The tax-deductible amount of a premium paid for the right of use or occupation of land or buildings, plant or machinery, patent design, trademark, copyright, or any other property of a similar nature is one of the following:

- The amount of premium or consideration divided by the number of years for which the right of occupation or use is granted.
- Where the period for which the right of occupation or use is granted exceeds 25 years, the deduction is one-twenty-fifth of the premium or consideration.

The premium is tax deductible only where the asset or right with respect to which the premium or consideration is paid is used for the generation of income. If a taxpayer acquires ownership of the asset or right, no further deduction of the premium or consideration is allowed from the date ownership is acquired.

### Pre-operating expenditures
A manufacturer may claim as a deduction any expenditure incurred in the course of establishing the business, provided that the following are true:

- The expenditure was incurred not more than 18 months before commencing business.
- The expenditure would have been allowed as a deduction if it had been incurred after commencing business.

### Research and development expenditures
Research expenditures are fully allowable as a deduction if they are for ‘experiments and research relating to trade’.

### Charitable contributions
Donations to approved charities and approved non-profit institutions formed for the purpose of social welfare, civic improvement, educational development, or other similar purposes are deductible. The minimum individual donation allowable is MWK 500. The minimum donation for other approved charities is MWK 250. In both cases, there is no maximum donation.

### Pension contributions
The tax-allowable amount of ordinary pension contributions made by an employer to an approved pension fund is subject to limitations. The limit with respect to each employee is the lowest of one of the following per annum:

- The actual contribution.
- 24% of the employee’s compensation.
- MWK 9,000.

No allowance is available if an employee is entitled to a tax-free gratuity.

### Net operating losses
Current taxable income may be offset against net operating losses brought forward and current operating losses may be increased by net unexhausted trading losses brought forward. Manufacturers and taxpayers in the agricultural industry may carry losses forward indefinitely, while other taxpayers may carry losses forward for only six years. Net operating losses may not be carried back.

### *Payments to foreign affiliates*
A deduction is allowed for payments to foreign affiliates if such payments are expended wholly, exclusively, and necessarily for the production of income or for the purposes of trade, and it can be demonstrated that the transaction is at arm's length.

## *Group taxation*

Group taxation is not permitted in Malawi.

### *Transfer pricing*
The transfer pricing regulations have not been fully introduced in Malawi. However, the tax anti-avoidance provision is used to check transactions between related parties. If transactions between related parties result in profits that are lower than what would be expected if the company was trading with an independent party, then the tax authorities can challenge the transaction.

### *Thin capitalisation*
There are no thin capitalisation rules in Malawi.

There are no restrictions on the level of external borrowings. If a Malawi company wants to borrow money from a foreign entity (whether or not a bank), it will require exchange control approval. In such instances, Reserve Bank does not consider the debt-to-equity ratio. It looks at the terms and conditions to see that they are what would be commonly available on the open market between unrelated parties. As you can see, this is an anti-transfer pricing measure.



If a new application is made for exchange control approval of foreign ownership (normally this is when there is a new business/investment into Malawi), Reserve Bank will look at the external debt to local equity ratio. There are no fixed rules, but Reserve Bank does not normally like external debt to be more than twice equity (i.e. 1:2 equity to external debt). It does give approval for external ownership where the proportion of external debt is higher than this as it looks at each proposal on its own merits. The applicant would have to justify the higher level of external debt in such a case.

### *Controlled foreign company (CFC) regime*
There is no CFC regime in Malawi.

## *Tax credits and incentives*

### *Export allowances*
Exporters, including those manufacturing in bond, are entitled to claim additional tax allowances for non-traditional exports:

- On the export of non-traditional products, there is a 15% tax allowance on taxable income derived from exports (prior to 1 July 2011, the allowance was 25%).
- There is a 15% transport tax allowance on international transport costs for non-traditional exports (prior to 1 July 2011, the allowance was 25%). Traditional exports are tea, coffee, cane sugar, and unmanufactured tobacco and tobacco refuse.

Export allowances may not be claimed in respect of exports from mining operations.

### *Investment allowance*

There is a 40% investment allowance on plant and machinery and industrial buildings for taxpayers in the manufacturing industry (prior to 1 July 2011, the investment allowance was 100%).

### *Farming operations*

Farming operations receive a 100% allowance with respect to expenditures incurred during any year of assessment on the following:

- Stumping, leveling, and clearing of land.
- Work in connection with the prevention of soil erosion.
- Boreholes.
- Wells.
- Aerial and geophysical surveys.
- Water control work, including any canal, channel, dyke, furrow, and any flood control structure, whether or not of a permanent nature.
- Water conservation work, meaning any reservoir, water dam, or embankment constructed for the impounding of water. In the case of water conservation work, the Taxation Act limits the amount deductible to amounts actually paid, where the farmer incurs a liability in terms of any law relating to natural resources.

Where a farmer derives taxable income from growing timber, the farmer may elect that the taxable income is determined in accordance with the following rules:

- Carryforward the cost of planting the timber until the timber reaches maturity.
- Add annually to the cost of planting the timber an amount calculated as 5% of the cost of planting the timber until the timber reaches maturity.
- When the timber is sold, a proportionate amount of the total of the carryforward cost and annual added cost is deducted from the proceeds.
- In each year of assessment, the annual added cost is treated as taxable income in the hands of the farmer.

A farmer may not deduct any expenditures that have been recovered through a subsidy or claim a capital allowance on any assets where the expenditures have been recovered through a subsidy.

### *Mining operations*

Mining operations receive a 100% allowance with respect to mining expenditures incurred during any year of assessment. Mining expenditures are defined as capital expenditures incurred in Malawi by a person carrying on or about to carry on mining operations in Malawi:

- In searching for or in discovering and testing or in winning access to deposits of minerals.
- In the acquisition of or of rights in or over such deposits, other than the acquisition from a person who has carried on mining operations in relation to such deposits.
- In the provision of plant and machinery and industrial buildings that would have little or no value to such person if the mine ceased to work.
- On the construction of any buildings or works that would have little or no value if the mine ceased to be worked.
- On development, general administration, and management prior to the commencement of mining operations.

Persons engaged in mining operations are not entitled to claim the export tax allowance on non-traditional exports or the 15% transport tax allowance on international transport costs for non-traditional exports.

## Withholding taxes

| Nature of payment | WHT rate (%) |
|---|---|
| Royalties | 20 |
| Rents | 15 |
| Payment of more than MWK 60,000 per annum for any supplies to traders and institutions | 3 |
| Commission | 20 |
| Payment for carriage and haulage | 10 |
| Payment to contractors and subcontractors in the building and construction industries | 4 |
| Payment for public entertainment | 20 |
| Payment of more than MWK 12,000 for casual labour | 20 |
| Services | 20 |
| Bank interest in excess of MWK 10,000 | 20 |
| Fees | 10 |

### Dividend WHT

Dividend WHT is a final tax and is charged at 10%. The dividend is not included in the taxpayer's taxable income and the WHT is not deducted from the taxpayer's tax liability.



## Tax administration

### Returns

Income tax returns are due within 180 days after the end of the financial year.

### Payment of tax

Tax is payable in two instalments at 30 November and 30 January, with the balance of the tax being paid on 30 April.

### Penalties

A penalty for late submission of returns is MWK 200,000.

# Malaysia

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## Significant developments

To encourage Malaysians working abroad to return to Malaysia and contribute to the country's economic transformation with their experience and expertise, the Prime Minister recently announced at Invest Malaysia 2011 that returning Malaysian professionals will be eligible for a reduced income tax rate of 15%. This new incentive is for a period of five years and only applies to employment income.

## Taxes on corporate income

For both resident and non-resident companies, the income tax is imposed on income accruing in or derived from Malaysia at a flat rate of 25%.

As a concessionary treatment for resident companies with paid-up capital from ordinary shares of 2.5 million Malaysian ringgit (MYR) or less, the rate of tax is 20% on the first MYR 500,000 of chargeable income and 25% on any income in excess of MYR 500,000. If a company meets the above capital requirement, but controls or is being controlled directly or indirectly by another company which has a paid-up capital of more than MYR 2.5 million in respect of ordinary shares, it is not eligible for the concessionary tax rate.

### Petroleum income tax

Petroleum income tax is imposed at the rate of 38% on profits from petroleum operations in Malaysia. No other taxes are imposed on income from petroleum operations.

## Corporate residence

A company is tax resident in Malaysia in a basis year if, at any time during the basis year, the management and control of its affairs are exercised in Malaysia. Generally, a company is regarded as resident in Malaysia if at any time during the basis period for a year of assessment, at least one meeting of the Board of Directors is held in Malaysia concerning the management and control of the company.

### Permanent establishment (PE)

Generally, a non-resident entity is regarded as having a PE in Malaysia if it has a fixed place of business in Malaysia, where the business of the entity is wholly or partly carried on. A non-resident company may also be deemed to have a PE in Malaysia under certain circumstances, such as the following:

- It is represented by a dependent agent in Malaysia, who has the authority to conclude contracts on its behalf and who has repeatedly exercised that authority.
- It carries on supervisory activities in Malaysia for six/nine months in connection with a construction, installation, or assembly project.

## Other taxes

### Sales tax and service tax

A single-stage *ad valorem* tax (sales tax), at rates ranging from 5% to 10%, is imposed on all goods imported into or manufactured in Malaysia, unless specifically exempted.

As of 1 January 2011, service tax is imposed at the rate of 6% on the value of taxable services sold or provided by taxable persons. Prior to 1 January 2011, the rate was 5%. A list of 'taxable services' and 'taxable persons' is found in the Service Tax Regulations, 1975.

### Goods and services tax (GST)

A GST of 4% was originally expected to be implemented in mid 2011, but its implementation is now delayed indefinitely. The reason reported for the delay is to allow the government more time to engage with the public in order to gather feedback on the implementation of the GST. Nevertheless, the introduction of the GST is included in the New Economic Model unveiled by the Prime Minister on 30 March 2010, as a key component of fiscal reforms aimed at transforming Malaysia into a high income nation.

GST, when implemented, will replace the sales tax and service tax currently imposed and collected under the Sales Tax Act 1972 and the Service Tax Act 1975. Companies with revenue below a certain threshold (to be gazetted separately and expected to be MYR 500,000) will be exempted from imposing GST.



### Import duties

Import duties are levied on goods that are subject to import duties and imported into the country. Import duties are generally levied on an *ad valorem* basis but may also be imposed on a specific basis. The *ad valorem* rates of import duties range from 2% to 60%. Raw materials, machinery, essential foodstuffs, and pharmaceutical products are generally non-dutiable or subject to duties at lower rates.

### Excise duties

Excise duties are imposed on a selected range of goods manufacture and imported into Malaysia. Goods which are subject to excise duty include beer/stout, cider and perry, rice wine, mead, un-denatured ethyl alcohol, brandy, whisky, rum and tafia, gin, cigarettes containing tobacco, motor vehicles, motorcycles, playing cards, and mahjong tiles.

The rate of excise duties vary from a composite rate of MYR 0.1 per litre and 15% of the value for certain types of spirituous beverages, to as much as 105% of the value of motorcars (depending on engine capacity).

### Stamp duty

Malaysia imposes stamp duty on chargeable instruments executed in certain transactions. In a stock deal, Malaysian stamp duty is payable at the rate of 0.3% on the consideration paid or market value of the shares (whichever is higher). In an asset deal, stamp duty ranging from 1% to 3% is payable on the market value of the dutiable properties transferred under the instrument. Stamp duty is payable by the buyer.

### Real property gains tax

Real property gains tax (RPGT) is charged upon gains from disposals of real properties (referred to as 'chargeable assets') situated in Malaysia, including shares of a real-property company (RPC). A RPC is a controlled company that owns real property or RPC shares with a defined value of not less than 75% of its total tangible assets.

As of 1 January 2010, RPGT is imposed at the rate of 5% on gains arising from disposals of chargeable assets in respect of real properties within five years of their acquisition.

### Property tax

Property tax is levied on the gross annual value of property as determined by the local state authorities.

### Windfall profit levy

A levy is imposed on crude palm oil and crude palm kernel oil at a maximum of MYR 50 per ton where the price exceeds MYR 2,500 per ton in Peninsula Malaysia, and MYR 3,000 per ton in the states of Sabah and Sarawak.

### Contract levy

A levy of 0.125% on contract works having a contract sum above MYR 500,000 is imposed on every registered contractor by the Construction Industry Development Board.

### Human resource development levy

Employers engaged in the manufacturing and services sectors that employ more than a specified number of employees must contribute to the Human Resource Development Fund (HRDF). The levy required to be paid is at the rate of 1% of the employees' monthly wages on a monthly basis.

## Branch income

Tax rates on branch profits of a company are the same as those on corporate profits. No tax is withheld on transfer of profits to a foreign head office.

## Income determination

### Inventory valuation

Inventories are generally stated at the lower of cost or net realisable value. Cost for this purpose may be determined by using one of several possible bases, such as unit cost, average cost, or the first in first out (FIFO) method, as long as the basis used is consistent from one year to another.

### Capital gains

Generally, gains on capital assets are not subject to tax, except for gains arising from the disposal of real properties. Gains arising from the disposal of real property (which include the disposal of shares in a RPC) situated in Malaysia is subject to RPGT *(see the Other taxes section for more information)*.

### Dividend income

A single-tier system of taxation came into force on 1 January 2008 which replaced the previous full imputation system. There is a six-year transitional period (until 31 December 2013) for all companies to migrate into the single-tier system.

Under the previous (full-imputation) system, dividends received from Malaysian companies are taxed at gross in the hands of shareholders (whether corporate or individuals). Companies distributing dividends are required to deduct tax at source at the prevailing corporate tax rate, from gross dividends payable, but the income tax deducted or deemed deducted from the dividends is available as a credit (deducted) against the income tax liability of the shareholder. If a dividend is paid by a company which was subjected to tax at the rate of 20% *(see Taxes on corporate income),* tax is to be deducted or is deemed to be deducted from the dividend at the normal 25% corporate tax rate.

Under the single-tier tax system, dividends are exempt in the hands of shareholders. Companies are not required to deduct tax from dividends paid to shareholders, and no tax credits will be available for offset against the recipient's tax liability. Corporate shareholders receiving exempt one-tier dividends can, in turn, distribute such dividends to their own shareholders, who are also exempt on such receipts.

### Stock dividends

A Malaysian corporation may distribute bonus shares tax-free to shareholders.

### Foreign income

Under the Income Tax Act, 1967 (ITA) a Malaysian tax-resident corporation and a unit trust are not taxed on their foreign-sourced income, regardless of whether such income is received in Malaysia. However, income of a resident company from the businesses of banking, insurance, and air or sea transport is assessable on a global basis, except for income attributable to a Labuan business activity of the branch or subsidiary of a Malaysian bank in Labuan which is subject to tax under the legislation applicable to Labuan entities in Labuan (Labuan Business Activity Tax Act 1990). A Labuan entity may also make an irrevocable election to be taxed under the ITA in respect of its Labuan business activity.



In respect of Malaysian-owned banks, insurance companies, and takaful (Islamic insurance) companies, the profits of newly established branches overseas or remittances of new overseas subsidiaries are tax exempt for five years, provided that the applications to establish overseas branches or subsidiaries are received by the Central Bank of Malaysia no later than 31 December 2015.

Relief from double taxation is available by means of a bilateral credit if there is a governing tax treaty or unilateral relief where there is no treaty. The relief is restricted to the lower of Malaysian tax payable or foreign tax paid if there is a treaty, or one-half of the foreign tax paid if there is no treaty.

Undistributed income of foreign subsidiaries is not taxable.

## Deductions

### Depreciation and depletion

Tax depreciation (called capital allowance) on machinery, equipment, and industrial buildings is available at specific rates for all types of businesses. Locally acquired machinery and equipment qualify for an initial allowance of 20%, while imported heavy machinery (used in building and construction, mines, plantation, and timber industries) qualifies for 10% when the expenditure is incurred and the asset is in use.

An annual allowance ranging from 10% to 20% is calculated on cost for every year during which the asset is in use for the purposes of the business.

An accelerated capital allowance is available for certain types of plant and machinery, such as computers, information technology equipment, environmental protection equipment, waste recycling equipment, and plant and machinery used in the business of plantation companies. Small-value assets costing less than MYR 1,000 each are entitled to 100% capital allowance, subject to a maximum total cost of MYR 10,000.

Depreciation recapture on the sale of plant and machinery is taxable as ordinary income. Tax depreciation is not required to conform to book depreciation.

A depletion allowance is available on natural-resource properties.

### *Taxes*
Taxes on income are generally not deductible, whereas indirect taxes, such as sales tax and service tax, are deductible.

### *Net operating losses*
The carryforward of business losses and capital allowances is not available for deduction in subsequent years of assessment if the company does not meet the conditions of a shareholders' continuity test. However, a recent guideline issued by the Ministry of Finance states that the rule restricting the carryforward of losses and capital allowances based on the shareholder continuity test applies only to dormant companies. Carryforward of business losses and capital allowances is unlimited in time for non-dormant companies.

Current-year business losses may be utilised against all sources of income. Set-off of unutilised carried-forward losses is restricted to income from business sources only. Utilisation of tax depreciation is also restricted to income from the same underlying business source.

There is hitherto no provision for loss or tax depreciation carryback to previous tax years. However, under the Economic Stimulus Package presented on 10 March 2009, a taxpayer (including a company) may make an irrevocable election for the current-year loss for year of assessment (YA) 2009 or YA 2010 to be carried back for offset against income of the immediately preceding year, up to a maximum loss of MYR 100,000.

### *Payments to foreign affiliates*
A Malaysian corporation can claim a deduction for royalties, management service fees, and interest charges paid to affiliates, provided that these are made at arm's length (i.e. the amounts it would pay if it was dealing with an unrelated entity).

## *Group taxation*

Group relief is available to locally incorporated, resident companies. A company that qualifies may surrender a maximum of 70% of its adjusted loss for a year of assessment to one or more related companies, if the following conditions are met:

- Both the claimant and surrendering companies must each have paid-up capital of ordinary shares exceeding MYR 2.5 million at the beginning of the basis period for that particular year of assessment, and must have the same (12-month) accounting period.

- The companies must be 'related' throughout the period that forms the basis period for a particular year of assessment as well as the 12 months preceding that basis period. 'Related company' is defined by law and involves the application of a two-tier test. The first test relates to the proportion of one company's ownership in the ordinary share capital of the other company (at least 70%), or at least 70% ownership of the surrendering and claimant companies' shares by a third company. The other test is based on the proportion of distributable profits and assets on winding up to which the holding company is entitled (at least 70%).

Companies that wish to avail themselves of group relief must make an irrevocable election to surrender or claim the tax loss in the return to be filed with the Inland Revenue Board for that year of assessment.

### *Transfer pricing*
A new provision was introduced, effective as of 1 January 2009, which empowers the Director General of Inland Revenue (DGIR) to make adjustments on transactions of goods and services if the DGIR is of the opinion that the transactions were not entered into on an arm's-length basis.

### *Thin capitalisation*
A new provision for thin capitalisation was also introduced, effective as of 1 January 2009. With regard to this, the portion of the interest charge that relates to the amount of financial assistance which is excessive will be disallowed as a deduction. However, the implementation of specific rules relating to this provision has been deferred to the end of December 2012.



## *Tax credits and incentives*

### *Inbound investment incentives*
#### Pioneer status (PS)
Corporations in the manufacturing, agricultural, hotel and tourism sectors, or any other industrial or commercial sector that participate in a promoted activity or produce a promoted product may be eligible for PS. This incentive is given by way of exemption from income tax on 70% of the annual profits for five years. The remaining 30% of the profits is taxed at the prevailing corporate income tax rate. The profits exempted from tax are available for distribution as tax-free dividends.

In the following cases, the general rule of tax exemption and period of incentive is varied:

- Corporations undertaking a project of national and strategic importance involving heavy capital investment and high technology will be granted full exemption on its profits. The tax-relief period may be extended for a further five years. Projects recognised to be of national and strategic importance include forest plantation activities, projects with Multimedia Super Corridor (MSC) status, and production of electronic wafers.
- High-technology companies engaging in a promoted activity or in the production of a promoted product in areas of new and emerging technologies, as well as companies participating in an industrial linkage programme, may be granted PS, which entitles them to full exemption on profits for a period of five years.
- Corporations with projects eligible for PS (applications must have been made before 31 December 2010) that are located in the eastern corridor states of Peninsular Malaysia, Sabah, and Sarawak will be granted exemption on 100% of their profits

for five years. An existing pioneer or ex-pioneer corporation that undertakes an expansion programme through a subsidiary or controlled company in the eastern corridor states of Peninsular Malaysia, Sabah, Sarawak, and Labuan, and the state of Perlis, that involves the same promoted activities or promoted products is eligible for a second round of PS or investment tax allowances if certain conditions are satisfied. The eastern corridor states include Kelantan, Trengganu, and Pahang, and the district of Mersing in Johor.
- Existing locally owned companies reinvesting in production of heavy machinery, machinery, and equipment are to be granted exemption on 70% of the increased statutory income arising from reinvestment for five years.
- New and existing companies utilising oil palm biomass and reinvesting to produce value-added products are to be entitled to full exemption on profits for a period of ten years.
- Small companies that meet with specified conditions are entitled to full exemption on profits for a period of five years.
- A second round of PS is available for hotel and tourism companies which invest in expansion, modernising, and renovation, as well as for companies providing cold-chain facilities and services for perishable agricultural produce.
- Companies engaged in generating energy from renewable sources or in providing energy efficiency services will be given a full exemption for ten years for applications received before 31 December 2015.

A company granted PS which intends to reinvest before the expiry of its PS is eligible for reinvestment allowance provided that it surrenders its PS *(see section on Reinvestment allowance below)*.

**Deduction for export expenses**
Resident corporations in the manufacturing, hotel, tourism, and service sectors are entitled to double deduction for expenditures incurred on the promotion of exports, such as overseas advertising, free samples, export market research, participation in trade exhibitions, preparation of tenders, travel, participation in virtual trade shows, participation in trade portals for promotion of local products, and maintenance of overseas sales offices and warehouses. For promotion of export of services, expenses such as feasibility studies for overseas tender projects, participation in a trade or industrial exhibition in Malaysia or overseas, airfares, and sustenance are entitled to double deduction. Expenses incurred by pioneer companies are aggregated and offset against post-pioneer (taxable) profits.

**Investment tax allowance (ITA)**
A corporation may be granted an ITA of 60% of capital expenditure incurred on a factory or plant and machinery used for purposes of an approved manufacturing, agricultural, hotel, tourist, knowledge-intensive, or other industrial or commercial activity (other than one granted PS). ITA is granted on capital expenditure incurred for a period of five years. For an integrated agricultural activity, ITA may be granted for both the agricultural and the processing activities for five years each.

The amount of ITA to be utilised for each year of assessment is restricted to a maximum of 70% of the profits, while the balance of 30% of the profits is taxed at the prevailing corporate income tax rate. Unutilised allowances may be carried forward indefinitely for offset against future profits of the business. Dividends paid out of exempt profits are exempt from tax in the hands of shareholders.

The ITA incentive is enhanced for the following types of projects:

- A corporation undertaking a project of national and strategic importance may be granted ITA at a rate of 100% and would be able to utilise the amount of ITA granted for offset against 100% of profits each year, without restriction.
- A high-technology company may be granted ITA at the rate of 60%, and the amount of ITA would be available for offset against 100% of profits. This incentive is an alternative to PS.
- A company granted ITA in respect of a project located in the eastern corridor states of Peninsular Malaysia, Sabah, Sarawak, and Labuan, and the state of Perlis, will be granted ITA at a rate of 100%, and the amount of allowance can be offset against 100% of its profits for each year. An existing ITA or ex-ITA company that undertakes an expansion programme through a subsidiary or controlled company in the eastern corridor states of Peninsular Malaysia, Sabah, Sarawak, and Labuan involving the same promoted activities or promoted products is eligible for a second round of ITA if certain conditions are satisfied (applications must have been made before 31 December 2010).
- A company that provides technical and vocational training or science courses in biotechnology, medical and health, molecular biology, material sciences, and food sciences in Malaysia may be granted ITA of 100% of qualifying capital expenditures incurred within a period of ten years, and the maximum amount of ITA that could be utilised each year would be restricted to 70% of profits.
- Existing locally owned companies reinvesting in production of heavy machinery, machinery, and equipment are granted ITA at the rate of 60% on additional qualifying expenditure incurred for a period of five years.
- New and existing companies utilising oil palm biomass and reinvesting to produce value-added products are granted ITA at a rate of 100%, and will be able to utilise the amount of ITA granted for set-off against 100% of profits each year, without restriction.
- A second round of ITA is available for hotel and tourism companies which invest in expansion, modernising, and renovation, as well as companies providing cold-chain facilities and services for perishable agricultural produce.
- Companies investing in or upgrading an existing testing laboratory for testing medical devices may be granted ITA of 60% on qualifying expenditures incurred within a period of five years to be offset against 100% of profit for each year of assessment.
- Companies investing in certain equipment used to generate energy from renewable sources or investing in energy conservation equipment will be given ITA at a rate of 100% for five years and will be able to utilise the amount of ITA granted for offset against 100% of profits each year, without restriction. This is in respect of applications received before 31 December 2015.



### Reinvestment allowance
A corporation that embarks on a programme to expand, modernise, automate, or diversify its existing manufacturing business is entitled to a reinvestment allowance. The amount of reinvestment allowance is 60% of qualifying capital expenditure incurred within a period of 15 years on a factory or plant and used for expansion, modernisation, automation, or diversification activity. The reinvestment allowance will be withdrawn if the asset for which the reinvestment allowance is granted is disposed of within five years.

The amount of reinvestment allowance that can be utilised each year is limited to 70% of profits after deduction of capital allowances. The remaining 30% is taxed at the normal corporate income tax rate. Unutilised reinvestment allowances may be carried forward indefinitely for offset against future profits of the business. The 70% restriction does not apply to projects that achieved the level of productivity as prescribed by the

Minister of Finance and to projects located in the eastern corridor states of Peninsular Malaysia, Sabah, Sarawak, and Labuan and the state of Perlis.

A reinvestment allowance is also extended to a tax-resident company undertaking an approved agricultural project that incurs qualifying capital expenditure for the purposes of expanding, modernising, or diversifying its cultivation and farm businesses.

Dividends paid out of exempt profits are not taxable in the hands of shareholders.

### Venture capital company

A company investing in approved venture companies in the form of start-up or seed capital is given a deduction equivalent to the value of the investment. To qualify for the deduction, the investment must not be in a company that is listed on a stock exchange, and it should not be in a company related to the investing company at the point of first investment. Where this deduction is not claimed, the venture capital company may be eligible for tax exemption for a period of ten years or the life of the fund established for the purpose of investing in a venture company, whichever is the lesser, on income from all sources, other than interest income from savings or fixed deposits and profits from syariah-based deposits, if at least 50% of its funds are invested in venture companies (reduced to 30% in respect of applications received by the Securities Commission from 30 August 2008 to 31 December 2013).

### *Development corridors*

As part of the Malaysian government's plan for national economic advancement through regional development and growth acceleration in various strategic locations by promotion of domestic and foreign investments, the following 'development corridors' were launched during the period from the end of 2006 to early 2008:

| Economic region | Location | Year of launch |
|---|---|---|
| Iskandar Malaysia (renamed in April 2008 and formerly known as 'Iskandar Development Region') www.iskandarmalaysia.com.my | Southern Johor | 2006 |
| Northern Corridor Economic Region www.ncer.com.my | States of Perlis, Kedah, Penang, and northern Perak | 2007 |
| East Coast Economic Region www.ecerdc.com | States of Kelantan, Terengganu, Pahang, and district of Mersing in Johor | 2007 |
| Sabah Development Corridor www.sdc.gov.my | Western, central, and eastern regions of Sabah | 2008 |
| Sarawak Corridor of Renewable Energy www.sarawakscore.com.my | Central Sarawak | 2008 |

Basic to the strategy for promotion of investments in these development corridors is the provision of all necessary infrastructure (financial and non-financial) for the creation of a business-friendly environment, including tax and other financial incentives. Apart from existing incentives which are available for promoted activities and products provided under the Promotion of Investments Act 1986 (PS, ITA ,etc.) and the Income Tax Act 1967 (outlined above), special incentives customised for the purpose of each development corridor have been (or will be) developed. So far, however, special legislation has been enacted only in respect of Iskandar Malaysia (IDR) to grant the following exemptions/incentive:

- Income tax exemption for an approved IDR-status company in respect of income from the provision of qualifying services to a person situated within designated nodes in the IDR or outside Malaysia, for ten years, provided that these operations commence before 31 December 2015.
- Income tax exemption for non-residents in respect of income from technical fees, interest, or royalties received from approved developers in designated nodes in the IDR, or IDR-status companies. Withholding tax (WHT) requirements are also waived in respect of such payments.
- Income tax exemption for an approved developer on income from the disposal of rights over land or buildings in designated nodes in the IDR or rental from such buildings until 2020. Exemption is also granted to an approved development manager on income from the provision of management, supervisory, and marketing services to such developers until 2020.
- A qualified person (defined) who is a knowledge worker residing in Iskandar Malaysia is taxed at the rate of 15% on chargeable income from an employment with a designated company (defined by legislation) engaged in a qualified activity (e.g. green technology, educational services, healthcare services, creative industries, financial advisory and consulting services, logistics services, tourism) in that specified region. The employment must have commenced on or after 24 October 2009 but not later than 31 December 2015.

Information pertaining to each development corridor, including incentives available, may be obtained from the corridor's website, the address of which is provided above.

### *Other tax incentives*

#### Operational headquarters company (OHQ)



An OHQ company that provides qualifying services to its offices and related companies may be granted approved OHQ status.

The income (business income, interest, and royalties) derived by an approved OHQ from the provision of qualifying services is exempt from income tax for a period of ten years. This includes income from services provided to related companies in Malaysia, provided such income does not exceed 20% of the OHQ income. Dividends distributed from exempt income are exempt in the hands of shareholders. Expatriates working in an OHQ are taxed only on the portion of chargeable income attributable to the number of days they are in Malaysia. An OHQ is also granted special facilities, including the following:

- Approvals for expatriate posts are based on the requirements of the OHQ.
- Credit facilities in foreign currency can be obtained from licensed commercial banks in Malaysia, without approval of the Central Bank of Malaysia.
- There is no restriction on investments in foreign securities and lending to related companies outside Malaysia.
- A single or foreign currency account may be opened with licensed commercial banks in Malaysia or banks in Labuan.

#### International procurement centre (IPC)

An IPC is a company incorporated in Malaysia, whether local or foreign owned, that is engaged in the procurement and sale of raw materials, components, and finished products to related or unrelated companies in Malaysia or abroad.

Tax incentives include:

- Exemption for ten years on income from qualifying activities in respect of export sales after deduction of tax-depreciation allowance (subject to conditions).
- Dividends paid from exempt income are exempt from tax in the hands of shareholders.
- Goods brought into free zones, bonded warehouses, or licensed manufacturing warehouses for repackaging or cargo consolidation and integration before distribution to final consumers are exempt from customs duties.

To qualify, an IPC must serve as a collection and consolidation centre for finished goods, components, and spare parts from overseas or within the country to be distributed to the dealer, importer, or its subsidiary or associated company within or outside the country.

In addition, other available non-tax incentives include:

- Approval for expatriate posts based on the requirements of the IPC.
- Ability to maintain more than one foreign currency account for the retention of export proceeds with any licensed commercial bank and without any limit on the balance in the accounts.
- Permission to enter into foreign exchange forward contracts with a licensed commercial bank to sell forward export proceeds based on projected sales.
- Exemption from foreign equity ownership restrictions.

### International trading companies
Companies that obtained approval as 'international trading companies' are exempt for five years on income equivalent to 20% of increased export value, up to a maximum of 70% of statutory income. To qualify for the incentive, the company must meet the following three conditions:

- Be incorporated in Malaysia, with 60% Malaysian ownership.
- Achieve minimum annual sales of MYR 10 million, not more than 20% of which may be derived from the trading of commodities.
- Use local services (banking, finance, and insurance) and infrastructure (local ports and airports) in its operations.

### Regional distribution centre
A regional distribution centre (RDC) is a collection and consolidation centre for finished goods, components, and spare parts produced by its related company for its own brand, from overseas or within the country to be distributed to the dealer, importer, or its subsidiary or associated company within or outside the country. Among the activities involved are bulk breaking, repackaging, and labelling. Incentives accorded to an RDC include:

- Exemption for ten years on income from qualifying activities in respect of export sales, after deduction of tax depreciation allowance (subject to conditions).
- Dividends paid from exempt income are exempt from tax in the hands of shareholders.
- Import duty and sales tax on goods for distribution are tax exempt.

Other non-tax incentives include:

- Exemption from foreign equity ownership restrictions.

- Approval for expatriate posts based on requirement of the RDC.
- Eligibility to open one or more foreign currency accounts with any licensed commercial bank to retain their export proceeds, without any limit imposed.
- Permission to enter into foreign exchange forward contracts with any licensed commercial bank to sell forward export proceeds, based on projected sales.

**MSC Malaysia status companies**

MSC Malaysia is Malaysia's initiative for the global information technology industry and is designed to be the research and development (R&D) centre for industries based on information technology (IT). Conceptualised in 1996, MSC Malaysia has grown into a thriving information communication technology (ICT) hub, hosting multinational corporations, foreign-owned, and home-grown Malaysian companies focused on multimedia communications products, solutions services, and R&D. The Malaysian government has equipped core areas in MSC Malaysia with high-capacity global telecommunications and logistics networks. MSC Malaysia is also supported by secure cyber laws, strategic policies, and a range of financial and non-financial incentives for investors.

The Multimedia Development Corporation (MDeC) was established to develop and manage MSC Malaysia. The MDeC is a fully empowered 'one-stop shop' that acts as approving authority for companies applying for MSC Malaysia status.

MSC Malaysia status is awarded to both local and foreign companies that develop or use multimedia technologies to produce or enhance their products and services as well as for process development. Companies awarded MSC Malaysia status are eligible for incentives which include the following:



- PS for five years (extendable up to five additional years) or investment tax allowance of 100% for five years for a new company or an existing company on its additional income.
- Eligibility for R&D grants (for majority Malaysian-owned, MSC Malaysia status companies).
- Exemption from indirect taxes on multimedia equipment.
- Unrestricted employment of local and foreign knowledge workers.
- Freedom to source funds globally for investments.
- Protection of intellectual property and cyber laws.
- No censorship of the Internet.
- MSC Malaysia status companies located within this area will enjoy globally competitive telecommunication tariffs and services guarantees, world-class physical and IT infrastructure, and excellent R&D facilities, including the region's first Multimedia University.

**Biotechnology industry**

Companies undertaking biotechnology activity with approved bionexus status from Malaysian Biotechnology Corporation Sdn Bhd are eligible for 100% income tax exemption for ten years from the first year in which the company derives profit or ITA of 100% on qualifying capital expenditures incurred for a period of five years. Dividends distributed from exempt income are tax exempt for the recipient. Double deduction is available for expenditures incurred on R&D and on promotion of exports.

The following incentives are also available:

- A company or individual investing in a bionexus company is given a tax deduction of an amount (approved by the Minister of Finance) equal to the value of investment for the purpose of financing activities at seed capital stage or early stage of a new business.

- Stamp duty and real property gains tax exemption is granted to a bionexus company undertaking a merger and acquisition with a biotechnology company within a period of five years until 31 December 2011.
- Accelerated industrial building allowance is given (over ten years) on qualifying building expenditures for buildings used by a bionexus-status company for the sole purpose of its new business or expansion project.
- Concessionary tax rate of 20% of statutory income from qualifying activities to be applied for ten years upon expiry of the tax exempt period.
- Exemption of import duty and sales tax on import of raw materials and machinery.

### Unit trusts

Gains from the realisation of investments are not regarded as taxable income of a unit trust. Interest received by unit trusts from certain bonds and securities, as well as interest credited by banks and other financial institutions licensed under the Banking and Financial Institutions Act 1989 or the Islamic Banking Act 1983, are exempt from tax. Distributions from such gains are tax exempt to the unit holders.

Capital allowance in respect of plant and machinery used for the purpose of the letting of properties is allowed at the rate of 10% per annum against the rental income of a property unit trust.

### Research and development (R&D)

Companies that provide R&D services to third parties are eligible for PS with full exemption of their profits for a period of five years. A second round of PS incentive is available for another five years. As an alternative, such companies may be granted ITA at the rate of 100% of qualifying capital expenditure incurred within a period of ten years and a further ten years for a second round of ITA. The ITA incentive may also be granted to companies undertaking R&D for their group.

Companies undertaking in-house R&D projects are eligible for ITA at the rate of 50% of the qualifying capital expenditure incurred within a period of ten years.

A company that has made an investment for the sole purpose of financing a project on commercialisation of R&D findings (which must be R&D findings in the resource-based industry, wholly owned by a public research institute or public institute of higher learning in Malaysia) is given a deduction equivalent to the value of that investment.

Double deduction is granted for expenses incurred on approved R&D projects, as well as for payments made to defined R&D companies. Local universities are recognised as approved research institutes for the purposes of claims for the double-deduction incentive by companies making cash contributions or payments for the use of the services of such universities for R&D activities.

Buildings used for approved R&D activities qualify for the industrial building allowance at the normal rate.

### Training

There is a double deduction for approved training expenditures incurred to train employees under an approved training programme. Manufacturing corporations with 50 or more Malaysian employees registered with the HRDF are not eligible for this incentive. These corporations are, however, eligible to seek financial assistance from the fund for training their employees.

Preoperating training expenses are also available as a double deduction to small and medium-scale manufacturing companies that are not registered with the HRDF. The normal deduction for preoperating training expenses may also be available to certain resident companies.

Training expenses incurred by employers for employees who complete certain courses, including aircraft maintenance engineering courses and post-graduate courses in ICT, are given double deduction (for YA 2009–2012).

### Approved service projects

A resident company undertaking a project in the service sector in relation to transport, communications, utilities, or other approved subsectors may elect to apply for an investment allowance or for an income tax exemption for a period of five years. The mechanisms for tax exemption and investment allowance are similar to those for PS and ITA, respectively.

Dividends paid out of exempt profits are exempt in the hands of shareholders.

Buildings used solely for the purposes of approved service projects qualify for an industrial building allowance.

### Foreign fund management company

A foreign fund management company providing fund management services to foreign clients is taxed at a concessionary rate of 10% in respect of the income derived from the management of foreign funds, while income arising from services rendered to clients in Malaysia is taxed at the prevailing corporate tax rate. Its income after deduction of tax at 10% may be distributed as tax-exempt dividends to its shareholders.



A foreign fund management company is a Malaysian incorporated company licensed under the Capital Markets and Services Act 2007. Its activities are regulated by the Securities Commission.

### Shipping

Tax-resident corporations and individuals carrying on shipping business are exempt from tax on income derived from the operation of Malaysian ships. Dividends distributed by a company qualifying for this incentive are exempt from tax in the hands of the shareholders.

### Export incentives

Partial tax exemption is granted at various rates for export-oriented companies. Manufacturing companies are eligible for exemption on profits after deduction of tax depreciation allowances on 10% (or 15%) of the value of the increase in the company's exports, provided it attains at least 30% (or 50%) value added. Companies exporting fruits and cut flowers or exporting selected services also enjoy an exemption on profits, after deduction of tax depreciation allowances, equivalent to 10% of the value of the increase in exports. Companies engaged in export of selected services are eligible for exemption on profits on 50% of the value of increased exports.

A Malaysian-owned manufacturing company may be granted exemption on profits, after deduction of tax depreciation allowance of an amount equal to 30% of the value of increased export value, provided it achieves a significant increase in exports. The rate is increased to 50% of the value of increased export for a company that succeeds in penetrating new markets. Full exemption on increased export value is granted if the company achieves the highest increase in export.

### Resource-based industries

Malaysian companies that are engaged in the manufacture of rubber, oil palm, and wood-based products that are of export potential may be granted the following tax incentives when they incur capital expenditures for the purpose of an expansion:

- Companies located outside promoted areas:
  - PS for five years (exemption is restricted to 70% of statutory income) or
  - ITA of 60% of qualifying capital expenditure incurred within five years (ITA is restricted to 70% of statutory income).
- Companies located within promoted areas (applications must have been made before 31 December 2010):
  - PS for five years (exemption of 100% of statutory income) or
  - ITA for five years (ITA of 100% of statutory income).

### Manufacturing-related services

Companies providing integrated logistics, marketing support, and utility services may be given the following incentives:

- Income tax exemption of 70% of statutory income for five years. The rate of exemption is increased to 100% of statutory income for projects located in areas designated as the eastern corridor of Peninsula Malaysia, Sabah, and Sarawak; or ITA of 60% of qualifying capital expenditure (QCE) incurred within five years of the date upon which QCE was first incurred, to be offset against 70% of statutory income. This ITA incentive is enhanced to 100% of QCE, to be offset against 100% of statutory income for projects in the eastern corridor of Peninsula Malaysia, Sabah, and Sarawak.
- Exemption from import duty and sales tax on equipment in the related projects.

### Offshore trading through websites in Malaysia

Income received by companies undertaking offshore trading (comprised of the buying and selling of foreign goods to non-residents) via websites in Malaysia is to be taxed at a reduced rate of 10% for a period of five years. The approval of the Minister of Finance must be obtained.

### Islamic banking and other Islamic financing activities

To further the government's objective of developing Malaysia into a leading international Islamic financial centre, the following incentives are available:

- Tax deduction is allowed for expenses incurred in the issuance of Islamic securities approved by the Securities Commission or by the Labuan Financial Services Authority until YA 2015 only.
- Full income tax exemption for ten years is granted to Islamic banks licensed under the Islamic Banking Act 1983 on income from Islamic banking business conducted in international currencies, and to takaful (Islamic insurance) companies on income from the takaful business conducted in international currencies. (Effective from YA 2007 until YA 2016.)
- Full income tax exemption on management fees received by local and foreign companies for managing funds of foreign and local investors established under Syariah principles is granted (effective from YA 2008 until YA 2016). Such funds must be approved by the Securities Commission.
- A special-purpose vehicle (SPV) established solely for the purpose of Islamic financing approved by the Securities Commission or one established under the Offshore Companies Act 1990 is not subject to income tax and is not required to comply with administrative procedures under the tax law. Deduction for the

cost of issuance of Islamic bonds is allowed for the company that established the SPV, which is also deemed to be the recipient of income received by the SPV and taxed accordingly.
- Expenses incurred prior to the commencement of an Islamic stock-broking company are allowed to be deducted, provided the company commences business within two years from the date of approval. (Available for applications to establish such a company that is received by the Securities Commission before 31 December 2015.)
- Double-tax deduction is granted for specified expenses incurred for the purpose of its business in promoting Malaysia as an international Islamic financial centre for YA 2008 until YA 2015.

### Real estate investment trusts (REITs)

REITs or property trust funds (PTFs) approved by the Securities Commission are exempted from income tax on chargeable income distributed to unit holders whereas its undistributed chargeable income is taxed at 25%. However, REITs/ PTFs are exempted from tax on all income, provided that at least 90% of their total income is distributed to unit holders. If the 90% distribution condition is not complied with, all income is taxed at the prevailing income tax rate and tax credit is claimed by the unit holders. Unit holders are taxed as follows:

| Unit holders | Income tax |
|---|---|
| Individuals (whether resident or non-resident), body of persons, or other unincorporated persons | Withholding tax (WHT) of 10% from 1 January 2009 to 31 December 2011. |
| Non-resident company | WHT at 25%. |
| Resident company | No WHT (income to be included in annual tax return) |
| Institutional investor (pension fund, collective investment scheme, or other person approved by the Minister of Finance) | WHT at 10% from 1 January 2009 to 31 December 2011. |

Other incentives available are:

- Real property gains tax exemption on disposal of real property to a REIT/PTF.
- Stamp duty exemption on transfer of real property to REIT/PTF.
- Tax deduction given for consultancy, legal, and valuation service fees incurred on the establishment of a REIT.

### Healthcare service providers

A tax exemption is granted to healthcare service providers on statutory income equivalent to 100% of the value of increased services (defined by legislation), but limited to 70% of statutory income (YA 2010 to 2014 only). Any unutilised allowance can be carried forward indefinitely for deduction in the future. Export income is income derived from providing healthcare services to foreign clients. ‘Foreign clients’ include entities such as a corporation or partnership registered outside Malaysia, or a non-Malaysian citizen (excluding those holding a Malaysian student pass or work permit and their dependents).

### Buildings awarded Green Building Index (GBI) Certificate

A person (resident in Malaysia) awarded a GBI certificate by the Board of Architects Malaysia from 24 October 2009 until 31 December 2014 is granted 100% allowance on qualifying expenditure incurred for the purpose of obtaining the GBI certificate, to be offset against 100% of statutory income.

### Forest plantations

The following incentives for forest plantations are available only for applications received no later than 31 December 2011.

- A company undertaking a new forest plantation project or an expansion forest plantation project which is an approved project is eligible for tax exemption of 100% of statutory income. The exemption period is ten years commencing from the first year of assessment (YA) in which the company derives income from the new forest plantation project, or five years in respect of an expansion project, commencing from the first YA in which the company derives income from the expansion project, and that first YA shall not be earlier than the YA in which the date of approval falls. Losses incurred before and during the exemption period are allowed to be carried forward for deduction in the post-exempt year and subsequently until fully utilised.
- A company undertaking its first forest plantation project for specified species of trees and has surrendered the losses from that project to one or more related companies (as defined by legislation) which is/are resident in Malaysia, is eligible for exemption from income tax on 100% of statutory income for ten years commencing from the first YA in which the company derived income from that project. Losses surrendered are allowed to be deducted from income of the related/claimant company, but any losses not surrendered in that YA will not be available to any claimant company for any subsequent YA.

### Export of financial services

Income tax exemption is granted to Malaysian banks, insurance companies, and takaful companies on profits of newly established branches overseas or income remitted by new overseas subsidiaries. The exemption period, which is five years, may commence from a date to be determined by the company but should not be later than the third year of operations. Applications to establish new branches or subsidiaries overseas should be received not later than 31 December 2015.

### Small and medium enterprises (SMEs)

Expenses incurred by SMEs on the registration of patents and trademarks are allowed as deduction against business income. The term SME must come within the definitions provided in specified legislation.

## *Withholding taxes*

Corporations making payments of the following types of income are required to withhold tax at the rates shown in the table below. *See Note 7 for other types of income.*

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties and certain rentals (%) [--] (3, 4, 5) |
|---|---|---|---|
| Resident corporations | 0 | 0 | 0 |
| Resident individuals | 0 | 0/5 | 0 |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 0 | 0/15 | 10 |
| Treaty: | | | |
| Albania | 0 | 0/10 | 10 |
| Australia | 0 | 0/15 | 0/10 [0] |
| Austria | 0 | 0/15 | 10 |
| Bahrain | 0 | 0/5 | 8 [10] |

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties and certain rentals (%) [--] (3, 4, 5) |
|---|---|---|---|
| Bangladesh | 0 | 0/15 | 0/10 [10] |
| Belgium | 0 | 0/10 | 10 |
| Bosnia & Herzegovina* | 0 | 0/10 | 8 [10] |
| Brunei | 0 | 0/10 | 10 |
| Canada | 0 | 0/15 | 0/10 [10] (6) |
| China, P.R. | 0 | 0/10 | 10 |
| Chile | 0 | 15 | 10 [5] |
| Czech Republic | 0 | 0/12 | 10 |
| Croatia | 0 | 0/10 | 10 |
| Denmark | 0 | 0/15 | 0/10 [10] |
| Egypt | 0 | 0/15 | 10 |
| Fiji | 0 | 0/15 | 10 |
| Finland | 0 | 0/15 | 0/10 [10] |
| France | 0 | 0/15 | 0/10 [10] |
| Germany | 0 | 0/10 | 7 |
| Hungary | 0 | 0/15 | 10 |
| India (new agreement) | 0 | 0/10 | 10 |
| Indonesia | 0 | 0/15 | 10 |
| Iran | 0 | 0/15 | 10 |
| Ireland, Rep. of | 0 | 0/10 | 8 [10] |
| Italy | 0 | 0/15 | 0/10 [10] (6) |
| Japan | 0 | 0/10 | 10 (6) |
| Jordan | 0 | 0/15 | 10 |
| Kazakhstan | 0 | 0/10 | 10 |
| Korea, Rep. of | 0 | 0/15 | 0/10 [10] |
| Kuwait | 0 | 0/10 | 10 |
| Kyrgyzstan | 0 | 0/10 | 10 |
| Laos* | 0 | 0/10 | 10 |
| Lebanese Republic | 0 | 0/10 | 8 [10] |
| Luxembourg | 0 | 0/10 | 8 |
| Malta | 0 | 0/15 | 10 |
| Mauritius | 0 | 0/15 | 10 |
| Mongolia | 0 | 0/10 | 10 |
| Morocco | 0 | 0/10 | 10 |
| Myanmar | 0 | 0/10 | 10 |
| Namibia | 0 | 0/10 | 5 |
| Netherlands | 0 | 0/10 | 0/8 [8] |
| New Zealand | 0 | 0/15 | 0/10 [10] |
| Norway | 0 | 0/15 | 0/10 [10] (6) |
| Pakistan | 0 | 0/15 | 0/10 [10] |
| Papua New Guinea | 0 | 0/15 | 10 |
| Philippines | 0 | 0/15 | 0/10 [10] |
| Poland | 0 | 0/15 | 0/10 [10] |
| Qatar | 0 | 0/5 | 8 |
| Romania | 0 | 0/15 | 0/10 [10] |

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| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties and certain rentals (%) [--] (3, 4, 5) |
|---|---|---|---|
| Russian Federation | 0 | 0/15 | 10 |
| San Marino* | 0 | 0/10 | 10 |
| Saudi Arabia | 0 | 0/5 | 8 |
| Senegal* | 0 | 0/10 | 10 |
| Singapore | 0 | 0/10 | 8 [5] |
| Sri Lanka | 0 | 0/10 | 10 |
| Seychelles Republic | 0 | 0/10 | 10 |
| Spain | 0 | 0/10 | 7 [5] |
| South Africa | 0 | 0/10 | 5 |
| Sudan | 0 | 0/10 | 10 |
| Sweden | 0 | 0/10 | 8 |
| Syria | 0 | 0/10 | 10 |
| Switzerland | 0 | 0/10 | 0/10 [10] |
| Thailand | 0 | 0/15 | 0/10 [10] (6) |
| Turkey | 0 | 0/15 | 10 |
| Turkmenistan | 0 | 0/10 | 10 [0] |
| United Arab Emirates | 0 | 0/5 | 10 |
| United Kingdom | 0 | 0/10 | 8 |
| Uzbekistan | 0 | 0/10 | 10 |
| Venezuela | 0 | 0/15 | 10 |
| Vietnam | 0 | 0/10 | 10 |
| Zimbabwe* | 0 | 0/10 | 10 |

Notes

Rate for certain rentals is shown in parenthesis […] if different from royalty rate.

* Treaties pending ratification

Restricted tax treaties dealing with taxation of specific transport operations in international traffic have also been signed with Argentina and the United States.

1. A single-tier system of taxation came into force on 1 January 2008 which replaced the previous full imputation system. There is a six-year transitional period (until 31 December, 2013) for all companies to migrate to the single-tier system.
   Under the previous imputation system, dividends are franked with (deemed to be paid net of) the tax paid by corporations. If any dividend-paying corporation has not paid sufficient tax to cover the total tax deemed deducted from dividends, it must pay the balance of the tax to the tax authorities.
   Under the single-tier system, dividends are exempt in the hands of shareholders.
   Malaysia, at present, has no WHT on dividends in addition to tax on the profits out of which the dividends are declared. Some treaties provide for a maximum WHT on dividends should Malaysia impose such a WHT in the future.
2. Interest on loans given to or guaranteed by the Malaysian government is exempt from tax. Interest paid to a non-resident by a commercial or merchant bank operating in Malaysia is also exempt from tax.
3. Approved royalty payments under certain treaty provisions are exempt from WHT.
4. Other income:
   - Contract payments made by a person (including a partnership) to non-resident contractors (including professionals) in respect of services under a contract project are subject to a 13% deduction of tax (10% on account of the contractors' tax liability and 3% on account of their employees' tax liability). This deduction of tax at source does not represent a final tax, which is determined upon the filing of the tax return.
   - Payments made to non-residents in respect of the provision of technical services performed in Malaysia and rental of movable properties are subject to a 10% WHT (unless exempted under statutory provisions for purpose of granting incentives).

5. Royalty income received by non-resident franchisors under franchised education scheme programmes approved by the Ministry of Education is exempted from tax.
6. Royalty income does not include royalty paid in respect of motion picture films or tapes for television or broadcasting or of the operation of a mine, oil well, quarry, or any other place of extraction of natural resources or of timber or other forest products.
7. WHT is also applied in respect of income of a non-resident from sources other than the following:
   - Sources shown in the preceding table.
   - A business source.
   - An employment source.

   The rate of WHT on such income is 10%. This is applicable on payments made to residents of all the treaty partners previously listed, except for certain countries (including Germany, Turkmenistan, Bosnia & Hezegovinia, Senegal, and Jordan) where the respective double taxation agreements (DTA) have provided for such type of income to be taxed only in the contracting state in which the recipient is resident.

## *Tax administration*

Assessment of income is on a current-year basis. A company is taxed on income from all sources (whether business or non-business) arising in its financial year ending in the calendar year which coincides with that particular year of assessment. For example, a company that closes its accounts on 30 June of each year is taxed on income earned during the financial year ending on 30 June 2011 for the year of assessment 2011.

### *Returns*

Self-assessment for companies was implemented from the year 2001. Under the self-assessment system, companies are required to submit a return of income within seven months from the date of closing of accounts. Particulars required to be specified in the return include the amount of chargeable income and tax payable by the company. An assessment is deemed to have been made on the company upon submission of the return. The return is deemed to be a notice of assessment that is deemed to be served on the company upon the date the return is submitted.



'E-filing' or online filing of tax returns via the Internet is available. E-filing is encouraged by the Inland Revenue Board.

### *Payment of tax*

Tax payable under an assessment upon submission of a return is due and payable by the 'due date.' The 'due date' is defined as the last day on expiry of seven months from the date upon which the accounts are closed.

Companies are required to furnish estimates of their tax payable for a year of assessment no later than 30 days before the beginning of the basis period. However, from the year of assessment 2008, a newly established company with paid-up capital of MYR 2.5 million or less that meets with certain specified conditions is exempted from this requirement for two years, beginning from the year of assessment in which the company commences operation. A revised estimate can be submitted in the sixth and ninth months of the basis period for a year of assessment.

Companies are then required to pay tax by monthly instalments (based on the estimates submitted) commencing from the second month of the company's basis period (financial year).

From year of assessment 2011, a company commencing operations in a year of assessment is not required to furnish estimates of tax payable or to make instalment payments if the basis period for the year of assessment in which the company commences operations is less than six months.

# Malta

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## Significant developments

A number of changes to Maltese tax legislation were published in 2010.

In a Maltese domestic context, the new tax provisions introduce a number of anti-abuse provisions as well as some new taxing provisions. While many of these provisions target transactions in immovable property situated in Malta and companies owning such property, the new amendments also cover a number of other important aspects from a Maltese domestic tax perspective.

Some other rules dealing with international tax matters have also been introduced. The main purpose of these rules is to further facilitate the use of Malta as a financial services centre, thus demonstrating Malta's continuing commitment to remaining an attractive jurisdiction of choice for investors.

The new innovative provisions include, among others, the following:

- An option for a step-up in the cost of acquisition of assets situated outside Malta owned by persons (including companies) effecting a change in domicile or residence or becoming Maltese companies as a result of cross-border mergers.
- An exemption for royalties derived from qualifying patents with respect to inventions and which satisfy the applicable conditions.
- Provisions that any income derived from the ownership, use, or lease of aircraft when such aircraft is employed for international transport shall be deemed to arise outside Malta and hence outside the Maltese tax base, irrespective of the country of incorporation of the aircraft or whether the aircraft calls or operates from Malta. Such new provisions are intended to facilitate the use of Malta for international aviation activities.
- Extension of the Maltese tonnage tax regime to cover qualifying non-Maltese-flagged vessels and ship management activities.
- Legislation providing for the taxation of private foundations that complements the Private Foundation Law embodied within Maltese Civil law.

The exchange of information provisions under Maltese tax law have been extended in order to be more in line with those contained in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention.

The Value-added Tax (VAT) Act has been amended in line with the provisions of Council Directive 2008/8/EC (i.e. bringing into force new place of supply rules). Such amendments became effective as of 1 January 2010.

## Taxes on corporate income

Companies are subject to income tax at a flat rate of 35%. There is no corporation tax structure separate from income tax.

A company incorporated in Malta is considered as both domiciled and resident in Malta and consequently taxable on a worldwide basis. A non-Maltese incorporated company which is resident in Malta through management and control is subject to Maltese tax on income arising in Malta and on income received in/ remitted to Malta.

### Petroleum profits tax

Petroleum profits tax is levied as income tax with similar deductions being allowed in respect of incurred expenditure. In the case of a Production Sharing Contract signed after 1 January 1996, any petroleum profits are taxed at the standard corporate tax rate of 35%. However, all other petroleum profits are subject to a 50% tax rate.

### Insurance profits tax

Insurance profits tax is levied as income tax and subject to the normal standard tax rate of 35% as other corporate profits; however, the manner in which such profits are ascertained is subject to a number of detailed rules which take into account the special nature of the insurance industry. In the case of non-resident companies, the computation is applied with reference only to business carried on in or from Malta.

## Corporate residence

All companies incorporated in Malta are considered to be both domiciled and resident in Malta. Other bodies of persons (including companies incorporated overseas) are considered to be resident in Malta when the control and management of their business are exercised in the country.



## Other taxes

### Value-added tax (VAT)

Supplies of goods and services in Malta are subject to VAT at the standard rate of 18% (5% on accommodations in hotels and licensed premises, supply of electricity, works of art, collector's items and antiques, certain confectionery, medical accessories, printed matter, and items for exclusive use by the disabled). Exports to countries outside the European Union, food, and certain other goods and services are exempt from VAT and provide a right to credit of VAT remitted.

### Customs and excise duties

Goods imported from outside the European Union may be subject to customs duties. A Customs Code provides for customs procedures and concepts, which are based on European Community requirements.

Excise duties are chargeable on certain energy products, certain alcoholic drinks, certain manufactured tobacco products, and mobile telephony services at a 5% rate (although other rates may apply in different circumstances).

### Employer’s social security contributions

Employers are obliged to pay social security contributions at the rate of 10% of the individual employee’s salary and at fixed rates of 35.39 euros (EUR) per week for annual salaries exceeding EUR 18,400, provided the employee is born on or after 1 January 1962.

### Stamp duty

Stamp duty is charged on, among other transactions, transfers of immovable property (5% for both residents and non-residents) and marketable securities (2%; 5% in the case of transfers of shares in property companies). Furthermore, in the event that the market value of shares held by a person is reduced following a change in the company’s issued share capital or voting rights and the value shifts onto the other shareholders, the transferor would be deemed to have transferred the said value to the transferee(s) and such value shifting may be subject to a stamp duty liability (although certain exceptions/exemptions may apply).

Maltese legislation also provides for the possibility of a stamp duty exemption in a number of instances, subject to the satisfaction of certain conditions. Some of the more commonly availed of exemptions include the acquisition or disposal of marketable securities by or in the following: (i) licensed collective investment schemes; (ii) licensed persons providing management, administration, safekeeping or investment advice to collective investment schemes; (iii) companies being owned as to more than 50% by non-Maltese residents and satisfying certain other conditions; and (iv) a company that carries on or intends to carry on more than 90% of its business outside of Malta.

## Branch income

The tax rate on branch income is the same as that for resident companies. Other than the tax charged on a branch’s income, no tax is withheld on transfers of profits to the head office.

## Income determination

### Inventory valuation

Inventory valuations are generally made at the lower of cost or market value. In general, the book and tax methods of inventory valuation will conform. However, the last in first out (LIFO) method is not accepted for taxation purposes. Obsolescence is accepted where proven, but there are no provisions to take into account the effects of monetary inflation on the inventory valuation.

### Capital gains

Tax is chargeable on capital gains realised on the transfer of immovable property (real estate), shares and other securities, business goodwill, business permits, copyrights, patents, trade names, trademarks, interests in a partnership, and beneficial interests in a trust. In the case of transfers of immovable property, a final withholding tax of 12% on the transfer value applies. Note that there are certain cases where the 12% final withholding tax on the transfer value may not apply, and the transfers would be subject to the normal tax on capital gains regime with the chargeable profit being taxed at the taxpayer’s applicable rate(s).

No tax is levied on investments that yield a fixed rate of return. A tax exemption applies in certain instances and subject to the satisfaction of certain conditions on the capital gain arising on the transfer of shares in a company listed on a recognised stock exchange other than shares held in certain collective investment schemes. If the capital gain arising on the transfer of listed shares is subject to tax, then special rules apply with respect to the calculation of the gain and such gain would be subject to tax separately at the rate of 15%.

Subject to the satisfaction of certain conditions, if the asset is transferred between group companies, no loss or gain is deemed to arise from the transfer. Note that a provision has been enacted to bring to charge the transfer of shares in property companies (as specifically defined) that were originally subject to intra-group tax deferral when the transferor and the transferee cease to be members of the original group within six years from the date of such intra-group transfer.

Gains realised from the transfer of other assets fall outside the scope of the tax. Gains arising outside Malta and derived by a company that is either not domiciled or not ordinarily resident in Malta are not subject to tax. There are also a number of exemptions provided in the law. For example, capital gains realised by non-residents on transfers of units in Maltese collective investment schemes, similar investments relating to linked long-term insurance business and shares, or securities in Maltese companies (except for companies holding certain Maltese immovable property) are exempt from tax.

### *Rollover relief*

Rollover relief is granted with respect to capital assets used in a business for a period of at least three years and which are transferred and replaced within one year by an asset used solely for similar business purposes (i.e. no tax is chargeable on the capital gain). In such instances the cost of acquisition of the new asset is reduced by the gain on the transfer of the previous asset which would otherwise have been taxable.



Maltese tax law also provides for the surrendering and claiming of allowable losses between companies that form part of the same group *(see Group taxation for more information)* as well as for reorganisation relief, subject to certain specific conditions.

### *Dividend income*

Dividends received by one resident company from another, whether or not a subsidiary, are taxable on the gross amount in the recipient's hands. If the distributed profits have been taxed, no further tax should be chargeable to the recipient company. However, for resident shareholders, if the corporate rate of tax in the year in which the profits are earned is lower than that in the year in which they are distributed, an amount equivalent to the difference in rates (topping up) is payable. If the distribution is made from untaxed income, the dividend would be tax-free in the hands of the recipient company.

Dividends and gains on disposal of shares received by a corporate investor from a non-resident company (or from a non-resident limited partnership) may qualify for a participation exemption in Malta, subject to the satisfaction of certain statutory conditions.

The participation exemption may also apply to gains upon the disposal of equity holdings in Maltese-resident entities. Distributions of taxed income by Maltese-resident companies are not subject to further tax under the full imputation system.

### Stock dividends

A Maltese company may distribute bonus shares from profits, whether of an income or capital nature, and from share premium and capital redemption reserves. When bonus shares represent a capitalisation of profits, they are deemed to be dividends for tax purposes. Such bonus shares are subject to tax in the recipients' hands, gross of any tax paid at the corporate level on the relative profits, but tax credits equivalent to the gross-up of tax are available to stockholders.

### Foreign income

A company is taxable on its worldwide income when it is ordinarily resident and domiciled in Malta. A company that is either not ordinarily resident or not domiciled in Malta is taxable on its foreign income only insofar as such income is remitted to / received in Malta. Foreign tax is relieved by way of tax credits. This may occur under the terms of a double taxation treaty. Where no treaty exists, the foreign tax can be relieved through a system of unilateral relief. Relief for underlying tax is also granted with respect to dividend income, either in terms of a double taxation treaty or as unilateral relief. Such relief may be available if, among other things, evidence of tax paid abroad is produced.

Profits of Malta resident companies are subdivided for Maltese tax purposes into five accounts: the Immovable Property Account, the Final Tax Account, the Maltese Taxed Account, the Untaxed Account, and the Foreign Income Account. The last of these includes, among other things, taxable profits of Maltese-resident companies resulting from foreign investments; profits of a foreign permanent establishment; and profits resulting from foreign investments, assets, or liabilities of an onshore bank licensed in Malta. Income allocated to the Foreign Income Account for which no evidence of tax paid abroad is available can qualify for a flat-rate foreign tax credit of 25%.

The Immovable Property Account would include profits and income derived directly or indirectly from immovable property situated in Malta. The Final Tax Account would include, among other items, profits that have been subject to a final tax at source or were exempt from tax and such exemption is extended to shareholders upon a distribution of such profits. The Maltese Taxed Account would include any other taxed profits while the Untaxed Account would represent the difference between the distributable profits and the profits allocated to the other taxed accounts.

Under Malta's system of taxation of dividends, shareholders receiving distributions from the Maltese Taxed Account and/or the Foreign Income Account may be entitled to a tax refund of part or the full tax paid by the distributing Maltese company on such profits being distributed. The tax refund may be either a six-sevenths refund, a five-sevenths refund, a two-thirds refund, or a full refund of the tax suffered by the Maltese distributing company on the distributed profits. The type of the tax refund depends on the nature of the income to be distributed.

No anti-controlled foreign company rules or legislation are applicable in Malta.

## Deductions

The basic condition for deductibility of expenses is that deductions are allowable only with respect to expenditures which are wholly and exclusively incurred in the production of income.

The Income Tax (Deductions) Rules of 2001 provide for specific conditions on deductions with respect to the use of cars and the payment of employee compensation. The cost on which capital allowances on certain motor vehicles may be claimed is restricted to EUR 7,000 (increased to EUR 14,000 for year of assessment 2011). Deductions for lease payments on cars are restricted in a manner that corresponds with the stated restriction of EUR 7,000 (increased to EUR 14,000 for year of assessment 2011) that applies to capital allowances on owned cars. With respect to payment of employee compensation, the Deduction Rules require that in order for employee compensation to be allowed as a deduction for tax purposes in the hands of the employing company, it must have been duly accounted for. In particular, the employee compensation must have been reported on the appropriate forms and within the statutory time limit to the Office of Inland Revenue. The rules also provide for restrictions on deductibility of emoluments with respect to the payment of certain fringe benefits to employees.

### *Depreciation and depletion*

Tax depreciation is computed on the straight-line method. The rate of depreciation on plant and machinery varies according to the category of the plant and machinery in question.

Maltese tax law prescribes the minimum number of years over which items of plant and machinery are to be depreciated as follows:

| Category | Years |
|---|---|
| Computers and electronic equipment | 4 |
| Computer software | 4 |
| Motor vehicles | 5 |
| Furniture, fixtures, fittings, and soft furnishings | 10 |
| Equipment used for constructions of buildings and excavation | 6 |
| Catering equipment | 6 |
| Aircraft – aircraft airframe | 6 |
| Aircraft – engines | 6 |
| Aircraft – engine or airframe overhaul | 6 |
| Aircraft – interiors and other parts | 4 |
| Ships and vessels | 10 |
| Electrical and plumbing installations and sanitary fittings | 15 |
| Cable infrastructure | 20 |
| Pipeline infrastructure | 20 |
| Communications and broadcasting equipment | 6 |
| Medical equipment | 6 |
| Lifts and escalators | 10 |
| Air-conditioners | 6 |
| Equipment mainly designed or used for the production of water or electricity | 6 |
| Other machinery | 5 |
| Other plant | 10 |

The wear and tear rate on industrial buildings and structures (including hotels) may not exceed 2% per annum. New acquisitions of industrial buildings and structures are entitled to a concurrent extra 10% allowance in the year of acquisition. Tax depreciation is not required to conform to book depreciation.

The total allowances over the asset's useful life may not exceed 100% of its cost. If a surplus arises on disposal of a tax-depreciated asset, it is either added to the year's income or utilised to reduce the cost of any replacement. If the asset has been under-depreciated, a balancing allowance is granted.

No deduction is available for the depletion of natural resources.

The rules on tax deductions for wear and tear of plant and machinery provide for certain specific treatment in particular situations including, among other things, the following:

- To establish the cost of an asset when it is transferred between related companies, the lower of the actual cost of the asset or the tax written-down value adjusted by any balancing charge or allowance incurred by the transferring company should be applied.
- Deductions for wear and tear are allowed only where proper records and documentation have been kept that support the cost of the respective assets.
- A proportional deduction is allowed where an asset is used partly in the production of income and partly for other purposes.

### *Other significant items*
Capital expenditures on scientific research, patents, and intellectual property rights are written off over a number of years. In the case of scientific research, a deduction may be granted at 150% of the expenditure. Certain pre-trading expenses are also allowed as a deduction, subject to the satisfaction of certain statutory conditions.

### *Net operating losses*
Net operating losses may be carried forward indefinitely until absorbed. There is no carryback of losses, not even in terminal years. Unabsorbed capital allowances may be carried forward only against the same underlying source of income. Where the source ceases to exist, any remaining balance of unabsorbed capital allowances is lost.

### *Payments to foreign affiliates*
There are no restrictions on the deductibility of royalties, interest (except for interest, discount, or premium which are in any manner connected to Maltese immovable property and subject to the satisfaction of certain other statutory conditions, in which case, the interest/discount/premium should not be tax deductible in Malta), and service fees paid to foreign affiliates as long as the particular expenses are considered to be incurred in the production of the particular income and satisfy the applicable statutory conditions. Interest, discount, premium, or royalties derived by non-residents are exempt from tax, subject to the applicable statutory requirements.

## *Group taxation*

Two companies that for tax purposes are resident exclusively in Malta, where one company is a 50% plus subsidiary of the other or both are 50% plus subsidiaries of a third Malta-resident company, qualify as members of a group of companies. Allowable losses may be surrendered by a company to another company within the group where both companies have concurrent accounting periods and form part of such group throughout the entire basis year for which this relief is claimed; however, such surrendering of losses may not occur where the surrendering or claimant company is carrying on the business of insurance. Each company must file a separate tax return, and no combined grouping or consolidated returns are permitted.

## Tax credits and incentives

### Foreign tax credit

A credit for foreign taxes may be applied against the Maltese tax charge *(see Foreign income in the Income determination section for more information).*

### Inbound investment

Investments by foreigners may be readily repatriated together with profits.

The Malta Enterprise Act and other related legislation provide a comprehensive package of incentives for inbound investment. These incentives are reserved for enterprises carrying on certain activities in Malta, mainly manufacturing activities. The focus is on high-value-added activities, and approval of a project's eligibility for benefits by the Malta Enterprise may be required. In general, eligibility does not depend on whether the company produces for the local or for export markets. The main tax incentives include the following:

- Enterprises carrying out qualifying activities, which mainly include manufacturing activities, qualify for investment tax credits whereby a percentage of up to 30% (50% in the case of small-sized enterprises and 40% in the case of medium-sized enterprises) of qualifying expenditures are off-set against the tax charge (not against taxable income). Any unused credits are carried forward and added to the credits for subsequent years. The amount carried forward is increased by a percentage rate which is based on EU parameters as updated from time to time.
- Certain tax credits and special incentives may be available, subject to certain conditions. These tax credits are calculated on the basis of specific expenditures incurred by a company while the special incentives grant tax exemptions on all or part of the chargeable income in specified circumstances.
- No further tax is charged on distributions from profits that had previously been taxed at a reduced rate. This benefit is also extended to amounts that were not subject to tax on account of the investment allowance, investment tax credits, and specific tax credits/special incentives.
- A 15.75% tax rate is applicable to profits reinvested in the enterprise, pursuant to a project approved by the Malta Enterprise.
- The combination of certain tax treaties and Maltese domestic law lowers the Maltese tax rate on certain companies receiving certain industrial assistance (i.e. mainly assistance in terms of the Business Promotion Act and Business Promotion Regulations) to 15%.



### Capital investment

In the case of qualifying companies, an investment allowance of 50% on plant and machinery and of 20% on industrial buildings and structures may be available (subject to certain capping rules), bringing the total allowances granted during the lifetime of the assets up to 150% and 120%, respectively. Apart from the investment allowances, normal allowances for wear and tear are also available on such assets *(as set out under the heading Depreciation and depletion in the Deductions section).*

### Shipping profits

A beneficial tonnage tax regime is applicable under Maltese law. Such regime covers profits from shipping activities as defined under the applicable regulations which are derived by qualifying Maltese-flagged and EU / EEA vessels as well as non-EU / EEA vessels satisfying certain additional rules. Furthermore, qualifying ship management activities are also entitled to the benefits of the tonnage tax regime. Profits qualifying under the tonnage tax regime may also be distributed tax-free. The related company shares are exempt from the provisions of the Duty on Documents and Transfers Act (stamp duties).

### *International business profits*

Tax benefits are available for shareholders with respect to distributions by such companies of specified types of income. A beneficial tax regime is also available in respect of collective investment schemes.

The Maltese fiscal implications relative to trusts vary, depending on a number of circumstances including: (i) the particulars of the parties involved (e.g. domicile or residence of the trustees or beneficiaries); (ii) the act or event under review (e.g. the settlement of property, transfers of beneficial interests, distributions of trust assets); and (iii) the nature of the trust assets. Furthermore, in certain circumstances, tax transparency provisions are set out in the law, particularly so as to allow, among other things, the application of tax exemptions that would have applied to beneficiaries if there was no trust relationship.

## *Withholding taxes*

Domestic corporations paying certain types of income are subject to deduction of tax-at-source obligations as follows:

| Recipient | Dividends (1) (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations | 35 | 35 (2) | 0 |
| Resident individuals | 35 | 25 (2) | 0 |
| Non-resident corporations: | | | |
| Non-treaty | 35 | 0 (3) | 0 (3) |
| Non-resident individuals: | | | |
| Non-treaty | 35 | 0 (3) | 0 (3) |
| Non-resident corporations and individuals: | | | |
| Treaty | (4) | 0 (3) | 0 (3) |
| Albania | 35 | | |
| Australia | 35 | | |
| Austria | 32.5 | | |
| Barbados | 35 | | |
| Belgium | 35 | | |
| Bulgaria | 30 | | |
| Canada | 35 | | |
| China, P.R. | 35 | | |
| Croatia | 35 | | |
| Cyprus | 35 | | |
| Czech Republic | 35 | | |
| Denmark | 35 | | |
| Egypt | 35 | | |
| Estonia | 35 | | |
| Finland | 35 | | |
| France | 35 | | |
| Germany | 35 | | |
| Georgia | 35 | | |

| Recipient | Dividends (1) (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Greece | 35 | | |
| Hungary | 35 | | |
| Iceland | 35 | | |
| India | 35 | | |
| Ireland | 35 | | |
| Isle of Man | 35 | | |
| Italy | 35 | | |
| Jersey | 35 | | |
| Jordan | 35 | | |
| Korea, Rep. of | 35 | | |
| Kuwait | 10/15 | | |
| Latvia | 35 | | |
| Lebanon | 35 | | |
| Libya | 15 | | |
| Lithuania | 35 | | |
| Luxembourg | 35 | | |
| Malaysia | 35 | | |
| Montenegro | 35 | | |
| Morocco | 35 | | |
| Netherlands | 35 | | |
| Norway | 35 | | |
| Pakistan | 35 | | |
| Poland | 35 | | |
| Portugal | 35 | | |
| Qatar | 35 | | |
| Romania | 30 | | |
| San Marino | 35 | | |
| Serbia | 35 | | |
| Singapore | 35 | | |
| Slovakia | 35 | | |
| Slovenia | 35 | | |
| South Africa | 35 | | |
| Spain | 35 | | |
| Sweden | 35 | | |
| Syria | 35 | | |
| Tunisia | 35 | | |
| United Arab Emirates | 35 | | |
| United Kingdom | 35 | | |
| United States | 35 | | |

Notes

Treaties relating to international air and shipping traffic are in force with Switzerland and the United States. The numbers in parentheses refer to the following notes:

1. Malta makes no distinction between portfolio and substantial holdings. The tax at source is not a withholding tax because no additional tax is imposed on distributions other than the tax charged on the company with respect to distributed profits. Under Malta's full-imputation system of taxation of dividends, the corporate tax is assimilated with the personal income tax of the shareholder with respect to the dividend. In the shareholder's hands, the dividend is taxed at the gross amount, and the relevant amount of corporate tax offsets the shareholder's tax liability on income from all taxable

sources. Special provisions exist for taxation of distributions from income that would not have suffered tax at the corporate level.
2. Withholding of tax may be required only where the interest is debenture interest or interest on any other loan advanced to a corporation for capital purposes. The withholding tax is in effect a prepayment of the recipient's final liability because a reassessment on income is made upon the submission of returns. Any resulting overpayment is refunded.
3. Interest and royalty income derived by non-residents is exempt from tax in Malta as long as certain conditions are complied with (e.g. they are not effectively connected to a permanent establishment of the recipient situated in Malta).
4. Under its treaties, Malta retains the right to tax dividends at a rate not exceeding that paid by the company in question on the profits out of which the dividends are distributed. This rate is currently 35% (in certain treaties, for example those with Austria, Bulgaria, Kuwait, Libya, and Romania, the maximum tax is set at a lower rate). In a number of treaties, the rate of deduction and of tax is reduced to 15% in the case of companies enjoying certain tax incentives. *See also Note 1 with respect to Malta's full-imputation system of taxation of dividends.*

## *Tax administration*

### *Returns*

An income tax return for income earned during the previous year must be filed for every year of assessment. The year of assessment is a calendar year, but a company may obtain authorisation from the Maltese Revenue to have a different year end (i.e. other than 31 December). Companies pay tax in the currency in which their share capital is denominated. The tax return for a company must be submitted by the later of nine months following the end of the financial year or by 31 March following the year of assessment (however, in recent years the Commissioner of Inland Revenue has provided concessionary extensions to such statutory deadlines in the case where the tax return is submitted electronically). Penalties are incurred on late filing of returns. The tax return submitted by the company is a self-assessment, and the Commissioner of Inland Revenue will not raise an assessment unless there is not agreement with the self-assessment.

### *Payment of tax*

During the basis tax year, a company is generally required to make provisional tax (PT) payments every four months. In general, the PT payments are based on the last self-assessment filed by the company, and payments are divided into three instalments of 20%, 30%, and 50%, respectively. Any tax liability that is still due at the tax return date after deducting all tax credits must be settled immediately with the submission of the return. Interest at 0.75% per month is charged on any unpaid tax.

In certain instances, especially for companies with mostly international operations, PT may not be payable, and the tax payment is normally paid on the earlier of the date profits are distributed or 18 months after the end of the relative accounting period.

The employer is required to withhold income tax and social security contributions from employees' salaries and pass on such tax / contributions to the Office of Inland Revenue. This system of withholding tax at source is referred to as the Final Settlement System (FSS), and the employer is legally required to operate such a system. The salary from which the withholding is to be effected should also include the value of any taxable fringe benefits. There are three main categories of fringe benefits: (i) use of motor vehicles; (ii) use of other assets including accommodation; and (iii) other benefits. The method of valuation in each case varies, and the employer is required to refer to the Fringe Benefits Regulations (and also to the fringe benefits guidelines) so as to calculate the correct value of any fringe benefits being provided to the employees and to deduct the right amount of tax accordingly.

# Mauritius

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## Significant developments

### Gains on immovable property

As of 1 January 2011, a company or trust shall be taxable at the rate of 15% and 10% respectively on any gains from the sale or transfer of immovable property exceeding 2 million Mauritian rupees (MUR).

An entity will be taxable at 15% on any income derived from property business forming part of its non-current assets.

*See Tax on gains from the sale or transfer of immovable property in the Other taxes section for more information.*

### Special levy on banks

The increased rates of the special levy on banks have been extended by a further two years. These rates are as follows:

| Year of assessment commencing | Rates |
|---|---|
| 1 January 2011 | 3.4% on book profit<br>1.0% on operating income |
| 1 January 2012 | 3.4% on book profit<br>1.0% on operating income |
| 1 January 2013 and subsequent years | 1.7% on book profit<br>0.5% on operating income |

### One-off charge on banks

Every bank, except the Development Bank of Mauritius, shall create a one-off charge in the year preceding the year of assessment 2012, where the basis of calculation is:

- 0.5 % of the turnover and
- 1.25% of the book profit relating to the banking transactions with persons, other than non-residents and companies holding a Global Business Licence.

The fund created shall be used to finance the new equity fund referred to in the Ministry's document entitled 'Facing the Euro Zone Crisis and Restructuring for Long Term Resilience' during the year immediately preceding the year of assessment 2012.

Where the amount used to finance the private equity fund is less than the one-off charge, the difference shall be remitted to the Mauritius Revenue Authority (MRA) on submission of the return for the year of assessment 2012.

### *Global Business Category 1 (GBC1) companies*
A GBC1 company shall be allowed to conduct business in Mauritius, and the local source income shall be subject to income tax at 15%.

Where a GBC1 company derives both local and foreign source income, it shall submit together with its annual return a certificate from the auditor certifying that such expenditure or loss has been apportioned in a fair and reasonable manner with respect to the local and foreign source income.

### *Capital Allowances*
Effective from the income year commencing on 1 January 2011, capital allowances on motor cars, except for a person carrying on the business of tour operator and car rental, shall not exceed MUR 3 million.

### *Royalty withholding tax (WHT)*
From the year of assessment commencing 1 January 2011, Mauritius-source royalties payable to a non-resident will be subject to a tax deduction at the rate that is the lower of 15% or the rate specified in the double taxation convention in place between Mauritius and the foreign country where the payee is resident. The WHT will be deemed to be the final tax payable in Mauritius. This does not apply to GBC1 companies paying royalties out of foreign source income.

### *Submission date*
The submission date for companies with a due date of 31 December for advance payment system statements or final tax returns has now been brought forward by two working days prior to 31 December.

## *Taxes on corporate income*

Resident companies are taxed on their worldwide income whereas non-resident companies are taxed only on income derived from Mauritius.

Income tax is payable on total net income before distribution at the following rates:

| Entity | Rate (%) |
|---|---|
| Global Business Category 1 (GBC1) companies and offshore trusts | 15 |
| Private freeport developers and operators carrying on activities other than processing | Exempt (until 31 December 2013)* |
| Third-party Freeport developers and operators carrying on processing activities | 15 |
| All other companies | 15 |

* The normal tax rate will then apply after the exemption period.

Global Business Category 2 (GBC2) companies incorporated under the laws of Mauritius are exempt from income tax. *See the Tax credits and incentives section for more information on GBC1 companies, GBC2 companies, and freeport developers.*

Companies paying or declaring dividends must either pay tax computed in accordance with normal rules or pay an alternative minimum tax (AMT), whichever is higher.

### *Alternative minimum tax (AMT)*
AMT is calculated where the normal tax payable for an income year by a company is less than 7.5% of its book profit. The AMT is the lesser of 7.5% of its book profit or 10% of dividends declared in respect of that year.

Book profit is the profit computed in accordance with internationally accepted accounting practices, excluding:

- dividends received from resident companies
- profits or loss on disposal of fixed assets, and
- profits or gains or loss from sale of securities.

AMT does not apply to the following:

- Companies which have not declared any dividend.
- Companies which are exempt from payment of tax.
- GBC 1 companies.
- Where the amount representing 10% of dividends declared does not exceed the normal tax payable.

### *Special levy on banks*
The increased rates of the special levy on banks have been extended by a further two years. These rates are as follows:

| Year of assessment commencing | Rates |
|---|---|
| 1 January 2011 | 3.4% on book profit<br>1.0% on operating income |
| 1 January 2012 | 3.4% on book profit<br>1.0% on operating income |
| 1 January 2013 and subsequent years | 1.7% on book profit<br>0.5% on operating income |



### *One-off charge on banks*
Every bank, except the Development Bank of Mauritius, shall create a one-off charge in the year preceding the year of assessment 2012, where the basis of calculation is:

- 0.5 % of the turnover and
- 1.25% of the book profit relating to the banking transactions with persons, other than non-residents and companies holding a Global Business Licence.

The fund created shall be used to finance the new equity fund referred to in the Ministry's document entitled 'Facing the Euro Zone Crisis and Restructuring for Long Term Resilience' during the year immediately preceding the year of assessment 2012.

Where the amount used to finance the private equity fund is less than the one-off charge, the difference shall be remitted to MRA on submission of the return for the year of assessment 2012.

### *Local income taxes*
Local income taxes levied by local administration, such as urban councils, do not exist in Mauritius.

## Corporate residence

A company incorporated in Mauritius is resident in Mauritius for tax purposes.

A company not incorporated in Mauritius is resident in Mauritius only if it is centrally managed and controlled in Mauritius. A GBC2 company is not considered a resident in Mauritius for the purposes of double taxation treaties (DTTs).

## Other taxes

### Value-added tax (VAT)

VAT is charged by VAT-registered entities at the standard rate of 15% on all goods and services supplied by them, other than the following exempt supplies:

- Rice, bread, butter.
- Medical, hospital, and dental services, including clinical laboratory services, services provided in a health institution other than cosmetic surgery services, and veterinary services.
- Educational and training services provided by institutions approved by the Mauritius Qualification Authority.
- Construction of building for residential purpose, provided letter of intent relating to an Integrated Resort Scheme was issued prior to 1 October 2006.
- Sale or transfer of an immovable property, a building or part of a building, apartment, flat, or tenement.
- Banking services except:
  - services provided to merchants accepting credit/ debit card
  - services in respect of safe deposit locker, issue and renewal of credit/debit cards
  - services for keeping and maintaining customer's accounts, and
  - services supplied by a bank holding a banking licence under Banking Act 2004 in respect of its banking transactions with non-residents and corporations holding a Global Business Licence.

An entity should register for VAT if turnover exceeds MUR 2 million a year. However, certain service providers (e.g. accountants and auditors, attorneys and solicitors, consultants, surveyors, valuers) should register for VAT irrespective of their turnover.

### Tax on gains from the sale or transfer of immovable property

As of 1 January 2011, a company or trust shall be taxable at the rate of 15% and 10% respectively on any gains from the sale or transfer of immovable property exceeding MUR 2 million.

An entity will be taxable at 15% on any income derived from property business forming part of its non-current assets.

The tax on gains will be payable at the time the income tax return of the company is being filed with the MRA. The gains are computed by deducting the following from the proceeds:

- Cost of the acquisition.
- Any capital expenditure incurred on the immovable property.
- Any land transfer tax paid under the Land (Duties and Taxes) Act (LDTA) on the sale.
- Any cost in connection with the sale.

If immovable property was acquired before 1 January 1988 and a building was constructed thereon before 1988, the original cost of the building will be increased in accordance to the table below:

| Year of acquisition | Cost increased by a multiplying factor of |
|---|---|
| Up to 1963 | 7.5 |
| 1964 to 1968 | 7.0 |
| 1969 to 1973 | 6.0 |
| 1974 to 1978 | 3.0 |
| 1979 to 1983 | 1.5 |
| 1984 to 1987 | 1.1 |

In cases where the acquisition cost of land or any other immovable property is not known and that property is now being sold or transferred, the proceeds from the sale or transfer will be discounted according to the following table:

| Year of acquisition | Discount the proceeds by a multiple of |
|---|---|
| Up to 1988 | 0.25 |
| 1989 to 1993 | 0.30 |
| 1994 to 1998 | 0.45 |
| 1999 to 2003 | 0.60 |
| 2004 to 2010 | 0.85 |



If a company owns immovable property, the value of which exceeds 95% of the value of its total assets and who transfers its shares resulting in a change of control of that company or any increase in the shareholding of the controlling shareholder within a period of 12 months from the date of change of control, then the gains derived from the transfer of those shares will be subject to tax as per the following formula:

(Number of shares transferred / Total number of shares issued) x Gains

The value of the immovable property at the time of the transfer of shares are normally deemed to be the value disclosed in the statement of financial position of the company immediately preceding the transfer.

It is specified in the law that the gains derived from the transfer of shares will apply only where the value of the immovable property exceeds 95% of its total assets. In cases where the company owns immovable property not exceeding 95% of the value of its total assets, the gains on the transfer of shares will not be subject to tax.

'Total assets' has not been defined in the laws and therefore has the same meaning as per International Financial Reporting Standards. As per Statement of Financial Position (presented as per IAS 1), total assets is determined according to the following formula:

Total assets = Non-current assets + Current assets

It should be highlighted that the provision applies in case of a company dealing in immovable property. It does not apply to transfer of shares in a company whose subsidiary owns immoveable property.

Any gains derived from the sale or transfer of property between groups of companies and gains derived by a bank from the sale or transfer of an immovable property pursuant to an arrangement entered into between the bank and the person, whereby the bank initially purchased the property with a view to selling to the same person, are exempt from capital gains tax.

### *Customs duties/import tariffs*
There is import duty on all dutiable goods landed in Mauritius. The duty payable on any dutiable goods will be according to the Customs Tariff Act (CTA) at the time the bill is validated at the Customs. The Mauritius customs tariff schedule is comprised of only nine bands of tariff ranging from 0% to 80%.

### *Excise taxes*
An excise duty is chargeable on all excisable goods. Excisable goods are specific goods which are listed in Schedule 1 of Excise Act 1994 (e.g. spirits, vehicles, petroleum products).

### *Stamp duty*
Stamp duty is levied and paid to the Registrar General on every document at the time of registration, transcription, inscription, or erasure of inscription. Stamp duty varies from MUR 25 to MUR 500.

### *Morcellement tax*
A capital gains (morcellement) tax is payable by every landowner who parcels out land. The tax is calculated on the excess, if any, of the sale price over the aggregate of the amounts of purchase price and the cost of infrastructure works.

### *Land development tax*
Land development tax is payable by every person who parcels out land.

## *Branch income*

Tax rates on branch income are the same as on corporate profits. No tax is withheld on the remittance of profits to a head office.

## *Income determination*

### *Inventory valuation*
Inventories should be valued at the lower of historical cost or net realisable value. The last in first out (LIFO) basis of valuation is not allowed for tax purposes.

Conformity is required between book and tax reporting. Where the revenue authority is not satisfied that the basis of valuation is acceptable (e.g. where the LIFO basis has been applied) it will make such adjustment as it believes is appropriate to determine the profits arising from the business carried on.

### *Capital gains*
There is no tax on capital gains in Mauritius. Therefore, any gains from dealings in units and securities are not taxable. Any gains derived from the sale of shares held for more than six months are classified as capital gains and therefore not taxed in Mauritius

However, gains realised from the sale of any property or interest in property acquired in the course of a business, the main purpose of which is the acquisition and sale of property as part of a profit-making undertaking or scheme, are taxable as ordinary income. Where a transaction is in the nature of trade, the revenue authority may take the view that it is an ordinary trading transaction and assess the gains derived as income.

*See Tax on gains from the sale or transfer of immovable property and Morcellement tax in the Other taxes section for other exceptions to the capital gains exemption.*

### *Dividend income*
Companies, whether resident or not, are exempt from tax on dividends received from resident companies.

### *Stock dividends*
A resident company can distribute stock dividends (bonus shares) proportionately to all its shareholders. Stock dividends per se or convertible into cash are not taxable in the hands of the recipient. Dividends in kind are treated as taxable benefits.

### *Foreign income*
Resident corporations are taxed on their worldwide income, but tax credit and treaty relief is generally available in order to avoid double taxation *(see Foreign tax credits in the Tax credits and incentives section for more information)*.

Undistributed income of foreign subsidiaries is not subject to any special taxation as long as the income of the foreign subsidiary before distribution is not included in the accounts of the local parent company. Dividends paid by the foreign subsidiary to the local parent company will, however, be taxable to the latter, whether or not such dividends are actually received in Mauritius.



## *Deductions*

### *Depreciation*
Annual allowance rates vary between 5% and 100% of base value (unless stated otherwise), as follows:

- 5% on industrial and commercial buildings and buildings used for education and training (on cost).
- 20% on ships and aircraft, furniture, and fittings.
- 35% on plant or machinery generally, 25% on motor vehicles (up to MUR 3 million as of 1 January 2011), 30% on hotel buildings, and 25% on agricultural improvements and scientific research.
- 50% on electronic and high-precision machinery, computer hardware and peripherals, and computer software.
- 100% on aircraft leased by a company engaged in aircraft leasing (on cost).
- 100% in respect of plant or machinery costing MUR 30,000 or less.

Tax depreciation need not conform to book depreciation. Depreciation is generally recaptured on disposal or sale when balancing charges or allowances are computed.

### *Taxes*
Taxes paid are not normally deductible; however, some taxes (e.g. municipal taxes relating to buildings, land transfer tax, irrecoverable input VAT) are deductible.

### Other significant items
A bank or an approved financial institution may claim as deductions any irrecoverable loans due by a company in liquidation in respect of which winding-up procedures have started or by a company in receivership.

### Net operating losses
Losses made in an accounting year are carried forward for a maximum of five years, provided the corporation can demonstrate a 50% continuity of shareholding between the year of loss and the year of claim. Losses resulting from capital allowances can be carried forward indefinitely. Loss carrybacks are not permitted.

Where a sugar factory operator that is not also a sugar cane planter incurs a loss, such loss, to the extent it is unrelieved, may be transferred in the income year in which it is incurred to a planter related to the operator.

Where a company takes over another company engaged in manufacturing activities, any unrelieved loss of the acquiree may be transferred to the acquirer in the income year in which the takeover takes place, on such conditions relating to safeguard of employment as may be approved by the Minister of Finance.

### Payments to foreign affiliates
Royalties, interest, and service fees payable to foreign affiliates are allowed as expenses, provided they correspond to actual expenses incurred, are reasonable, and do not exceed what would be paid under an arm's-length agreement. There are certain limitations if the recipient of the interest is not liable to Mauritius tax. Royalties paid to non-residents by GBC1 companies, banks out of their foreign-source income as defined in the Income Tax Act, and trusts are tax-exempt.

## Group taxation

There are no group taxation provisions in the Mauritius tax legislation other than the transfer of losses by tax incentive companies, sugar factory operators, subsidiaries located in the Island of Rodrigues, and manufacturing companies upon their take-over *(see Net operating losses in the Deductions section for more information)*.

### Transfer pricing
Mauritius does not have any specific transfer pricing legislation. However, it does contain an arm's-length provisions requiring transactions between related parties to reflect a commercially objective value which would be the amount charged for the services were the parties not connected.

### Thin capitalisation
Mauritius does not have specific thin capitalisation legislation; however, it does have other anti-avoidance provisions.

## Tax credits and incentives

### Global Business Category 1 and 2 companies
A GBC1 company is a limited liability company incorporated in Mauritius.

A GBC2 company is a limited liability company incorporated in Mauritius and which is tax resident in Mauritius. GBC2 companies are therefore not able to access the tax treaty network of Mauritius. However, GBC2 companies are exempt from Mauritius tax and are not required to file tax returns.

Since January 2011, a GBC1 company can now trade with a Mauritian resident as well as non-residents. Transactions made with a Mauritian resident will be taxed at the rate of 15% whereas transactions with non-residents are taxed at an effective tax rate of 3%.

The registration and application of GBC1 companies should be submitted to the Financial Services Commission (FSC) through a duly licensed Management Company on a prescribed form accompanied by the following:

- Law Practitioner's certificate certifying that the application complies with the laws of Mauritius.
- Any other information which the Chief Executive may request.

As for the application for a GBC2 licence, it should be submitted to the FSC on a prescribed form accompanied by the following:

- Law Practitioner's certificate certifying that the application complies with the laws of Mauritius.
- The incorporation document.

The Commission shall within 15 days of an application (both for GBC1 and GBC2 companies):

- approve the application
- reject the application, or
- request further information on the application.

Where the Registrar of Companies is satisfied that the application is in accordance with the Companies Act, the Registrar shall:

- enter the particulars of the company on a register
- assign a unique number to the company, and
- issue the certificate of incorporation.

The fees payable to the FSC for registering a GBC1 and a GBC2 company are as follows:

| Fee | GBC1 (USD) | GBC2 (USD) |
|---|---|---|
| Processing | 500 | 0 |
| Annual Licensing | 1,500 | 135 |

The GBC1 company shall meet the following legal operational requirements:

- The company should at all times have a local management company.
- The company should have a company secretary.
- The accounts of the company should be audited by local auditors.
- The company should have a registered office in Mauritius.
- All records and books of the company should be kept in Mauritius.
- The company should open and maintain, with a Mauritian bank, an account in foreign currencies.

A GBC1 company can apply for a Tax Residency Certificate (TRC) to show substance in Mauritius. The requirements for the GBC1 company to obtain a TRC are listed as follows:

- The company shall, at all times, have at least two directors resident in Mauritius, being of appropriate caliber and able to exercise independence of mind and judgment.
- All meetings of the Board of Directors shall be chaired and minuted in Mauritius. Board meetings can be held via conference calls as long as they are chaired from Mauritius.
- The company shall, at all times, keep all its accounting records at its registered office in Mauritius.
- The company shall ensure that all its main banking transactions are channelled through a bank account in Mauritius.
- The company's financial statements should be prepared in Mauritius and audited by Mauritian resident auditors.

The TRC is renewable on an annual basis and issued in respect of a particular country.

### *Freeport developers and operators*

A freeport operator is defined as a person who is duly licensed to carry out one or more of the following freeport activities:

- Warehousing and storage.
- Breaking bulk.
- Sorting, grading, cleaning, and mixing.
- Labelling, packing, repacking, and repackaging.
- Light assembly.
- Minor processing.
- Ship building, repairs and maintenance of ships and aircrafts.
- Storage, maintenance, and repairs of empty containers.
- Freight forwarding services.
- Quality control and inspection services.
- Export and re-export oriented airport and seaport based activities.

An occasional operator is defined as being only for the organisation and holding of international exhibitions and trade fairs.

A freeport developer is a private freeport developer or a third party freeport developer. A private freeport developer is a person licensed to carry out the following freeport activities according to the Freeport Act 2004 (FA 2004):

"Build, develop, and manage its own infrastructural facilities for use exclusively for the licensee's own business authorised freeport activities including warehouses, cold storage facilities, offices, exhibition centres, processing units and open storage facilities, provision of its own logistics services, and the carrying out of marketing activities and organising international exhibitions and international trade fairs."

However, a third party freeport developer can carry out the following activities according to FA 2004:

"Build, develop, and manage infrastructures to be rented to licensees in order to facilitate the authorised freeport activities including warehouses, cold storage facilities, offices, exhibition centres, processing units and open storage facilities, provision of third party logistics services to licensees, and the carrying out of marketing activities and organising international exhibitions and international trade fairs."

**Registration**

No freeport activity can be carried out unless the person applies for the appropriate freeport certificate and is duly licensed. No freeport certificate is required for an occasional operator.

A private freeport developer or a freeport operator can apply to the Managing Director to carry out activities relating to paper trading. As per FA 2004, paper trading is defined as the international buying and selling of tradable commodities either in the person's own name or as an agent, whereby the shipment of such commodities is made directly by the shipper in the original exporting country to the final importer in the importing country, without the commodities being physically landed in Mauritius.

A licence fee is payable by a freeport operator and a freeport developer of MUR 10,000 and MUR 150,000 respectively.

## *Foreign tax credits*

Generally, double taxation is avoided by means of a unilateral credit relief for foreign tax paid. The net amount of foreign income that has borne tax is grossed up at the foreign rate of tax, and the foreign tax paid is allowed as a credit against the Mauritius tax payable. However, the tax credit cannot exceed the Mauritius tax referable to the relevant foreign income. Unused credit is not refunded.

Regarding foreign income derived from countries with which Mauritius has treaties for the avoidance of double taxation, a tax credit is given for foreign tax in accordance with the treaties. There are clauses in the double taxation conventions which provide that income arising from certain specified foreign sources is to be exempt from Mauritius tax.



Mauritius has signed double taxation conventions with Barbados, Belgium, Botswana, the People's Republic of China, Croatia, Congo, Cyprus, France, Germany, India, Italy, Kuwait, Lesotho, Luxembourg, Madagascar, Malaysia, Mozambique, Namibia, Nepal, Oman, Pakistan, Rwanda, Seychelles, Singapore, South Africa, Sri Lanka, Swaziland, Sweden, Thailand, Uganda, the United Kingdom, Tunisia, United Arab Emirates, Senegal, and Zimbabwe. Double taxation treaties with Bangladesh, Malawi, Nigeria, Qatar, Russia, Vietnam, and Zambia have been signed and are awaiting ratification. Treaties with Canada, Czech Republic, Greece, Portugal, Egypt, and the Republic of Iran are under negotiation.

A GBC1 company may, in the absence of evidence of payment of foreign tax, claim as tax credit (presumed tax credit) an amount equal to 80% of the Mauritius tax chargeable on the foreign-source income. The presumed tax credit may also be claimed by a bank against the tax payable on income derived from banking transactions with non-residents and with GBC1 and GBC2 companies.

In the case of foreign dividends, the general tax credit includes foreign tax imposed on the profits out of which the dividends are paid (underlying tax), provided that the shareholding in the foreign company is at least 5%.

Mauritius also allows a tax-sparing credit under its local tax legislation.

### Income tax exemption for vessel owners
Owners of foreign vessels registered in Mauritius are exempt from income tax on income derived from such vessels. Owners of local vessels registered in Mauritius are also exempt to the extent that the income is derived from deep-sea international trade.

## Withholding taxes

There is no WHT in Mauritius for payments made by GBC companies to non-residents not carrying out any business in Mauritius. A non-resident company receiving service fees or interest from Mauritius is liable to tax thereon at the corporate rate of 15% through a self-assessment system.

Interest WHT of 15% (to be withheld by banks and deposit taking financial institutions only and for individual accounts only) may be exempt from WHT or taxed at reduced rates under certain tax treaties.

There is no WHT on dividends received from resident companies.

WHT at source is also applicable for the following:

- Royalties payable to residents: 10%.
- Royalties payable to non-residents: 15%.
- Rent: 5%.
- Payments to providers of specified services: 3% (in the construction industry).
- Payments to contractors and sub-contractors: 0.75% (in the construction industry).

## Tax administration

### Returns
Companies are assessed for a year beginning 1 January and ending 31 December on their income for the preceding year ending 31 December. Where a company closes its accounts at a date other than 31 December, it may elect to adopt as a basis year the accounting year ending in the 12-month period preceding the year of assessment.

Every company, both taxpayer and non-taxpayer, must file a return of its income on the basis of the income year preceding the year of assessment. The return must be filed within six months of the financial year-end.

### Payment of tax
Any tax due should be paid when the return is filed and within the six months deadline. If timely payment is not made, a penalty representing 5% of the amount of tax due is payable. In addition, interest at the rate of 1% of the tax unpaid for each month or part of a month is payable until the tax is paid. A penalty of MUR 2,000 for each month or part of a month is also prescribed for failure to file a return, subject to a maximum of MUR 20,000.

# Mexico

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## Significant developments

The Mexican Congress approved significant changes in the tax laws for 2010, mainly dealing with temporary income tax rate increases, a reduced timing benefit under the tax consolidation regime, and a 1% increase in Mexican value-added tax (VAT).

On 24 December 2010, the Mexican Government amended the regulatory framework for Maquiladoras (which is currently included as part of the Decree for the Promotion of the Manufacturing Industry, Maquiladora and Exportation Services Program, or 'IMMEX' program). These amendments importantly include a new definition of Maquiladoras operating in Mexico under the IMMEX regime.

The primary changes are focused on increasing control of certain sectors, providing legal certainty, and simplifying existing procedures.



It is envisioned that as of 30 June 2011, the Mexican Tax Authorities (Hacienda) will issue a comprehensive study on the performance of the flat tax (IETU) and the possible repeal of certain chapters of the Income Tax Law to include them in the IETU Law with the purpose of having a unified tax law on net income. Based on this, the Mexican Congress might propose certain changes in the 2012 Tax reform Act that will be discussed during the last quarter of 2011.

## Taxes on corporate income

### Federal income tax

The federal corporate income tax (CIT) rate for the period 2011 to 2012 is 30%. Beginning in 2013, the rate will drop to 29% and then back to 28% (as was in force until 2009) in 2014.

All corporate entities, including associations of a civil nature, branches, etc. are subject to the tax rules applicable to Mexican corporations (unless specifically ruled out, such as not-for-profit organisations).

The CIT rate applicable to taxpayers engaged exclusively in agriculture, livestock, fishing, and forestry activities is currently 21%.

Provisions to recognise the effects of inflation for tax purposes in the areas of monetary assets and liabilities (annual monetary adjustment) and depreciable assets are provided in the income tax law, even though recent inflation rates have been decreasing.

Once a corporation has paid its income tax, after-tax earnings (i.e. earnings arising from the after-tax earnings account, Cuenta de Utilidad Fiscal Neta or CUFIN) may be distributed to the shareholders with no tax charge at the corporate level and without income tax withholding regardless of the tax residence of the recipient.

Nonetheless, if a corporation makes a distribution out of earnings that for any reason have not been subject to CIT, such as distributions of book earnings (i.e. not yet recognised for tax purposes in Mexico), the corporation will be subject CIT on the grossed-up distributed earnings (gross-up factors are: 1.4286 from 2011 to 2012, 1.4085 in 2013, and 1.3889 as from 2014).

Tax paid on dividends distributed in excess of CUFIN can be credited against the CIT of the year or in the two fiscal years following the year in which the tax on the non-CUFIN distributions was paid. The CUFIN of the tax years in which the credit is applied must be reduced by an amount equal to the grossed-up dividend distribution.

### *Federal flat tax*

The flat tax applies to Mexican resident taxpayers' income from worldwide sources, as well as to foreign residents on the income attributed to their permanent establishments (PE) located in Mexico. The current flat tax rate is 17.5% and is applied to the flat tax base.

In general, the flat tax base is the excess of income actually collected relating to: (i) the sale or disposal of property, (ii) the provision of independent services, and (iii) the granting of temporary use or enjoyment of assets (i.e. rental income and unrelated party royalty income) over amounts actually paid for: (i) the acquisition of assets, (ii) the receipt of independent services, and (iii) the temporary use or enjoyment of assets, as well as certain (iv) other cash expenses, with the exceptions noted below. Even though there are no tax losses for flat tax purposes, a tax credit (with similar results to the application of net operating losses) may be available where flat tax deductions exceed income in a fiscal year, provided certain conditions are met. This credit may be used against flat tax liabilities for the subsequent ten years.

Salaries and wages, employer contributions to the social security system, non-taxable employee benefits, most interest income, and royalties received from related parties for the temporary use or enjoyment of intangible assets are not included within taxable income under the flat tax legislation. Accordingly, payments in respect of these types of expenses are non-deductible items. Nevertheless, the employer can obtain a flat tax credit on 'taxable' wages paid and social security contributions made, which is generally equivalent to deducting these two items.

Certain taxpayers are exempt from flat tax, principally those that are not considered taxpayers under the Mexican income tax law.

The flat tax operates as a supplemental tax to CIT, to the extent the flat tax due is higher than the income tax due for the fiscal year. Hence, the initial flat tax triggered is reduced by a 'credit' for an amount equal to CIT of the fiscal year plus any CIT on distributions exceeding the balance of the after-tax earnings account (i.e. non-CUFIN distributions).

Flat tax is computed on a cash-flow basis (with certain exceptions) and determined per calendar year. Nevertheless, advanced monthly flat tax payments are made based on the year-to-date flat tax gross income, minus the authorised deductions in that same period.

Depreciation and amortisation are not deductible for flat tax purposes.

Maquiladoras (factories importing duty free materials for processing and re-exporting) are subject to specific provisions that can significantly reduce their effective flat tax rates, to the extent certain conditions are satisfied.

Financial sector entities are subject to flat tax on their financing intermediation margin, less certain cash expenses paid, pursuant to specific rules applicable to these entities in the flat tax law.

### *State taxes*

There are no state taxes on corporate net income.

## *Corporate residence*

The federal tax code provides that corporations are deemed residents in Mexico if the principal centre of administration or the effective place of management is located in Mexico. A specific definition of 'tax resident' in any tax treaty overrides domestic law definitions, if the taxpayer is eligible to apply the treaty.

When a company ceases to be a Mexican resident in terms of the Mexican federal tax code or any tax treaty, it is deemed to be liquidated for tax purposes. In such cases, a notification is required at least 15 days before the change, and the CIT return must be filed with the Mexican tax authorities within 15 working days following the date on which the change of tax residency takes place.



### *Permanent establishment (PE)*

The income tax law considers a PE to be any place in Mexico where business activities or services are carried out or rendered by non-residents, such as agencies, offices, mining exploration sites, or any other place of exploration, extraction, or exploitation of natural resources, regardless of the length of time involved.

A foreign insurance company could also be considered as having a PE when it engages in activities consisting of insuring risk or collecting premiums (with the exception of reinsurance activities) in Mexico through a party other than an independent agent.

Sites used for display, storage, or purchasing facilities; inventories imported in-bond to be processed by a third party; short-term construction services; and offices to carry out auxiliary or preliminary activities and information gathering or scientific research are not considered to create a PE in Mexico. Non-residents may also keep merchandise in bonded warehouses (including merchandise delivered for importation into Mexico) without being considered as having a PE.

A non-resident is not considered to have a PE in Mexico as a result of the legal or economic relationships maintained with companies carrying out certain inventory processing activities (i.e. Maquiladoras) which normally process goods or merchandise maintained in Mexico by the non-resident by using assets provided by the non-resident or any related party, as long as certain requirements are met. The requirements include the conditions that the non-resident be resident in a tax treaty country and that the Maquiladora complies with the transfer pricing (TP) provisions provided in the law as well as the revised definition of Maquiladora that entered into force on 1 January 2011.

Maquila operations ('revised definition') are generally defined as those with the following characteristics:

- Raw materials are supplied by a foreign resident (with which a Maquila contract is in place) and are temporarily imported to be processed, transformed, or repaired and are subsequently exported, including for these purposes virtual import-export operations.
- The Maquila is also permitted to import goods in accordance with the permanent importation regime. Additionally, local purchases are allowed, as long as such goods are consumed in production and/or exported with the temporarily-imported inventory.
- The processing, transformation, or repair of goods must be performed with temporarily-imported machinery and equipment (M&E) which is the property of the foreign principal. In this regard, the foreign principal must own at least 30% of such M&E. It is important to mention that this M&E may not have been previously owned by the Maquila or by any other Mexican related party.

The limits for M&E will not apply to companies that were operating under an IMMEX program prior to 31 December 2009, if such companies have fulfilled all of their tax obligations, including those related to the TP safe harbour options under the Income Tax Law.

Maquiladoras under shelter programmes may not be considered as creating a PE in Mexico when assets of foreign residents are involved and certain information is provided to the Mexican Tax Administration in relation to the gross revenues earned and income taxes paid by its non-Mexican related party. This duration of benefit (in force until 2011) is expected to be extended by the Mexican Tax Administration.

A definition of PE in any tax treaty overrides domestic law definitions where the taxpayer is eligible to apply the corresponding tax treaty.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is payable at the general rate of 16% on sales of goods and services, as well as on lease payments and imports of goods and services, except in the border zones, where a 11% VAT rate generally applies (except on the sale of construction and developed real estate, which is subject to the general rate). The sale of medicines, as well as the sale of most food products, is zero-rated. The principal VAT-exempt transactions are the sale of land, credit instruments (including equity shares), residential construction, interest paid by banks, medical services, education, salaries and wages, rentals of residential property, and the sale of non-amortisable participation certificates on real estate investment trusts, provided specific requirements are satisfied.

The sale in Mexico of temporarily imported goods by non-residents to (i) other non-residents, (ii) Maquiladoras, or (iii) companies in the automotive industry is also VAT-exempt under certain circumstances.

The 0% VAT rate, which generally means that no VAT is payable, is applicable to a substantial number of transactions, including the sale of books, magazines, and newspapers published by the taxpayer, the exportation of goods and certain services (including some Maquiladora activities intended for exportation), the sale of certain basic foodstuffs, agricultural goods and services, sales and rentals of farm machinery and equipment, and other specified transactions.

Taxes paid by business enterprises on their purchases and expenses related to VAT taxable activities (including activities subject to the 0% VAT rate), may usually be credited against their liability for VAT they collect from customers on their own sales, services rendered, etc. The input VAT credit on goods or services of a general nature, or those not specially identified with either taxable or exempt activities for VAT purposes, is computed based on a VAT ratio proportional to the VAT taxable versus VAT exempt activities carried out by the taxpayer. Creditable VAT paid on purchases and expenses in excess of VAT collected from customers is recoverable via either a refund or a credit against subsequent VAT liabilities.

VAT is a 'cash basis' tax, with few exceptions (e.g. VAT on some types of interest must be paid on an accrued basis), therefore only the receipt of payment for goods or services triggers the output VAT liability, and an input VAT credit may be claimed only when the taxpayer pays VAT to its providers of goods and services. VAT is calculated for each calendar month as a final tax. In addition, VAT overpayments may be used to offset the tax liabilities arising from other federal taxes.

VAT must generally be withheld by Mexican residents acquiring or leasing tangible goods from non-residents if such foreign residents do not have a PE in the country to which income is attributed. Mexican business entities are required to withhold VAT on payments to individuals or entities for services consisting of ground transportation of goods. Mexican corporations must also withhold VAT on commissions paid to individuals, as well as on independent services rendered by Mexican individuals, and on tangible goods leased from individuals.



### *Compulsory profit sharing*
Although not a tax, every business unit with employees (irrespective of the type of organisation) is required to distribute a portion of its annual profits among all employees, except directors and the general manager. The amount distributable to the employees in most cases is 10% of taxable income, adjusted to eliminate income or deductions that relate to the recognition of inflation and include dividend income. Special rules apply to a limited number of specific businesses.

No profit sharing is paid during the first year of operations. Also, special rules apply for personal service entities and for entities deriving their income from rental activities, both of which can limit their profit sharing payment to the equivalent of one month of regular salary.

The profit sharing amount paid out is a deductible item for CIT purposes, provided certain requirements are met.

### *Excise tax*
The excise tax law (Impuesto Especial Sobre Producción y Servicios or IEPS) levies substantial federal excise rates on the importation and/or sale of certain taxable items, such as gasoline (% variable), beer (26.5%), wine (26.5% to 30%), spirits (53%), and cigarettes and other tobacco products (160% plus an additional quota), and on certain services related to these activities, such as commission, mediation, and distribution of excise taxable items as well as services for raffles and gambling (30%). Additionally, as of 2010, excise tax is also applicable to certain telecommunications services (3%).

In general terms, goods are exempt from IEPS when exported. However, since the input IEPS paid by exporters on their purchases is not creditable, that tax becomes an additional cost.

IEPS is payable (output tax) and creditable (input tax) on a cash basis. It is payable on the date that the charge invoiced is collected from the client and can be credited when the respective payment is made to the supplier. On imports, IEPS is creditable when paid at the customs offices.

In certain cases, the IEPS legislation allows taxpayers that are not subject to this tax to credit IEPS paid on the acquisition and/or the importation of certain goods, such as alcohol and semi-processed and fluid syrups (as a raw material), against CIT payable.

There is a specific procedure to calculate the tax for beer producers, bottlers, and importers; however, the tax can never be lower than 26.5%.

Among other obligations, IEPS taxpayers must file information regarding their 50 main clients and suppliers before the Mexican Tax Administration on a quarterly basis.

### *Customs duties/import tariffs*
Mexico's commercial conditions provide an excellent business and investment opportunity. Mexico is a member of the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation Mechanism (APEC), and the Organisation for Economic Co-operation and Development (OECD).

Mexico lies in a strategic geographical location for international trade, sharing borders with the United States of America, while facing Europe and Asia, and representing an easy entry to the rest of Latin America.

Mexico has signed twelve Free Trade Agreements (FTAs), which provide for preferential duty rates on foreign trade operations with 43 countries. FTAs signed by Mexico include NAFTA; Colombia; Costa Rica; Bolivia; Nicaragua; Chile; the European Union; Israel; Honduras, Guatemala and El Salvador (the Northern Triangle FTA), the European Free Trade Association, Uruguay, and Japan.

General Import Duty rates range from 0% to 35%, but most imports fall within the range of 3% to 20% (exceptionally, certain food products, shoes, and textiles pay higher duties).

Temporary imports are exempt from customs duties (except for fixed assets) and VAT payments.

### *Property taxes*
Annual taxes on real property are levied by the Federal District and all the states at widely varying rates applied to values shown in the property tax records, which in some cases are based on rental income from land and buildings held for rent to third parties. Assessed values have been increased substantially recently in the Federal District and some other areas.

### *Vehicle taxes*
Taxes are levied yearly on the ownership of motor vehicles as well as on the acquisition of new vehicles. These two taxes are payable in addition to the VAT on the purchase. Note that some vehicles considered as 'hybrid' (e.g. battery assisted vehicles) are not subject to the new vehicle acquisition tax, and ownership tax will be levied at a 0% rate.

### Title transfer taxes
The transfer of real estate is almost without exception subject to a variable transfer tax at rates averaging 3% to 4%. The tax is levied by most states and the Federal District.

### Tax on cash deposits (IDE)
As of 2010, IDE is applicable at 3% on monthly cash bank deposits exceeding 15,000 Mexican pesos (MXN) or its equivalent in foreign currency. This tax can be credited against certain taxes, including CIT.

### Stamp taxes
There are no stamp taxes in Mexico.

## Branch income

Mexican branches of foreign corporations (i.e. PEs) are generally subject to the same tax rules as Mexican corporations, with some exceptions. Such exceptions include that branches may deduct pro rata allocations of home office expenses, provided certain requirements are complied with (such as the existence of an applicable tax treaty and a comprehensive agreement for the exchange of tax information between the relevant territory and Mexico), but may not deduct remittances to their home offices, even when such remittances are classified as royalties, fees, commissions, services, or interest.

In general terms, distributions to the head office (other than those regarded as a return to the head office of the capital invested into the branch) either in cash or in kind from branches or other PEs are subject to the statutory corporate tax rate on the grossed-up distribution, unless the remittance is made from the CUFIN account balance (i.e. the after-tax earnings account).



## Income determination

### Recognition of income
Income is generally recognised on an accrual basis. However, the service revenues of civil entities that render professional services (e.g. law and accounting firms) are reported on a cash basis.

### Inventory valuation
The costing system to be used will be the incurred cost system, based on historic costs or pre-determined costs. If the requirements provided on the regulations of the income tax law are met, the direct cost system (based on historical costs) may be used.

Inventory may be determined by any of the following methods:

- First in first out (FIFO).
- Last in first out (LIFO).
- Identifiable costs.
- Average cost.
- Retail.

The FIFO and LIFO methods must be applied to each type of merchandise and each movement. The monetary FIFO and LIFO methods may not be used. Taxpayers selling goods that are identifiable by serial numbers, at a cost exceeding MXN 50,000, must determine their inventory by the identifiable cost method.

Once elected, a method is compulsory for five years and can be changed only if the requirements established in the regulations of the income tax law are fulfilled. The monetary results of the change in method are amortised over the following five years.

For accounting purposes, different methods and certain variations can be adopted. However, a record of the differences must be maintained, and such difference will not be taxable or deductible.

The cost of imported goods may be deducted (and included in the cost of goods sold) only if it can be supported that the goods were legally imported into the country.

### *Capital gains*

Capital gains are taxed as follows.

#### Securities

Gains on securities are included in regular taxable income. There are two different procedures for computing the tax basis of a Mexican company's shares, depending on the period for which the shares are held (i.e. whether less or more than 12 months).

The tax basis of shares of Mexican corporations sold may be increased by the inflation adjustment applicable for the holding period.

In the case of shares with a holding period of more than 12 months, there are certain items to be considered when computing the tax basis, such as: (i) the movement in the after-tax earnings account (CUFIN) of the issuing company (including the possible negative CUFIN effects), as adjusted for inflation, (ii) the unamortised prior years' tax losses at the date of the sale, (iii) tax losses arising prior to the date on which the shares were acquired and amortised during the holding period, and (iv) any capital reductions of the issuing company.

When the sum of: (i) the CUFIN balance at the date of acquisition of the shares, (ii) the capital reductions paid, (iii) the unamortised prior years' tax losses at the date of the sale, and (iv) the negative CUFIN balance of the issuing corporation is higher than the sum of: (i) the CUFIN balance at the date of the sale and (ii) the tax losses arising prior to the date on which the shares were acquired, and amortised during the shares' holding period, the difference must be subtracted from the tax basis of the shares to be disposed (potentially resulting in the shares' tax basis being equal to zero).

When the aforementioned difference exceeds the tax basis of the shares disposed, this excess (restated by inflation) must be subtracted from the tax basis of the shares in any subsequent share sale by the same taxpayer, even if the shares are issued by a different company.

The aforementioned procedure allows the average cost (tax basis) of the shares to be determined, which is then updated and considered as the acquisition cost for future sales.

A different but simpler procedure applies for computing the tax basis of shares held during a period of 12 months or less.

Deduction of losses arising from the sale of shares is limited to the value of gains from similar transactions in the same or the following five fiscal years. Losses may not be deducted by non-residents selling shares.

A gain from the sale of shares is considered Mexican-source income when the transferred shares are issued by a Mexican resident or when more than 50% of their book value arises directly or indirectly from immovable property located in Mexico, including cases where the shareholding is structured in different levels.

In general terms, the sale by non-residents of shares issued by a Mexican company is subject to a 25% withholding tax (WHT) applicable to the gross amount of the transaction (i.e. without deductions). However, there may be the option for gains realised by non-residents on the sale of shares issued by a Mexican company to be taxed by applying the statutory 30% rate to the net gain (i.e. the value of the transfer less the tax basis of the shares). The tax rate for these purposes is the same as that applicable to corporate taxpayers in each year, as mentioned above. Hence, in 2013 the rate will be reduced to 29% and to 28% in 2014.

This net income election is available only if the foreign shareholder is resident of a country that is not considered a 'preferred tax regime jurisdiction' (tax haven) or a country with a territorial tax system. The non-resident seller must have previously appointed a representative in Mexico and have a public accountant assigned to issue a statutory tax audit report on the transfer of shares. The public accountant issuing the respective report must specify the accounting value of the shares sold and explain the factors used in determining the sales price and the market value of the shares if shares are sold between related parties.

The representative is jointly liable for the tax on the sale of shares, even when the statutory report is issued by a public accountant.



The tax authorities may authorise the deferral of taxes that would otherwise be triggered by the transfer of shares in a group reorganisation (the authorisation must be obtained prior to the share transfer). The price used on the transaction must be at arm's length. The tax deferred, adjusted for inflation, is due upon the sale of the originally transferred shares outside the same interest group. An interest group consists of shareholders that have over 50% common voting stock of the companies.

In principle, authorisations for tax deferral are not granted if the party acquiring or selling the shares is resident in a tax haven or is a resident of a country that has not signed a broad exchange of information agreement with Mexico. However, in the latter case, an authorisation may still be granted if the taxpayer provides documentation to the Mexican tax authorities stating that the taxpayer has authorised the foreign tax authorities to provide information to the Mexican authorities regarding the operation in question.

If the share sale qualifies as an exempt reorganisation under tax treaty rules, the non-resident must appoint a legal representative in Mexico prior to the sale and file a notice with the Mexican Tax Administration informing them of such appointment and the details of the reorganisation process intended to be carried out. Additionally, certain formal requirements are established in the regulations of the Mexican income tax law that must be satisfied when carrying out this type of transaction.

Tax treaty rules (optionally) override domestic law rules when the seller resides in a tax treaty country.

### Shares sold through the stock market
In certain specific cases, the sale of shares is exempt from CIT when such shares are disposed of by individuals and residents abroad through authorised stock markets to the extent that certain requirements are met.

### Real estate
In determining the taxable gain of real estate, the cost basis of land and buildings may be adjusted (i.e. increased) for tax purposes on the basis of the period of time for which the assets have been held. This adjustment is performed by applying inflation adjustment factors to the net undepreciated balance. Similar rules apply to non-residents electing to pay tax on net income by appointing a legal representative in Mexico. The rate of tax on the net gain is 30% (in 2013 the rate will be reduced to 29% and to 28% in 2014). Otherwise, the 25% final WHT on gross income applies to non-residents.

### Machinery and equipment
Gains or losses from the disposal of machinery, equipment, and other fixed assets are also calculated after adjusting the basis in these assets, by applying inflation factors to the net undepreciated balance.

## *Inflationary gain or loss*
Taxpayers are required to calculate an adjustment for inflation (resulting in additional taxable income or deductible expense) on an annual basis by applying the percentage increases in the National Consumer Price Index (NCPI) to the value of essentially all liabilities, reduced by monetary assets, including bank balances, investments (except in shares), and some debt and receivables.

## *Dividend income*
Dividends received by Mexican corporations from other Mexican corporations need not be included in gross income. However, dividend income is subject to the 10% compulsory profit sharing and must be included within the recipient corporation's CUFIN.

No further taxes apply on dividends distributed out of the CUFIN. However, non-CUFIN distributions (i.e. distributions that for any reason have not been subject to CIT) are generally subject to tax at the level of the distributing company at the general income tax rate on the grossed-up distribution.

## *Foreign income*
A Mexican corporation is taxed on foreign-source income when earned. Double taxation is reduced, or possibly avoided, by means of foreign tax credits. However, the undistributed profits of a foreign subsidiary are not subject to Mexican tax until dividends are paid, with the exception of companies with investments in entities located in a tax haven ('income subject to preferred tax regimes'), in which case income is generally taxable even if no distributions are received from those entities.

## *Investments in tax havens (income subject to preferred tax regime)*
Investments in tax havens include those made directly or indirectly in entities, branches, real property, shares, bank accounts, or investment accounts, and any kind of participation in entities, trusts, joint ventures, or investment funds, as well as in any other similar legal entities created or incorporated in accordance with foreign law and located in a tax haven, and including those that are carried out through an intermediary.

A business, entity, trust, or joint venture is considered to be located in a tax haven when it has a physical presence, an address, a post office box, or effective management in a tax haven, or when its bank account is held in or through financing entities located in a tax haven.

Unless it can be demonstrated that the taxpayer does not have management control of the foreign investments, the taxpayer must include the income generated through such entities or foreign vehicles in the proportion that corresponds to their direct or indirect participation in the capital of the entity or vehicle.

Income and profits subject to preferred tax regimes (PTR) are taxed separately. This income cannot be combined with other taxable income or losses and it is not considered for purposes of making advance income tax payments. Tax applicable to this type of income is payable together with the annual CIT return.

The classification of a PTR is not based on the location of the investment but on the tax effectively paid on the income generated abroad. An investment is considered subject to a PTR if the income tax paid abroad is less than 75% of the income tax that would have been incurred and paid in Mexico, if the income had been taxed under Mexican rules.

In general, interest income and the annual inflationary adjustment made to liabilities of the investment in the tax haven are included in taxable income without subtracting the annual inflationary adjustment on receivables.

However, the annual inflationary adjustment on receivables may be subtracted from interest income earned, provided an information return is filed.



Tax on investments in a PTR is determined by applying the general CIT rate to taxable income. Additionally, net operating loss carryforwards associated with an investment in a PTR may be amortised against the tax profit of the following tax years arising from investments in PTR, and tax deductions related to the investment may also be applied, as long as accounting records pertaining to those investments are available and the annual information return on the investments is filed on time.

Undistributed income from investments in entities located in a PTR need not be immediately included in taxable income (under the provisions discussed above) in certain particular cases (e.g. income arising from qualified active business activities in accordance with the applicable legislation and in the case of indirect investments in a tax haven when certain strict conditions are met).

Income earned in a PTR will be exempted where the PTR income arises from a business activity. This exemption will not be applicable, however, if income such as interest, dividends, royalties, certain capital gains, and rents (i.e. passive income) represent more than 20% of the total income generated.

Other specific exemptions may remain applicable in the case of share transfers within the same group and for income derived from royalties and interest that do not represent a tax deduction for Mexican tax residents to the extent that certain specific requirements are fulfilled.

### *Maquiladoras*

As discussed in the Corporate residence section, companies operating under an IMMEX programme (Maquiladoras/In bond processing companies) are considered to not have a PE in Mexico. This is the case for the non-resident principal which owns the M&E and inventory, to the extent it is a resident of a country that has a tax treaty in force with Mexico, complies with all the terms and requirements of the treaty, satisfies any mutual agreements between Mexico and its treaty partner, and complies with the TP provisions provided in the law as well as the revised definition of Maquiladora that entered into force on 1 January 2011. This relief applies only if the Maquiladora complies with any of the following options stated under the domestic law:

- Maintenance of documentation on TP in accordance with the applicable legislation, adding to the Maquila fee 1% of the net book value of the M&E owned by the foreign related company and used by the Maquiladora in its activities.
- Reporting of a taxable income margin of a minimum of the higher of:
  - 6.9% of the value of assets used in the Maquila activity (including the inventories and fixed assets owned by the foreign related party), or
  - 6.5% of the value of the operating costs and expenses of the Maquiladora.
- Maintenance of documentation on TP using the transactional net margin method (TNMM) and considering a return on the net book value of M&E owned by the foreign related company used by the Maquiladora in its activities, adjusted by financing terms.

Maquiladoras that apply the first or third option may request an advanced pricing agreement (APA) from the Mexican tax authorities. However, this APA is not mandatory in order to obtain the PE exemption.

Maquiladoras that apply any of the three options above are not required to file an annual information return on transactions with foreign related parties. This exemption is only available in respect of the Maquila activity.

If the Maquiladora renders services other than exported Maquila services (including domestic sales), specific TP requirements apply and potential PE issues must be evaluated.

In general terms, the Maquiladoras receive a significant reduction on their effective income tax and flat tax rates to the extent certain conditions are satisfied.

The Mexican Tax Administration has recently initiated a detailed review of the Maquiladora programme, hence it is expected that significant tax reforms will be approved in the coming years.

## *Deductions*

The applicable deduction requirements must be complied with no later than the last day of the tax year to which the deduction applies, although the invoice supporting the expense may be provided up to the date on which the tax return for the period in question is filed (or comes due). An expense invoice must contain a date within the year for which the deduction is claimed.

Deductions for certain business expenses are limited in the case of business meals and use of company owned cars.

### *Depreciation, amortisation, and depletion*

Straight-line depreciation is permitted at the rates specified in the law (i.e. estimated lives for assets are 20 years for buildings, 3.3 years for computers, 4 years for cars, 10 years for certain machinery and equipment, etc.), and the deduction may be increased by applying the percentage increases in the NCPI from the month in which the asset was originally acquired. When an asset is disposed of or becomes useless, the remaining undepreciated historical cost may also be deducted, after application of the appropriate inflation adjustment factor to the undepreciated historical cost.

Mining exploration and development expenses incurred prior to the commencement of operations and the cost of mining claims may be amortised at 10% per year, after applying inflation adjustment factors, unless the taxpayer elects to deduct these costs as incurred.

Intangible assets for the exploitation of goods that are in the public domain, or for rendering public services under concession, are considered deferred assets (i.e. not deducted as incurred). Therefore, these assets are subject to amortisation for income tax purposes.

Specific annual depreciation rates are established for goods used in certain industries.

### *Charitable contributions*
The maximum amount for deductible donations is limited to 7% of the taxable income of the previous year.

### *Taxes*
In general, all federal, state, and local taxes levied on a company (not including those required to be withheld from other parties) represent deductible expenses for CIT purposes, with the following exceptions:



- CIT.
- Flat tax.
- Federal VAT and excise tax when the company is entitled to credit the tax.
- Taxes on acquisitions of fixed assets and real estate, which must be capitalised and deducted as part of the total cost of such assets to be depreciated.

### *Net operating losses*
Subject to certain limitations, losses incurred in prior years by a business may be carried forward and deducted from income earned over a subsequent ten-year period. Net operating loss carrybacks are not allowed.

Losses carried forward may be increased by the percentage increase in the NCPI between the seventh and 12th months of the fiscal year in which they are incurred and thereafter up to the sixth month of the fiscal year in which they are applied.

Tax loss carryforwards are non-transferable; however, they can be used by the surviving entity, in a merger with certain restrictions. In the case of a spin-off, tax loss carryforwards can be divided between the surviving entity and the spun-off entities in proportion to the following:

- Inventories and accounts receivable transferred in the case of commercial entities.
- Fixed assets transferred, in all other cases.

Current tax legislation limits the utilisation of tax losses in changes in ownership. The rule provides that changes in ownership representing more than 50% of the voting shares prevents the utilisation of tax losses against income obtained in the same trade of business (‘giro’), with certain exceptions.

### *Payments to foreign affiliates*

Taxable income and authorised deductions must be determined on the basis of prices that would be agreed with independent parties in comparable transactions (arm's-length values).

For this purpose, taxpayers must secure and maintain contemporaneous documentation supporting transactions with related parties residing abroad, demonstrating that income and deductions are based on market values. This documentation must be prepared per type of transaction and must include all operations carried out with related parties.

Domestic transactions must also be supported by the application of a recognised TP method selected in accordance with the preferred ordering methods determined in the legislation.

Payments made to residents of tax havens (or PTRs) are considered non-deductible, unless it can be demonstrated that the price of the transaction is the same that would have been set between or among unrelated parties in comparable transactions. Unless the contrary is demonstrated, it is assumed that operations with companies, entities, or trusts resident in a PTR are carried out between or among related parties and that prices are not set as they would be in comparable operations between or among independent parties.

The sales price of shares (other than publicly traded shares) sold to a related party must be set at market value and the transaction must be supported by the corresponding contemporaneous TP documentation.

In order to be deductible, payments of technical assistance fees and for the transfer of technology or royalties must be made directly to companies with the required technical capabilities to provide the corresponding service and should correspond to services actually received.

Payments to non-residents of a prorated portion of expenses (i.e. allocations of expenses) are not deductible for Mexican corporations.

## *Group taxation*

The income tax law contains a chapter that allows certain holding companies to file a consolidated income tax return with their majority-owned subsidiaries. Tax consolidation is applicable for CIT purposes but not for other taxes (e.g. flat tax and VAT) or compulsory employee profit sharing.

The principal requirements for a company to qualify as a holding company for fiscal consolidation are that it must be a Mexican tax resident with no more than 50% of its shares owned by other companies, regardless of their country of residence. Shares that qualify as placed among the general investing public and non-voting shares are not considered for this purpose.

Where more than 50% of the holding company's shares are held by a foreign corporation, the above qualifying rule precludes the possibility of filing a consolidated return for a Mexican group, for companies that would otherwise qualify. However, there is an exception in cases where the foreign corporation that owns the shares of the

Mexican holding company is a resident in a country that has executed a comprehensive agreement for the exchange of tax information with Mexico.

As of 4 February 2011, Australia, Austria, Bahamas, Barbados, Bermudas, Brazil, Canada, Chile, China, the Czech Republic, Denmark, Ecuador, Finland, France, Germany, Greece, Iceland, India, Italy, Japan, New Zealand, the Republic of Korea, the Netherlands, the Netherlands Antilles, Norway, Panama, Poland, Portugal, Romania, Russia, Singapore, Slovak Republic, South Africa, Spain, Sweden, Switzerland, the United Kingdom, Uruguay, and the United States have agreements of this nature with Mexico, and other agreements or tax treaties that might contain such an agreement are awaiting ratification or being negotiated.

The Mexican Tax Administration must authorise the application of the consolidation regime, and financial statements and written consent of the legal representative must be filed before 15 August of the year prior to the first year of consolidation. There is a minimum five-year period of fiscal consolidation, and special consolidated tax accounts should be prepared by the consolidated group.

There are some entities that are non-qualifying entities for inclusion in the consolidation regime, such as non-profit entities, credit institutions, insurance corporations, trusts, auxiliary credit institutions, stock exchange entities, foreign exchange houses and capital investment companies, non-resident companies, companies in liquidation, civil or social associations, and cooperatives.

In general terms, the consolidation regime allows certain benefits, such as:



- Individual company loss offset against profits of other companies in the same group during a deferral period.
- Deferral of tax on dividends in excess of the individual CUFIN, to the extent that the dividend flow remains within the consolidation group.
- Capital losses in the holding company from the sale of subsidiaries deducted as an ordinary loss in the year.

Prior to 2010, these deferral benefits were subject to recapture, and could generally be triggered if:

- A member leaves the consolidated group.
- The ownership percentage is reduced.
- The group is deconsolidated.
- Certain carryforward limitations expire (i.e. tax loss and capital loss recapture is required if any of the above three events occur during the ten-year period).

The significant 2010 tax reforms introduced important modifications to the consolidation regime, including a reduction of the recapture period from ten to five years in the case of tax losses and capital losses. Moreover, the introduction of new rules now trigger excess dividends over the CUFIN balance and other recapture items after five years while these deferrals were often considered indefinite before the reform, as long as the same group remained in the consolidation with the same ownership percentages.

As a result, most of the consolidated benefits will be reversed in five years, and the deferred income tax will be payable with the submission of the tax return starting from 'Year six', as follows:

- 25% in each of years six and seven.
- 20% in year eight.
- 15% in each of years nine and ten.

Similar transition rules have also been implemented for the recapture and repayment of certain consolidated benefits obtained in years prior to 2010.

### *Transfer pricing*

Mexican TP legislation has significantly developed as a result of Mexico's admission to the Organisation for Economic Co-operation and Development (OECD) in 1994. This development has resulted in the implementation of TP guidelines that are in line with the global economy and market liberalisation.

In general terms, from a Mexican TP perspective, all related party transactions (including certain Joint-Venture relationships) must be reported at arm's length.

Local legislation allows the selection of both traditional methods and profit-based methods consistent with the OECD guidelines. However the legislation requires a strict ordering for the application of a method.

Mexican legislation is generally 'form over substance' oriented; therefore contractual terms remain relevant when defining the economic substance of the transactions subject to the TP analysis.

Limited reliable financial information is not always publicly available for Mexican entities. Hence, reliance is often placed on foreign information, which is then adjusted to properly reflect local market conditions and render the transactions in question more comparable.

### *Thin capitalisation*

Interest generated by excess debt lent by a related party is non-deductible for CIT purposes. Excess debt is defined as more than three times the value of shareholders' equity (i.e. a 3-to-1 debt-to-equity ratio) as per the taxpayer's Mexican generally accepted accounting principles (GAAP) balance sheet.

In principle, all liabilities are considered in determining the annual average liabilities for purposes of calculating the ratio and thereby the disallowed interest expense amount. However, certain liabilities incurred for construction, operation, or maintenance of the productive infrastructure associated with the strategic areas of Mexico may be excluded from this computation.

Taxpayers may also be able to obtain a ruling from the Mexican Tax Administration in order to apply a higher financial leverage (i.e. not the 3-to-1 debt-to-equity ratio), owing to the characteristics of their activities. Also, the thin capitalisation rules do not apply to the financial sector.

In addition, taxpayers are entitled to use the sum of the average balances of the capital contributions account (CUCA) and the after-tax earnings account (CUFIN) to determine the 3-to-1 debt-to-equity ratio instead of shareholders' equity. Taxpayers that opt for this tax equity computation must continue to use it for at least five years. This alternative computation is mandatory for those taxpayers that do not account for capital following Mexican GAAP.

Specific provisions dealing with the disallowance of interest expenses for debt financing structured though back-to-back loans should also be closely observed.

## Tax credits and incentives

### Foreign tax credit

The income tax law allows Mexican corporations and individuals a foreign tax credit on income from foreign sources. The law provides that taxpayers may credit against their Mexican income tax liability the amount of income tax paid in foreign countries on their foreign-source income, as long as such income is subject to income tax in Mexico.

In general, credit is available in respect of foreign income taxes directly withheld from foreign-source income or paid with a tax return filed in the foreign country in the name of the Mexican resident or by a foreign branch of a Mexican corporation. However, in the case of dividends or distributions of profits received from corporations resident in a foreign country, when a

Mexican corporation owns at least 10% of the capital of the foreign corporation for six months prior to the dividend, a deemed-paid credit can also be taken for the proportionate part of the underlying foreign corporate income tax paid by that corporation, corresponding to the dividend or distribution of profits received. In calculating the amount of income subject to Mexican tax in these cases, the dividend or distribution must be grossed up to include the proportionate amount of tax paid by the foreign corporation. This credit is allowed also on tax paid on a second holding tier, provided certain requirements are met.

The foreign tax credit will be allowed up to the effective Mexican rate of tax on the taxable income (tax result) shown by the annual return under an 'overall' type limitation. Taxpayers who are not in a position to take full credit for the taxes paid to a foreign country on foreign-source income are allowed a ten-year carryforward of such excess foreign taxes, provided certain compliance requirements are met and the credit is limited to the corporate tax rate of 30%.



### Duty-deferral programmes

A deferral programme is an authorisation provided by the Mexican Ministry of Economy to those companies importing raw materials and fixed assets on a temporary basis to manufacture finished products within Mexico that will be exported.

In addition to the benefits described for CIT purposes in the Income determination section, IMMEX companies (known as Maquiladoras - i.e. entities with a Manufacturing, Maquila, and Export Service Program in force) are entitled to the following customs benefits:

- No payment of import duties and VAT for temporarily imported raw materials, as long as they are exported.
- Sales of temporarily imported goods to other Maquila companies at a 0% VAT rate.
- Temporary import of fixed assets without paying VAT.

Another programme allowing preferential duty rates is the Program of Sectoral Promotion (known as PROSEC) which allows manufacturers to apply lower duty rates on the permanent import of raw materials and machinery required for its productive processes, regardless of their country of origin and regardless if they are for the Mexican market or for export. These programmes were created by the federal government in order to establish competitive tariff conditions for Mexican manufacturers needing to import raw materials and fixed assets from non-NAFTA countries due to the changes made in 2001, where non-originating merchandise exported to NAFTA countries must pay duties.

The Ministry of Economy also provides a Registry for High Export Companies (known as ALTEX) which provides the following benefits:

- A company can obtain refunds of its favourable VAT balances in a shorter period of time.
- A company is exempted from the second customs review of its exports which expedites the customs clearance process.

Companies in Mexico which had formerly performed import operations with values from MXN 200 million to MXN 400 million per semester could take advantage of significant customs and administrative benefits if registered into the 'Certified Company Registry' (authorised by the Ministry of Finance).

In general terms, the main benefits provided by the Certified Company Registry are as follows:

- Permission to perform import customs clearance through any customs office.
- Reduction in time and number of reviews when clearing goods at customs facilities.
- Permission to perform clearance of goods for export at the company's own facilities.
- Possibility to amend information contained within the import-export documents (including origin), fines reductions, and self-correction.
- In the event of an 'Administrative Customs Process Review', the obligation to comply with non-tariff regulations can be met within 60 days of receiving notification from the Customs Authority, without the seizure of the imported goods. For 2010, 58.15% of 10,900 tariff items were exempt from import duties, and for the remaining tariff items the average import duty rate was 5.34%.

### *Accelerated depreciation*
Investments in certain new fixed assets outside Mexico City, Guadalajara, and Monterrey are entitled to an accelerated depreciation deduction considering a present value discounted rate of the future stream of depreciation. Some taxpayers may benefit from this deduction in the aforementioned cities if they can show that their business operations do not contribute to pollution and do not require the intensive use of water.

### *R&D incentives*
An income tax incentive for taxpayers involved in certain technological research and development projects carried out during the year allows a cash subsidy to be yearly determined by the tax authorities, based on a budget to be approved by the Mexican Congress.

### *Employment incentives*
An incentive offers a credit equivalent to 100% of the income tax corresponding to the salary paid to workers/employees with certain types of disabilities.

An additional deduction is available for employers who hire first-job employees for newly-created positions, which is calculated using a specified method.

### Incentives for investments in movie production

A limited credit is applicable for investments in movie production activities through an immediate tax credit which is capped at 10% of the total income tax of the prior year, provided certain requirements are met.

### Incentives for investments in national theatre production

Income taxpayers can benefit from a tax credit (applicable to both the annual tax calculation and the estimated monthly payments ) equal to the amount they have invested in national theatre production, while not exceeding 10% of the income tax liability of the previous tax period.

### Marginal scarcely inhabited zones

Taxpayers investing in specific regions of Mexico considered to be 'marginal scarcely inhabited zones' (less than 50,000 inhabitants) can receive certain tax benefits, such as a 100% exemption on Social Security contributions to the extent certain requirements are met and financing benefits for the development of industrial facilities according to the guidelines and limitations provided by the Ministry of Economic Affairs in Mexico.

### Real estate investment incentives

Several tax benefits exist for qualifying real estate investments (i.e. Mexican REITs such as FIBRAS, SIBRAS, etc.) in Mexico.

### Capital investment

There are certain incentives to encourage risk capital investments in Mexico.

### Other incentives

Certain other specific and limited tax incentives are available for taxpayers engaged in certain activities (e.g. those engaged in air or sea transportation of goods or passengers with respect to aircraft and ships with a federal government commercial concession or permit; in the agricultural and forestry sectors; and in bond warehouses with respect to real property used for the storage, safeguarding, or conservation of goods or merchandise).



## Withholding taxes

### Payments to Mexican residents

Payments to resident corporations and PEs in Mexico are generally not subject to WHT.

Payments by resident corporations to resident individuals are subject to WHT as follows:

| Payment | WHT (%) |
|---|---|
| Wages, salaries, and other remuneration | 0 to 30 |
| Fees: | |
| Members of boards of directors and advisory boards | 30 |
| Other professional fees | 10 |
| Lease payments on real property | 10 |
| Interest on securities (1) | 0.6 |
| Interest on non-qualified securities | 20 |
| Dividends | 0 |
| Miscellaneous types of income of individuals, usually sporadic payments | 20 |

Note

1. WHT on interest paid by financial institutions to Mexican resident investors is generally set at 0.6% of the invested capital.

   To simplify the calculation of interest income from loans entered into with financial institutions, a new procedure has been proposed based on cash flow, which would enter into force on 1 January 2012.

   Through this procedure, financial services taxpayers would be relieved from the requirement to withhold the corresponding income tax on the principal of the loan. Income tax withheld would be considered as a final payment for individuals and an advance payment for corporations.

### *Payments to non-residents*

Income tax must usually be withheld from payments to non-resident corporations and individuals. In the case of non-tax treaty countries, the statutory withholding rates are as noted below.

Income tax of 40%, with no deductions, must be withheld on most payments made to foreign related parties located in tax havens, in lieu of the tax provided in the domestic law for non-tax haven residents. This is not applicable in certain cases, such as on income not subject to Mexican taxation in accordance with the regular provisions for income earned by non-residents from a source of wealth located in Mexico, income from dividends, and certain types of interest, including interest payments made to foreign banks. In these cases, the regular provisions of the domestic law should be applied to determine the income tax withholding.

Additionally, revenues for intermediation services, including commissions for brokerage, agents, distribution, and assignment, and generally all income from the negotiation of third-party interests, are also subject to 40% WHT when paid to tax haven residents.

Non-residents' wages and salaries are taxed on the basis of a 12-month earnings period at the following income tax withholding rates:

| Taxable income | | WHT (%) |
|---|---|---|
| From | To | |
| 0 | MXN 125,900 | 0 |
| MXN 125,901 | MXN 1,000,000 | 15 |
| MXN 1,000,001 | and above | 30 |

The above mentioned rates are also applicable to retirement fund payouts.

However, no tax arises on compensation (wages, salaries, or fees other than board fees) paid by a non-resident with no establishment in Mexico (even if not subject to tax) to which the services relate, provided the individual remains in Mexico for fewer than 183 days (consecutive or not) in any 12-month period.

The tax, when applicable, is withheld if the income is paid by a resident (or a non-resident with a PE in Mexico). Otherwise, the tax is generally payable within 15 working days of the associated payment, by the party earning the Mexican-sourced income.

Statutory withholding rates (not mentioned above) under local legislation are as follows:

| Payment | WHT (%) |
|---|---|
| Professional fees for services rendered in Mexico | 25 |
| Lease payments: | |
| Lease of real property | 25 |
| Lease of containers, airplanes, and ships authorised by the Mexican Government to be commercially exploited in the transportation of goods or persons | 5 |
| Lease of personal property | 25 |
| Time-sharing services (1) | 25 |
| Charter agreements | 10 |
| Sales: | |
| Real property located in Mexico (1) | 25 |
| Shares of Mexican companies (1, 2) | 25 |
| Transfers of ownership of Mexican public debt by other than the original creditors (intended to cover debt-for-equity swaps) (1) | 25 |
| Derivative transactions: | |
| On capital (1) | 25 |
| On debt (3) | Same rates applicable to interest |
| Interest (4): | |
| Paid to foreign government financing entities, to duly registered foreign banks and other entities that provide financing with funds obtained by issuing publicly traded debt instruments abroad, registered with the Ministry of Finance (5) | 10 |
| Interest on debt instruments placed abroad (6) | 4.9 |
| Interest payments to specific foreign financial institutions (7) | 4.9 |
| Other interest payments (not otherwise included above) paid by Mexican financial institutions to residents abroad | 21 |
| Paid to foreign suppliers of M&E, to others to finance purchases of such assets or inventory or working capital loans, if the lender is duly registered | 21 |
| Paid to reinsurance entities | 15 |
| Other interest payments (11) | 30 |
| Financial leases (on the portion deemed to qualify as interest or finance charge) | 15 |
| Dividends | 0 |
| Royalties (8): | |
| For the use of railroad cars | 5 |
| For the use of copyrights on scientific, literary, or art works, including motion pictures and radio and television recordings, as well as software and payments for the transmission of video and audio signals via satellite, cable, optic fibre, and similar media | 25 |
| On patents, invention or improvement certificates, trademarks, brand names, and advertising (11) | 30 |
| For the use of drawings or models, plans, formulas, or procedures, and of scientific, commercial, and industrial equipment; on amounts paid for information regarding scientific, commercial, and industrial experience; and for technical assistance | 25 |
| Short-term construction and the respective installation, maintenance, technical direction, or supervision (9) | 25 |
| Reinsurance premiums | 2 |

| Payment | WHT (%) |
|---|---|
| Income obtained by athletes and artists (1) | 25 |
| Income derived from prizes (e.g. lottery tickets or raffles) (10) | 1/21 |
| Other income (forgiven debts, indemnifications, rights to participate in business, investments, etc.) (11) | 30 |

Notes

1. The non-resident may elect to pay tax at a rate of 30% in 2011 *(see note 11 below for the rate applicable thereafter)* on the net taxable profit in the case of (i) time-sharing services, (ii) share sales, (iii) sales of real property, (iv) activities of sportsmen/artists, and (v) derivative stock and debt transactions provided that the non-resident recipient of the income has a legal representative resident in Mexico and to the extent that the following specific requirements are met:
    - For time-sharing services, the resident legal representative must keep the audited financial statements of the taxpayer available for inspection by the Mexican Tax Administration.
    - For share sales, a tax opinion issued by a registered public accountant is required.
    - For shares and debt-for-equity swap transactions, this election is available only where the foreign taxpayer is not a resident of a country classified as a tax haven or a country with a territorial tax system. It should be noted that there is an option to defer Mexican income tax arising from the sale of shares within the same group due to a corporate reorganisation provided certain conditions are met and that no legal representative is required for sales of real property by public deed.
2. The sale of shares through the Mexican Stock Exchange and government securities are exempt from income tax withholding provided certain rules are satisfied.
3. The applicable WHT rate (based on the WHT rates for interest) for debt-derivative transactions is applied on a net basis, that is, gross income less authorised deductions. However, if the transaction is liquidated in kind, the applicable WHT rate (on the same net basis) is 10%.
4. Interest payments to non-residents are exempt from Mexican income tax when they are paid on the following:
    - Loans to the federal government or to the Bank of Mexico (Central Bank) or bonds issued by the latter organisation to be acquired and paid abroad.
    - Loans for three or more years granted or guaranteed by duly registered financial entities that promote exports through special financing.
    - Preferential loans granted or guaranteed by foreign financial entities to institutions authorised to receive tax-deductible donations in Mexico, provided these institutions are properly registered and use the funds for purposes consistent with their status.
    - Loans derived from bonds issued by the Federal government or the Bank of Mexico placed on a recognised national stock exchange, to the extent the beneficial owner is a foreign resident.
5. In 2011, a 4.9% WHT rate (the rate has been extended for another year) is applicable when the interest is paid to registered banks resident in countries with which Mexico has signed a tax treaty.
6. The 4.9% WHT rate applies, provided the placement is handled through banks or brokerage firms resident in a country with which Mexico has signed a tax treaty if there is compliance with the information requirements established in the general rules issued by the Ministry of Finance. If there is failure to comply with these requirements, the 10% WHT rate applies. The 4.9% and 10% WHT rates mentioned in the preceding paragraphs do not apply, and instead a 30% *(see note 11 below for the rate applicable thereafter)* WHT rate is applicable to interest, when the direct or indirect beneficiaries of the interest, either individually or jointly with related parties, receive more than 5% of the interest arising from the instrument in question, and are either (i) holders of more than 10% of the voting shares of the issuing company, either directly or indirectly, either individually or jointly with related parties or (ii) business entities holding more than 20% of their shares, either directly or indirectly, either individually or jointly with parties related to the issuer.
7. The 4.9% WHT rate is applicable to interest payments made to foreign financial institutions in which the Mexican federal government or the Mexican Central Bank has an equity participation.
8. The WHT rate is applied to the gross amount of the payment.
9. The non-resident taxpayer may elect to pay 30% *(see note 11 below for the rate applicable thereafter)* tax on the net profit in 2011 and 2012 if the taxpayer has a resident legal representative and so advises the customer, who then makes no withholding. When business activities last for more than 183 days, the foreign taxpayer is deemed to have a PE in Mexico for tax purposes and is taxed in the same manner as a local resident corporation or branch.
10. The 21% federal rate is applied only in the case of non-qualifying prizes (i.e. income derived from prizes that is subject to a state tax that exceeds a rate of 6%).
11. A 30% WHT rate is applicable for the period 2011 to 2012. Beginning in 2013, the rate will reduce to 29% and then back to 28% in 2014. The statutory WHT rates mentioned above may be reduced by applying tax treaty provisions. During the last decade, Mexico has embarked on a policy of negotiating a network of tax treaties with its principal trading and investment partners.

As of 1 January 2011, the treaties with the following countries are pending ratification while waiting for the completion of specific formalities by the respective governments in order to become effective, have not been published yet in the Official Gazette, or are under negotiation: Bahrain, Colombia, Hungary, Kuwait, Latvia, Lebanon, Lithuania, Malaysia, Morocco, Nicaragua, Pakistan, Slovenia, Thailand, Ukraine, and Venezuela.

Note that the tax treaties in force with Austria, Luxembourg, and the United Kingdom are being renegotiated. Although, they have not been published yet in the Official Gazette, they are expected to be applicable as of 2012 (subject to certain formalities), in which case some of the rates displayed below may have to be updated.

Tax treaties with Australia, Austria, Barbados, Belgium, Brazil, Canada, Chile, China, the Czech Republic, Denmark, Ecuador, Finland, France, Germany, Greece, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, the Republic of Korea, Luxembourg, the Netherlands, New Zealand, Norway, Panama, Poland, Portugal, Romania, Russia, Singapore, the Slovak Republic, South Africa, Spain, Sweden, Switzerland, the United Kingdom, the United States, and Uruguay have been published in the Official Gazette and are in force.

The WHT rates negotiated under the tax treaties are as follows:

| | Dividends (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Portfolio** | **Substantial holdings** | **Interest (%)** | **Royalties (%)** |
| Australia | 15 | 0 (1) | 10/15 (25) | 10 |
| Austria | 10 | 5 (4) | 10 | 10 |
| Barbados | 10 | 5 (1) | 10 | 10 |
| Belgium | 15 | 5 (2) | 10/15 (16) | 10 |
| Brazil | 15 | 10 (6) | 15 | 10/15 (27, 29) |
| Canada | 15 | 5 (4) | 10 | 10 |
| Chile | 10 | 5 (6) | 5/15 (26) | 5/10 (29, 30) |
| China | 5 (7) | 5 (7) | 10 | 10 |
| Czech Republic | 10 (7) | 10 (7) | 10 | 10 |
| Denmark | 15 | 0 (3) | 5/15 (17) | 10 |
| Ecuador | 5 (7) | 5 (7) | 10/15 (16) | 10 |
| Finland | 0 | 0 | 10/15 (24) | 10 |
| France | 0/5 (9) | 0/5 (9) | 5/10 (29, 17) | 10 (29) |
| Germany | 15 | 5 (1) | 5/10 (18) | 10 |
| Greece | 10 (7) | 10 (7) | 10 | 10 |
| Iceland | 15 | 5 (1) | 10 | 10 |
| India | 10 (7) | 10 (7) | 10 | 10 (31) |
| Indonesia | 10 (7) | 10 (7) | 10 | 10 |
| Ireland, Rep. of | 10 | 5 (4) | 5/10 (17, 29) | 10 |
| Israel | 10 | 5 (10) | 10 | 10 |
| Italy | 15 (7) | 15 (7) | 10 (29) | 15 |
| Japan | 15 | 5 (8) | 10/15 (25) | 10 |
| Korea, Rep. of | 15 | 0 (1) | 5/15 (17) | 10 |
| Luxembourg | 15 | 8 (11) | 10 | 10 |
| Netherlands | 15 | 0 (12) | 5/10 (21) | 10 (28) |
| New Zealand | 15 (7, 13) | 15 (7, 13) | 10 | 10 |
| Norway | 15 | 0 (3) | 10/15 (16) | 10 |
| Panama | 7.5 | 5 (32) | 5/10 (17) | 10 (33) |
| Poland | 15 | 5 (3) | 10/15 (19) | 10 |

# Mexico

| Recipient | Dividends (%) Portfolio | Dividends (%) Substantial holdings | Interest (%) | Royalties (%) |
|---|---|---|---|---|
| Portugal | 10 (7) | 10 (7) | 10 | 10 |
| Romania | 10 (7) | 10 (7) | 15 | 15 |
| Russia | 10 (7) | 10 (7) | 10 | 10 |
| Singapore | 0 | 0 | 5/15 (17) | 10 |
| Slovak Republic | 0 (14) | 0 (14) | 10 | 10 |
| South Africa | 10 | 5 (1) | 10 | 10 |
| Spain | 15 | 5 (3) | 5/10/15 (21, 22, 29) | 10 |
| Sweden | 15 | 5 (5) | 10/15 (16) | 10 |
| Switzerland | 15 | 0 (34) | 5/10 (35) | 10 |
| United Kingdom | 0 | 0 | 5/10/15 (21, 23) | 10 |
| United States | 10 | 5 (4, 15) | 4.9/10/15 (23, 20) | 10 |
| Uruguay | 5 (7) | 5 (7) | 10 | 10 |

Notes

The applicable tax rates on dividends paid abroad in accordance with the tax treaties executed by Mexico are detailed below; however, no withholding is applied on dividend distributions under domestic law.

There are certain specific cases of interest paid to parties resident abroad that might be exempted by certain tax treaties (e.g. interest paid to a pension fund or paid by a bank, interest paid on certain loans granted or guaranteed by certain entities for exports under preferable conditions), which are not detailed in the information below.

1. This rate applies when the recipient corporation that is the beneficial owner of the dividend (except for civil partnerships) directly owns at least 10% of the capital of the distributing corporation. In the case of Barbados and South Africa, the specific exclusion of civil partnerships is not included.
2. This rate applies where the company that is the beneficial owner of the dividends directly or indirectly owns at least 25% of the capital of the distributing company.
3. This rate applies where the company that is the beneficial owner of the dividends (except for civil partnerships) directly owns at least 25% of the capital of the company distributing the dividends. In the case of Norway, taxation is limited to the country of residence of the party receiving the dividends, provided the aforementioned substantial holding rule is satisfied.
4. This rate applies where the recipient corporation that is the beneficial owner of the dividend owns at least 10% of the voting shares of the paying corporation. The Mexico-US tax treaty contains a most favoured nation clause.
5. This rate applies where a company that is the beneficial owner of the dividends (except for civil partnerships, although limited liability partnerships are included) directly owns at least 10% of the voting shares of the company distributing the dividends.
6. This rate applies where a company that is the beneficial owner of the dividends owns at least 20% of the voting shares of the company paying the dividends.
7. This is the maximum WHT rate for dividends, with no distinction for substantial holdings. In the case of Ecuador and India, the tax payable on dividends paid to residents in Mexico must not exceed a limit established in the treaty.
8. The 5% rate applies when a company that is the beneficial owner of the dividends owns at least 25% of the voting shares of the company paying dividends during the six months prior to the end of the tax period in which dividends are paid. Under certain particular rules and provided this ownership requirement is complied with, dividend payments are only subject to tax in the country of residence of the recipient of the dividends.
9. No withholding applies when more than 50% of the shares of the recipient corporation are owned by residents of France or Mexico or when the beneficial owner of the dividend is a resident individual. Accordingly, the WHT applies to dividends when more than 50% of the recipient corporation's shares are owned by residents of other countries. However, the WHT must not exceed 5% when the party receiving the dividend is the effective beneficiary of said dividend. Dividends paid by a company resident in France to a resident of Mexico, other than a company which directly or indirectly holds at least 10% of the capital stock of the first-mentioned company, may also be taxed in France, in accordance with the law of France, but if the recipient of the dividends is the beneficial owner, the tax thus charged must not exceed 15% of the gross amount of the dividends.
10. The 5% rate applies where the company that is the beneficial owner of dividends directly or indirectly owns at least 10% of the capital of the company distributing the dividends. There is a 10% tax rate that applies when these same ownership requirements are complied with, but the company paying

dividends is a resident of Israel (provided dividends are paid from earnings taxed in Israel at a tax rate lower than the regular corporate tax rate in Israel).
11. The applicable tax rate on the gross amount of the dividends when the recipient company (beneficial owner) (except for civil partnerships) directly holds at least 10% of the capital of the corporation paying the dividend must not exceed 5% in the case of Luxembourg and 8% in the case of Mexico. The protocol of the Mexico-Luxembourg tax treaty states that this rate might be reviewed in the future by the contracting states if the WHT is not fully creditable, and can be adjusted under the principle of avoiding double taxation, provided the adjusted WHT rate is not lower than 5%.
12. Dividends paid by a company resident in Mexico to a company resident in the Netherlands (which is the beneficiary of said dividends) are subject to a maximum tax of 5% on the gross amount of the dividends if the beneficial owner is a company that directly or indirectly owns at least 10% of the capital of the company paying said dividends. However, as long as a company resident in the Netherlands is not subject to Dutch income tax on dividends received from a company resident in Mexico under the terms of the Dutch income tax law and any future amendments thereto, the dividends mentioned in the preceding paragraph may only be taxed in the Netherlands (not in Mexico).
13. The Mexico-New Zealand tax treaty contains a most favoured nation clause that may be applicable in the future.
14. The exemption on dividend WHT is not applicable in the case of deemed dividends.
15. To the extent certain requirements provided in the Protocol are met, the WHT may be reduced to 0%.
16. The 10% rate applies to loans from banks.
17. The 5% WHT rate is applicable to interest paid to banks.
18. The 5% rate applies to interest on loans from banks, insurance companies, and retirement and pension plans.
19. The 10% rate applies to interest on loans from banks, insurance companies, and securities regularly and substantially traded on a recognised national stock exchange.
20. The 4.9% rate applies to interest on loans from banks and insurance companies and to interest on securities regularly and substantially traded on a recognised national stock exchange.
21. In the case of the Netherlands, the 5% rate applies to interest on loans from banks and to interest on securities regularly and substantially traded on a recognised national stock exchange. In the case of Spain and the United Kingdom, the 5% rate extends to interest paid to insurance companies.
22. The 10% rate applies to interest paid by financial institutions and interest paid to the original seller of M&E.
23. The 10% rate on interest applies in the case of interest paid to the original seller of M&E and interest paid by banks.
24. The 10% rate applies to interest on loans from banks and to interest derived from bonds or securities that are regularly and substantially traded on a recognised securities market, as well as to interest paid by the purchaser of M&E to a beneficial owner that is the seller of the M&E.
25. The 10% rate applies to interest on loans from banks and insurance companies, to interest on securities regularly and substantially traded on a recognised national stock exchange, to interest paid to the original seller of M&E in a sale on credit and to interest paid by banks.
26. The 5% rate is applicable to interest on loans granted by banks and insurance companies, securities traded on a recognised securities market, and the sale on credit of M&E.
27. It is understood that the definition of royalties applies to any type of payment received for the provision of technical assistance services. The 15% rate applies to royalties arising from the use of, or the right to use, trademarks.
28. The original rate is 15% but has been reduced to 10% as long as the Netherlands does not impose a WHT.
29. Reduced WHT rate results from the application of the most favoured nation clause.
30. The 5% rate applies to industrial, commercial, and scientific equipment.
31. The 10% rate also applies to fees for technical assistance which are payments of any kind, other than those mentioned in Articles 14 and 15 of the Treaty as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.
32. This rate applies where the company that is the beneficial owner of the dividends directly owns at least 25% of the capital of the distributing company.
33. The treaty broadly defines royalties and includes payments related to certain software.
34. This rate applies where the company that is the beneficial owner of the dividends directly or indirectly owns at least 10% of the capital of the distributing company.
35. The 5% rate applies on the gross amount of the interest paid to, among others, banks and insurance institutions.

## Tax administration

### Returns

Corporate taxpayers are required to file annual income and flat tax returns for the preceding calendar year by 31 March. Holding companies in the tax consolidation regime are required to file an annual consolidated tax return within four months of the end of the tax period (i.e. usually by 30 April).

Thereafter, the taxpayer is generally required to obtain a certification of tax compliance by an independent auditor and to file the related tax compliance opinion by the end of June. This certification process covers all federal taxes other than customs duties. This certification may become optional for certain taxpayers under a simplification measure recently introduced.

Business taxpayers meeting certain size criteria or belonging to a group that as a whole meets these criteria must also file a tax-compliance audit report on an annual basis with the Mexican Audit Administration. This report consists of audited financial statements and detailed schedules, together with a report by the auditor stating that no irregularities were observed in respect of the taxpayer's compliance with its federal tax liabilities. These reports must be filled electronically, and the auditor must be an independent CPA registered with the Mexican Audit Administration. From 2008 onwards, the amount of detailed information required to be filed, and the auditor's responsibility in connection therewith, has increased significantly. This obligation is now becoming elective for most companies and certain application rules will apply.

Employees' profit sharing payments are generally due by 31 May of the year following that in which the corresponding profit was obtained.

Information returns must also be filed no later than 15 February each year, reporting on, amongst others, the following activities performed in the immediately preceding year:

- Payments made to parties resident abroad.
- Loans received from or guaranteed by non-residents.
- Transactions conducted through a business trust.
- Parties to which the taxpayer makes payments and withholds income tax.
- Parties to which the taxpayer has made donations.
- Parties to which the taxpayer has paid dividends, and the value of such payments.
- Transactions carried out with suppliers and clients, either local or overseas.

Taxpayers making salary payments are also required to file information returns reporting salaries paid and salary credit paid in the immediately preceding calendar year.

An annual information return must be filed on investments made or held in a tax haven. This must be filed in February of the immediately following year.

An information return on transactions carried out with non-resident related parties must be filed together with the annual CIT return (no later than March of the following year).

An information return related to the VAT taxable activities carried out by the taxpayer, must be filed on a monthly basis.

Monthly informative returns must also be filed disclosing items used in the flat tax computation.

### *Payment of tax*

Corporate taxpayers are required to make estimated payments of CIT by the 17th day of each month based on their estimated taxable income at the end of the previous month and calculated principally by applying the profit factor to the cumulative monthly gross income. The profit factor is determined by dividing the taxable profit by gross income shown in the annual return for the preceding year, or, if no profit factor is to be found in that annual return, the factor appearing in the year preceding that and so on, up to five years, with certain adjustments. For this purpose, gross income includes nominal income, excluding inflationary adjustments. The balance of CIT for the year is due at the same time as the annual return.

Definitive monthly VAT payments and flat tax advance payments are also required by the 17th day of the immediately following month. The balance of flat tax for the year is due at the same time as the annual return.

Special procedures are provided for computing advance CIT payments and for obtaining authorisation to reduce the amounts of monthly advances after the sixth month of the year. No advance payments or adjustments thereto are required in the first year of operations.

### *Statute of limitations*

In general, the right of the tax authorities to collect taxes, review tax returns, or claim additional tax expires five years after the date the respective return is filed. However, in cases where the taxpayer has not secured a federal tax registration number, has no accounting records, has failed to keep accounting records for the required five-year period, or has not filed a tax return, the statute of limitations expires in ten years. Similarly, the period for claiming a refund of overpaid tax expires after five years.



## *Other issues*

### *International Financial Reporting Standards (IFRS) adoption*

All companies listed on the Mexican Stock Exchange are required to submit annual consolidated financial statements accompanied by the opinion of a Mexican independent CPA. Commencing in the year ending 31 December 2012, these financial statements must be prepared in conformity with IFRS and cover three years. Financial institutions and insurance companies must file audited financial statements with the appropriate regulatory agency.

The adoption of IFRS in Mexico presents companies with great challenges and opportunities. Changing from Mexican Financial Reporting Standards (MFRS) to IFRS requires companies to review their financial reporting procedures. Major changes in the requirements often have a ripple effect, impacting many aspects of a company's information reporting organisation.

Nevertheless, the benefits to Mexican companies in reporting under IFRS are numerous. Among the greatest of these is the opening up of the Mexican Stock Market to overseas investors. By adopting IFRS, investors are able to compare two companies on different sides of the world with greater ease, and thus it is hoped that the change will encourage investment in Mexican companies.

Adoption of IFRS is not a straightforward process, and it will require time and effort on the part of the adopting entities to be able to ensure a smooth transition from MFRS to IFRS and ensure that the changes and benefits from this transition are duly implemented.

# Moldova

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## Significant developments

The corporate income tax (CIT) rate applicable in 2011 is 0%. At the time of writing, there is a proposal of a 12% CIT rate to be introduced starting in 2012.

The timing of payment of VAT on imported services (i.e. services provided by non-residents to Moldovan residents with a place of supply in Moldova) has changed; it is now to be paid at the earlier of the date of advance payment or the date the final invoice is settled (previously it was due at the date of the service supply).

Legal entities registered as VAT payers will be liable to submit tax returns using automated methods of electronic reporting starting with:

- 1 January 2012: VAT payers which are administered by the Main State Tax Inspectorate and State Tax Inspectorates of the main cities (i.e. Chisinau, Balti, Comrat).
- 1 January 2013: all other VAT payers.



The excise duties rates were amended for a series of excisable goods (e.g. alcoholic beverages, cigarettes, vehicles). Also, some types of goods were excluded from the list of goods subject to excise duties (e.g. colouring substances, presented in shapes or wrappings for retail sale).

## Taxes on corporate income

The corporate income tax (CIT) rate applicable in 2011 is 0%. At the time of writing, there is a proposal of a 12% CIT rate to be introduced starting in 2012.

Taxpayers are still liable to calculate the taxable base for CIT purposes and to submit CIT returns. Moreover, the Moldovan Tax Authorities (MTA) are entitled to apply a fine of 15% to the amount by which a taxpayer under-reported its taxable income.

Individual entrepreneurs and farming enterprises are also subject to the 0% CIT rate in 2011. CIT deductibility rules applicable for individual entrepreneurs and farming enterprises generally follow the same rules as are applicable for legal entities.

If an MTA tax inspection, applying indirect methods, re-assesses the income amount compared to the declared gross income, a 15% CIT rate may be applied to the excess amount.

In addition, taxpayers that apply the 0% CIT rate have to compute and pay a 15% tax on the value of both of the following:

- Free of charge payments to parties and other social political organisations.
- Donations to individuals which are tax exempt for the individual and are treated as non-deductible expenses for the taxpayer from the perspective of CIT.

In addition, the application of this tax is maintained on any amount exceeding the deductibility limit for charity and sponsorship expenses.

## *Corporate residence*

Resident companies generally must calculate their taxable base for CIT purposes on their worldwide income. According to Moldovan tax law, a tax resident is a legal entity organised or managed in Moldova or that has its main place of business in Moldova. In practice, tax residency is determined by the place of incorporation.

Permanent establishments (PEs), unlike resident companies, are only required to calculate their taxable base for CIT purposes on income sourced in Moldova. Based on the Moldovan tax law, a PE is a fixed place of business through which a non-resident carries out, wholly or partly, either directly or through a dependent agent, entrepreneurial activity in the territory of Moldova (e.g. other services and activities, if the period during which such services/activities are carried out exceeds three months).

## *Other taxes*

### *Value-added tax (VAT)*

The standard VAT rate in Moldova is currently 20%. It is generally applied to local supplies of goods and services as well as to goods subject to import and services subject to the reverse charge mechanism.

The last case above refers to services rendered by a non-resident supplier to a Moldovan company, in which the place of supply is deemed to be in Moldova (e.g. consulting services, supply of information, supply of staff) and where the services do not fall under any specific VAT exemption. Such import VAT is due and payable to the Moldovan budget at the date of the service supply, duly confirmed under the correspondent documentation.

Apart from the above, certain types of supplies are subject to reduced VAT rates. For instance, local supplies of bread, bakery products, milk, and dairy products; the import and local supplies of sugar produced from sugar beet; and the import and local supply of drugs and certain pharmaceutical products are subject to a reduced 8% VAT rate. Natural and liquefied gas imported into or supplied in the territory of Moldova are subject to a 6% VAT rate.

A number of supplies are subject to a 0% VAT rate (i.e. VAT exempt with the right to exercise the input VAT deduction), including exports of goods or services and international transportation. Certain supplies are subject to VAT exemptions (i.e. without the input VAT right), including financial services and the sale or rental of dwellings and land.

It should be mentioned that input VAT incurred on acquisitions of goods and/or services may be deducted, provided it is incurred by a VAT registered payer to perform VAT-able supplies within its business activity.

A company is liable to register for VAT purposes if the total turnover within the last 12 consecutive months reached the threshold of 600,000 Moldovan lei (DML) (approximately EUR 36,200).

If input VAT is incurred by a business not registered for VAT purposes, if input VAT relates to acquisitions used for supplying VAT exempt supplies, or if input VAT relates to purchases performed not for business purposes, such input VAT may not be deducted and shall be treated as a cost/expense.

If input VAT relates to acquisitions destined to perform mixed supplies (i.e. both VAT-able and VAT-exempt ones), the input VAT deduction right is exercised on a pro-rata basis.

Should a company register a deductible input VAT exceeding its output VAT, this balance could be partially refunded, provided the company only carries out any of a range of specific business activities (e.g. export supplies, international transportation services, production of bakery and dairy products, leasing activity). Otherwise, such VAT amount may be carried forward only to the following months, offsetting against the company's future output VAT liabilities.

Additionally, VAT payers performing capital investments in Moldova, except in the cities of Chisinau and Balti, are entitled to refund the recoverable VAT related to these kinds of capital investments, provided they were performed after 1 January 2008. Note that specific conditions must be met, and there are few exceptions to this rule. At the time of writing, there is a proposal that the VAT refund for capital investments would be extended under certain condition for Chisinau and Balti for the year 2012.



The fiscal period for VAT purposes is considered the calendar month.

Every VAT payer (sometimes also non-registered entities for VAT purposes) must submit VAT returns and must settle related payable VAT liabilities by the end of the month following the reporting one (except for VAT on services supplied by non-residents, which are VAT-able in Moldova).

Generally, VAT payers are required to issue VAT invoices for the VAT-able supplies performed, as well as to keep detailed records of their acquisitions and supplies in the correspondent VAT ledgers, according to a set of specific rules.

### *Customs duties*

Moldova's current customs framework is regulated by the Customs Code, Law on Customs Tariff, International Agreements concluded by Moldova to date, and by other legal acts.

In general, any kind of goods and means of transport may enter and leave the territory of Moldova without any restriction. However, certain limitations specifically provided by the legislation are in force, which cover goods and means of transport crossing the border by breaching state security, public order, environment, etc.

#### Customs regimes

Definitive and suspensive customs regimes are provided under Moldovan law.

Definitive customs regimes refer to import and export, while suspensive customs regimes are comprised of transit, bonded warehouse, inward processing relief (with suspension), processing under customs control, temporary admission, and outward processing relief.

Of these customs regimes, the following are deemed to have economic impact: bonded warehouse, inward processing relief, processing under customs control, temporary admission, and outward processing relief.

The suspensive customs regimes allow for suspension of import duties payment, usually for a specific (limited) period and provided that certain conditions are fulfilled, whilst a customs regimes having economic impact triggers a specific economic advantage to the benefit of the company applying it (e.g. repayment of customs duties paid upon importation, application of lower customs duty rates or customs duties exemption).

Citizens of Moldova, as well as foreigners, are allowed to move any goods in or out of Moldova under a simplified customs regime, provided these goods are not intended for business or commercial purposes. Individuals are exempt from the payment of customs duties on goods whose customs value does not exceed EUR 200 and which are not used for entrepreneurial or commercial purposes.

Note that there are also some environmental pollution tax related to specific packaging that importers should pay.

### Customs tariff and duties

The Law on Customs Tariff establishes standard customs duty rates applicable upon import of goods into Moldova, depending on their specific customs tariff classification code. The Moldovan Customs Tariff is based on the Harmonised Commodity Description and Coding System.

Customs duty rates are generally indicated as percentages to be applied to the customs value (i.e. ad valorem duty rates) of goods imported into Moldova. The maximum ad valorem standard customs duty rate is 25%. There are also specific customs duty rates established, as well as combined rates.

### Customs valuation

Under Moldovan customs legislation, the customs valuation is generally performed in accordance with the customs valuation principles in the General Agreement on Tariffs and Trade (GATT).

The customs value is determined based on one of the six provided valuation methods (i.e. transaction value, transaction value of identical goods, transaction value of similar goods, deductive value, computed value, and reserve method). If the first method is not applicable, then the second method should be applied and so forth.

### Preferential tariff treatment

A preferential tariff treatment presumes a reduction of or exemption from customs duty, which may also be applied within a specific quota (settled either as value or quantity).

A preferential tariff treatment is granted for specific categories of goods depending on their origin and in accordance with the free trade arrangements (FTAs) to which Moldova is a party.

Moldova has concluded FTAs to date with most of the Commonwealth of Independent States (CIS) countries and is also a Central European Free Trade Agreement (CEFTA) contracting state.

From 1 March 2008 until 31 December 2012, Moldova benefits from Autonomous Trade Preferences (ATP) from the European Union (EU), which allows unlimited duty-free access to the EU market for all products originating in Moldova, except for certain agricultural products. Such agricultural products are accepted for import into the European Union either with exemptions from customs duties within the limits of specific tariff quotas (e.g. fresh, chilled, and frozen meat of bovine animals, dairy products, common wheat, barley, maize, white sugar) or with exemption of the ad valorem component of the import duty (e.g. tomatoes, grapes, apples).

To benefit from these preferential terms for imports of goods into the European Union, compliance with origin and certification requirements has to be observed.

### Favourable tariff treatment
A favourable tariff treatment presumes a reduction or an exemption from customs duty upon import of specific goods into Moldova, depending on their type or final destination, according to domestic customs law or international agreements to which Moldova is a party.

Moldovan customs law provides the following exemptions, among others, from customs duty:

- Goods imported by individuals for personal use, not exceeding a specific threshold.
- Fixed assets aimed at being contributed in kind to a company's statutory capital.
- Goods released in Moldova under transit, bonded warehouse regimes.
- Moldovan goods previously exported and released back within a three-year term in the same status, as well as compensatory products obtained under outward processing relief.
- Certain movable goods imported by legal entities carrying out leasing activities for the purpose of paying off their contractual liabilities derived from lease agreements concluded with Moldovan individuals or legal entities.
- Goods imported by legal entities for non-commercial purposes whose customs value does not exceed EUR 50.



### *Excise taxes*
Excise taxes apply to the production and import of cars, tobacco, alcohol, petrol and lubricants, and other goods. Special excise rates for each type of excisable goods are established in the tax code. The rates are widely variable and are based on multiple factors.

The following are liable for excise duties:

- Any individual or legal entity producing and/or processing excisable goods in the territory of Moldova.
- Any individual or legal entity importing excisable goods, unless there is no specific exemption provided.

Businesses or individuals that produce and/or process excisable goods in the territory of Moldova (or intend to do so) must possess excise duty certificates, which must be granted by the tax authorities before these operations are actually carried out. It is mandatory for individuals or businesses, upon submitting the relevant applications to the tax authorities, to attach the details of the excise premises.

Under certain circumstances, excise duty exemptions may apply. Some excise-liable goods are subject to mandatory excise stamp marking and labelling.

### *Local taxes*

Local taxation in Moldova refers to the application of the following types of taxes and duties:

- Tax on the following natural resources:
  - Water.
  - Mineral exploration.
  - Geological exploration.
  - Mining operations.
  - Usage of underground areas for the construction of underground structures not related to mining operations.
  - Exploitation of underground structures within the performance of entrepreneurial activity, not related to mining operations.
  - Standing wood.
- Tax on immovable property.
- Duty for the right to perform local auctions and lotteries.
- Tax on advertising placement.
- Fee for the right to use local symbols.
- Parking tax.
- Hotel room occupancy tax.
- Resort fee.

New amendments to the legislation provide that local authorities are now authorised to establish the list and the levels of tax rates for local taxes (i.e. previously it was the competence of the Moldovan Parliament to establish the maximum rates in this respect). Additionally,

- the publicity tax is no longer to be applied for placement of advertisements by means of broadcasting via TV, internet, radio, press, and printed media, and
- the terms of payment and submission of tax returns for some local taxes were amended (e.g. tax on organisation of auctions and lotteries in the territory of the administrative territorial unit, tax on passengers’ transportation services within municipalities, cities, and villages).

#### Road taxes

Road taxes are fees collected for the use of roads and/or protection zones of the roads outside the locality limits.

The system of road taxes includes the following:

- Tax for the use of roads by vehicles registered in the Republic of Moldova.
- Tax for the use of roads of the Republic of Moldova by vehicles not registered in the Republic of Moldova.
- Tax for the use of roads by the vehicles with total mass, axle loads, or dimensions exceeding the admitted limits.
- Tax for the use of road protection zones outside the localities for carrying out construction or installation works.
- Tax for the use of road protection zones outside the locality limits for placing outdoor advertisements.
- Tax for the use of road protection zones outside the locality limits for placing roadside service objects.

Depending on the type of road tax, the tax law establishes the taxable person, deadlines for payment of the road tax, tax rates, exemptions (e.g. a legal entity or an individual shall pay road tax on vehicles registered in Moldova (i) on the date of state registration of vehicle, (ii) on the date of the vehicle inspection/annual technical testing of the vehicle).

Recently, road tax rates have been increased.

**Tax on immovable property**
Tax on immovable property is a local tax paid on real estate (i.e. land and/or construction on the land) by the proprietor or owner of material rights. Residents and non-residents owning real estate located in the territory of Moldova have similar obligations.

The 0.1% rate on immovable property used for entrepreneurial activity (i.e. due by legal entities) is applied either on the property's estimated value (if such exists) or its book value. The 0.1% rate on property used for agricultural activities is applied on the property's book value.

The actual tax rate on immovable property for a legal entity is established in monetary value (i.e. MDL), depending on its destination (e.g. land for agriculture usage) and location.

The tax on immovable property is paid by legal entities on the estimated value once per year by 1 July, while the tax on the book value is paid quarterly.

## *Branch income*



### *Branches*
Moldovan tax law does not distinguish between branches of non-resident companies and local companies established by a foreign investor. As such, a non-resident's branch is registered in Moldova as an enterprise fully owned by the foreign investor and is subject to the same tax regime as local incorporated companies.

### *Representative offices*
Representative offices are often established as a first step to operating in Moldova. According to the tax law, a representative office can engage only in auxiliary or preparatory activities. A representative office can perform only a limited range of activities without being considered a permanent establishment of the non-resident.

All representative offices must submit by 31 March of the year following the reporting year the required Tax Reporting Statement on the activity conducted during the year concerned.

## *Income determination*

### *General provisions*
Resident legal entities are taxed on their worldwide income, while non-resident entities are taxed on their Moldovan-source income. Taxable income is computed as accounting income adjusted in accordance with tax legislation.

### *Inventory valuation*
Moldovan law provides for the following inventory valuation methods: standard cost method, retail method, weighted average cost, first in first out (FIFO), and last in first out (LIFO).

Assets are generally valued at their acquisition cost, production cost, or market value.

### *Capital gains*
The capital gains rule applies to Moldovan companies selling capital assets on an occasional basis and whose ordinary activity does not include transactions with land, buildings, and shares. Shares and other investment assets (e.g. land, property) are treated under the tax law as capital assets (i.e. property not used in the ordinary course of business).

The income earned from the sale, exchange, or disposal of capital assets is deemed to be a capital gain in the amount of 50% of the difference between the purchase price (i.e. all costs related to the acquisition of capital assets) and the sale price. This capital gain must be included in the total gross amount of income for the year in which the shares were sold. This amount is subject to CIT. For 2011, the CIT rate is set at 0%.

Capital gains may be decreased by capital losses registered in previous years.

### *Dividends*
Dividends received by Moldovan legal entities both from Moldovan or foreign legal entities are taxed in Moldova with the applicable CIT rate (i.e. in 2011, the 0% CIT rate is in force).

### *Exchange gains and losses*
Foreign exchange losses are CIT deductible in the period they are incurred. Revenues obtained from foreign exchange differences are to be included in the taxable income.

In certain circumstances (e.g. high depreciation of the national currency), foreign exchange differences should be capitalised to the value of assets in relation to which the expenses were incurred.

### *Non-taxable revenues*
Moldovan tax law provides for the following main types of non-taxable revenues:

- Contributions to the capital of an entity.
- Income earned while benefiting from an income tax exemption.
- Money received from special funds and which are used in accordance with fund destination.
- Interest derived by legal entities on bank deposits with a period exceeding three years, as well as the interest derived from corporate securities issued in the form of bonds for a period exceeding three years, is tax exempted until 1 January 2015.
- Interest derived from state bonds, until 1 January 2015.

## *Deductions*

### *Deductible expenses*
As a general rule, expenses incurred by a company are deductible for CIT purposes only if these expenses are deemed as ordinary and necessary, aimed at deriving taxable income, and justified with adequate supporting documentation.

Among others, the following expenses are CIT deductible:

- Depreciation of fixed assets calculated under the diminishing balance method.
- Amortisation of intangible assets computed under the straight-line method.
- Research and development expenses incurred during the fiscal year as current expenses, should certain conditions be met.
- Business trip expenses, representation expenses, and expenses on insurance of business entities, within the limits approved by the government.
- Waste, spoilage, and expiration expenses, within the annual limitation established by the company's manager.
- Bad debts, under certain conditions.
- Charity and sponsorship expenses borne for the benefit of specific beneficiaries, up to 10% of taxable income.
- Interest payable, in specific cases.

### *Depreciation*

Fixed assets are subject to CIT depreciation under the diminishing-balance method if their useful economic life exceeds one year and acquisition costs exceed MDL 3,000.

According to the fiscal law, fixed assets are divided into five categories. These categories are set out according to specific rules, mainly on the assets' useful life (i.e. the number of years during which the assets' utilisation generates economic advantages; the useful life for each type of depreciating asset is regulated by governmental decision). The depreciation rates vary as follows:

- First category: 5%.
- Second category: 8%.
- Third category: 10%.
- Fourth category: 20%.
- Fifth category: 30%.



Intangible assets are subject to CIT depreciation according to the straight-line method.

### *Interest expense*

Different CIT deductibility rules apply for interest on loans used for carrying out operational activities and for loans used for investment activities performed on an occasional basis.

As a general rule, deductions for interest and foreign exchange losses are allowed for CIT purposes provided such expenses are deemed as ordinary and necessary for carrying out the activities of the business. Expenses should also be incurred for the purposes of obtaining taxable income and justified by adequate backup documentation.

If the interest paid by a Moldovan company relates to its operational or day-to-day activities, the related expenses are CIT-deductible. A few other provisions should also be considered, namely the following:

- Interest expenses incurred, for the benefit of individuals and legal entities (except financial institutions and micro-financing organisations), by businesses are CIT-deductible limited to the base rate (rounded to the next whole percentage) established by the National Bank of Moldova in November of the previous fiscal year and applied to short-term monetary policy transactions (i.e. the limit for 2011 is 7%). At the time of this writing, there is a proposal that certain changes will occur starting in 2012 for such interest expenses.

- If the loan is obtained to acquire / build fixed assets, the related interest expense should be capitalised to the initial fiscal value of assets until they are commissioned. The deductibility of this expense would be capped at the above limit. The excess difference is treated as a CIT non-deductible expense for that fiscal year.
- If interest relates to an investment activity, the interest expense is CIT-deductible within the limit of the income derived from the investment.

### *Net operating losses*

Fiscal losses may only be carried forward in five equal instalments for five consecutive years following the year the losses were incurred, provided the company records taxable income. If the company recorded fiscal losses for more than one year, such losses are carried forward in the order in which they arose. Fiscal losses are recorded on off-balance-sheet accounts.

The carry forward of the fiscal losses of previous years does not represent a tax advantage in the view of the current 0% CIT rate applicability.

Losses may not be carried back.

## *Group taxation*

Moldovan tax law does not provide for group consolidation of gains or losses. No group taxation is envisaged under Moldovan tax law.

### *Transfer pricing*

Transfer pricing regulations are currently at the initial stage of development, as the law does not list any specific transfer pricing methods. Moreover, taking into account that Moldova is not currently an Organisation for Economic Co-operation and Development (OECD) member country, there is no possibility of applying the OECD Transfer Pricing Guidelines.

According to the law in force, transactions carried out between related parties should observe the arms-length principle. Transactions that do not follow this rule are disregarded for tax purposes.

In accordance with Moldovan tax law, a company is considered the taxpayer's related party if it controls the taxpayer, is controlled by the taxpayer, or both the company and the taxpayer are under the common control of a third party.

From a tax perspective, control is the ownership (either directly or through one or more related parties) of 50% or more in value of the capital or voting power of one of the companies. In this case, an individual is treated as owning all equity interest owned directly or indirectly by members of one's family. Two individuals are related parties if they are spouses or relatives up to the fourth degree.

Losses incurred in dealing between related parties carried out directly or through intermediaries are treated as non-deductible for CIT purposes.

According to current Moldovan tax law, there are no formal transfer pricing documentation requirements. However, at the time of writing, there is a proposal that formal transfer pricing documentation requirements will be introduced in the Moldovan tax law starting in 2014.

## *Tax credits and incentives*

### *Investment related CIT incentives*
CIT incentives provided under the tax law are suspended during the period of applicability of the 0% CIT rate. The CIT incentives below refer to provisions of tax law applicable in 2011, while at the time of writing, there is an intention that starting in 2012 the extension of some of them will be abolished.

### *Tax incentives for information technology (IT) companies*
CIT incentives are available to legal entities performing certain software development activities up to 1 January 2012. In addition, their employees may also benefit from a personal income tax exemption for employment salaries earned from such companies, if certain conditions are met.

IT companies performing certain specific software activities in Moldova may apply for the CIT exemption. Even though the 2011 CIT rate is 0%, it is worth applying for IT incentives since obtaining such approval also provides for the personal income tax (PIT) exemption and social contributions reduction related to the qualified employees in Moldova.

The PIT exemption for these employees is simultaneously applicable provided:

- the Company benefits from the CIT incentive in 2011 and
- the specific requirements mentioned below are met.

Based on the Moldovan law on social security contributions, a special incentive is to be granted to Moldovan employers that qualify for the above mentioned IT incentives. In such cases, the social security liability of the employers is limited only to a fixed monthly contribution amounting to MDL 1,518 (approximately EUR 90) for each employee who corresponds to the occupation specified in the law.

PIT exemption is applicable only for salary income and not for other non-salary remuneration income (e.g. benefits in kind, material aids).

### *Free entrepreneurial zones (FEZ)*
FEZ are territories where domestic and foreign investors can carry out entrepreneurial activities on preferential terms (i.e. favourable tax, customs, visa, and other regimes). There are currently nine FEZ in Moldova.

The following types of activities may be carried out in a FEZ:

- Production of goods preferentially for export (i.e. supply of goods in the territory of Moldova does not exceed 30% of the total amount of goods and services supplied within one year).
- Sorting, packing, marking, and other similar operations of goods transiting the customs territory of Moldova.
- Other supportive activities.

#### FEZ incentives
The CIT currently in Moldova is 0%, and the CIT incentives for FEZ are not applicable. However, there is an objective to introduce the 12% rate starting in 2012 and maintain the following CIT incentives for FEZ investors:

- Entities that are established in FEZ and export goods and services from FEZ outside the customs territory of the Republic of Moldova will be entitled to apply only 50% of the applicable CIT rate on such gains; for other cases, the CIT rate will be 75% of the established one.
- The income obtained from export of goods (services) originating from FEZ outside the customs territory of the Republic of Moldova is CIT exempted for a period of three years, provided that the FEZ residents invested in the fixed assets of their enterprises and/or in development of the infrastructure of the FEZ a capital equivalent to at least USD 1 million.
- The income obtained from export of goods (services) originating from FEZ outside the customs territory of the Republic of Moldova is CIT exempted for a period of five years, provided that the FEZ residents invested in the fixed assets of their enterprises and/or in development of the infrastructure of the FEZ a capital equivalent to at least USD 5 million.

From a VAT standpoint, goods and services supplied in FEZ from abroad, from FEZ outside the customs territory of the Republic of Moldova, in FEZ from other areas of Moldova, and those supplied to residents of other FEZ are subject to 0% VAT.

According to the customs provisions, goods are introduced into FEZ with no VAT or customs duty and are not subject to economic policy measures, according to specific criteria. However, certain taxes in specific situations might be incurred by residents of FEZ. Investors in FEZ are guaranteed and protected from changes in legislation for a general period of up to ten years, while under certain conditions this period may be extended to 20 years.

## *Withholding taxes*

### *Residents*

Resident legal entities making payments to individuals must withhold and pay withholding tax (WHT) to the MTA at the following rates:

- 5% preliminary withholding of payments made for the benefit of resident individuals, unless such payments are tax exempt or are computed as employment salaries. The beneficiary deducts (i.e. recovers) the 5% WHT from annual income tax due. At the time of writing, there is an intention that a 7% preliminary WHT on the above payments to resident individuals will be introduced starting in 2012.
- 10% final withholding of an individual's income derived from leasing, rent, usufruct of movable and immovable property, advertising campaign (according to certain specific rules).
- 15% final withholding of dividends paid out to individuals. At the time of writing, there is a proposal that a 6% WHT on dividends will be introduced starting in 2012.
- 15% preliminary withholding from royalties and interests. The beneficiary deducts (i.e. recovers) the 15% WHT from annual income tax due. At the time of writing, there is an objective that a 12% WHT on royalties and interests will be introduced starting in 2012.
- 18% final withholding from gambling revenues.

Further to the applicability of the 0% CIT rate in 2011, the WHT is not applied to payments between resident legal entities.

### *Non-residents*

Under the 2011 domestic tax provisions, the following WHT rates apply upon payments to non-residents:

- 15% for dividend payouts (a 6% rate might be introduced starting in 2012).
- 15% for (non)monetary payments whose amount is non-deductible for CIT purposes for the payer thereof (a 12% rate might be introduced starting in 2012).
- 15% for other revenues (a 12% rate might be introduced starting in 2012).

### *Double tax treaties (DTT)*

The DTTs in force between Moldova and other countries may provide for more favourable tax rates than those provided by the local provisions. For their application, the foreign beneficiary of such income should provide the paying entity with its fiscal residency certificate before the payments are actually made.

Operational DTTs to which Moldova is a party are outlined below:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Albania | 5/10 | 5 | 10 |
| Armenia | 5/15 | 10 | 10 |
| Austria | 5/15 | 5 | 5 |
| Azerbaijan | 8/15 | 10 | 10 |
| Byelorussia | 15 | 10 | 15 |
| Belgium | 15 | 15 | 0 |
| Bosnia & Herzegovina | 5/10 | 10 | 10 |
| Bulgaria | 5/15 | 10 | 10 |
| Canada | 5/15 | 10 | 10 |
| China | 5/10 | 10 | 10 |
| Croatia | 5/10 | 5 | 10 |
| Czech Republic | 5/15 | 5 | 10 |
| Cyprus | 5/10 | 5 | 5 |
| Estonia | 10 | 10 | 10 |
| Finland | 5/15 | 5 | 3/7 |
| Germany | 15 | 5 | 0 |
| Greece | 5/15 | 10 | 8 |
| Hungary | 5/15 | 10 | 0 |
| Ireland | 5/10 | 5 | 5 |
| Israel | 5/10 | 5 | 5 |
| Japan | 15 | 10 | 0/10 |
| Kazakhstan | 10/15 | 10 | 10 |
| Kyrgyzstan | 5/15 | 10 | 10 |
| Latvia | 10 | 10 | 10 |
| Lithuania | 10 | 10 | 10 |
| Luxembourg | 5/10 | 5 | 5 |
| Macedonia | 5/10 | 5 | 10 |
| Montenegro | 5/15 | 10 | 10 |
| The Netherlands | 0/5/15 | 5 | 2 |
| Oman | 5 | 5 | 10 |
| Poland | 5/15 | 10 | 10 |

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| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Portugal | 5/10 | 10 | 8 |
| Romania | 10 | 10 | 10/15 |
| Russian Federation | 10 | 0 | 10 |
| Serbia | 5/15 | 10 | 10 |
| Slovakia | 5/15 | 10 | 10 |
| Slovenia | 5/10 | 5 | 5 |
| Spain | 0/5/10 | 5 | 8 |
| Switzerland | 5/15 | 10 | 0 |
| Turkey | 10/15 | 10 | 10 |
| Tajikistan | 5/10 | 5 | 10 |
| Ukraine | 5/15 | 10 | 10 |
| Uzbekistan | 5/15 | 10 | 15 |
| United Kingdom | 0/5/10 | 0/5 | 5 |

## *Tax administration*

### *Returns*

An annual CIT return must be submitted to the MTA by 31 March of the year following the reporting year. For new business entities, the fiscal year is considered the period beginning with the registration date until the end of the calendar year.

The law also provides for various reporting deadlines for payments of WHT and VAT.

For WHT and VAT purposes, the fiscal period is the calendar month starting the first day of the month. WHT and VAT liabilities must be declared and settled monthly by the end of the month following the reporting month.

Individual entrepreneurs and farming enterprises with an annual average number of employees not exceeding three and not registered as VAT payers must submit a unified tax return, if certain conditions are met.

Moldovan tax law provides for a specific procedure for taxpayers submitting adjusted tax returns (after the taxpayer identifies previous errors) within a limited period of time. There is a proposal that starting in 2012 the only limitation for submitting the adjusted tax return will refer to initiation of tax inspection.

### *Payment of tax*

Taking into account that a 0% CIT is applied in Moldova, no income tax needs to be paid.

Still, legal entities that exceed the legally allowable limit on sponsorship and charity, as well as those who made payments to parties and other social political organizations or donations to individuals which are tax exempt for the individual and are treated as non-deductible expenses for the taxpayer, must declare and pay the applicable CIT by 31 March of the year following the reporting year. At the time of writing, there is an intention that starting in 2012 interim quarterly CIT payments will be reintroduced.

### Fines and penalties

In 2011, the MTA is entitled to apply a fine of 15% to the amount by which a taxpayer under-reported its taxable income for CIT purposes.

Taxpayers who settle amounts as assessed by the MTA within three business days and have no other outstanding liabilities qualify for certain tax incentives (i.e. 50% reduction of fines).

In addition, certain special provisions regarding tax evasion apply. Tax evasion is assessed on a case-by-case basis but usually assumes the insertion into financial statements, tax returns, and accounting documents of false information on revenues and expenses. In addition, hiding other taxable income may also be considered tax evasion.

Under tax law, the MTA is entitled to apply a fine in the amount of the undeclared tax if this is a result of tax evasion.

Should the amount of the tax due exceed MDL 50,000 (approximately EUR 3,000), the tax evasion is regarded as a criminal offence. According to the Moldovan Criminal Code, legal entities can be punished for tax evasion with a fine up to MDL 120,000 (approximately EUR 7,200) and preclusion from performing certain activities or winding-up.

At present time and until other amendments to the legislation enter into force, the daily penalty for failing to pay social security contributions is 0.1%, the daily penalty for failing to pay health insurance contributions is 0.1%, and the annual penalty for failing to pay other taxes is 12%.



### Rulings

The law does not provide for the possibility of obtaining binding rulings. However, taxpayers that inadequately computed tax liabilities due to incorrect written explanations issued by the MTA may not be subject to sanctions (i.e. fines and late-payment penalties). Tax liabilities may still be recomputed by the MTA. Written explanations are issued by the MTA free of charge and may remain valid for an indefinite period of time, unless cancelled by new legislation or other rulings. Such explanations are generally issued by the Moldovan competent authorities during a period of up to one month.

## Other issues

The legislation and the approach of the state authorities in Moldova related to corporate taxation have been and are expected to be subject to certain significant changes.

It is not possible to obtain binding rulings from the MTA. However, comfort letters can be obtained. As such, taxpayers should seek professional advice over specific issues, given that only limited interpretations have been issued by the MTA.

# Mongolia

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## Significant developments

Some of the significant developments in Mongolian Tax Law of 2010 are as follows:

- The windfall profits tax of 68% imposed on the marginal prices of gold and copper ore and concentrate was cancelled with effect from 1 January 2011.
- New, higher rates for mineral royalties have been introduced to reflect increased international prices, but further processing of the raw materials in Mongolia will reduce the rates.
- Final mining products (i.e. processed rather than raw materials) for export are zero-rated for VAT purposes. Raw mining materials are exempt from VAT.
- The new Law on Air Pollution fees came into effect in July 2010. Produced raw coal, used or imported organic solvents, and vehicles are subject to these fees.
- The new law on stamp duty is newly drafted and effective from 1 January 2011 *(see Stamp duty in the Other taxes section)*.

## Taxes on corporate income

Mongolian corporate income tax (CIT) is levied at the following rates, using a progressive-rate scale that ranges from 10% to 25%, as follows:

- 10% applies to the first 3 billion Mongolian tugriks (MNT) of annual taxable income.
- 25% applies to any excess of MNT 3 billion of annual taxable income.

However, the income described in the chart below is excluded when determining the annual taxable income and is taxed at different tax rates on a gross basis:

| Source of income | Applicable tax rate (%) |
|---|---|
| Dividends | 10 |
| Royalties | 10 |
| Interest | 10 |
| Gambling, betting games, and lotteries (net) | 40 |
| Sale of immovable property | 2 |
| Sale of rights (e.g. mining licenses, special activity licences, and other rights granted by the authorised organisations for conducting specific activities) | 30 |

## *Corporate residence*

A resident legal entity is an economic entity formed under the laws of Mongolia or a foreign economic entity that has its headquarter office in Mongolia. There has not been further development of this concept, so it cannot be assumed that the standard place of effective management or control test will apply.

A non-resident company is a foreign economic entity that conducts its business for Mongolian clients.

### *Permanent establishment (PE)*

The concept of a PE is not well developed, and it is no longer possible to register a branch of a foreign legal entity in Mongolia. Therefore, non-resident companies will suffer a 20% withholding tax (WHT) on a range of payments unless treaty protection is available.

## *Other taxes*

### *Value-added tax (VAT)*

A VAT at the rate of 10% is imposed on the supply of taxable goods and services in Mongolia and on imports into Mongolia.

VAT is specifically levied on the following:

- Goods sold in Mongolia.
- Work performed and services rendered in Mongolia.
- All goods imported into Mongolia to be sold or used.
- Goods exported from Mongolia for use or consumption outside Mongolia.

### *Excise tax*

Excise tax is levied on goods manufactured in or imported into Mongolia, such as tobacco, alcohol, gasoline and diesel fuel, and passenger vehicles. Excise tax is also levied on the physical units of special-purpose technical devices and equipment used for betting games and gambling and on the activities of individuals and legal entities that conduct such activities. The excise tax rates vary according to the origin, type, and place of entrance of the goods.

### *Immovable property tax*

Immovable property tax is an annual tax levied at 0.6% (this will vary from 0.6% to 1% depending on the decisions made by the local representatives' committee beginning 1 January 2013) of the value of the immovable property that is owned. For tax purposes, the value used is the value registered with the government registration authority. If the property is unregistered, the insured value is used. In the absence of either a registered or insured value, the accounting value is used.

This tax does not apply to property owned by persons and financed through the state budget, to any dwelling houses, or to any buildings and construction for public use.

### *Stamp duty*

Under the Law of Mongolia on State Stamp Duties, there are 43 types of activities subject to stamp duties, including the following:

- Settlement of a legal dispute by a court.
- Court involvement in arbitration.
- Notary services.
- Consulate services.
- State registration services for legal entities.
- Registration services for foreign invested economic entities and representative offices of foreign organisations.
- Other specific activities that need permissions and rights from the state authorities.

The amount of duty varies depending on the types of services or activities involved.

### *Customs duty*

A flat customs tariff of 5% applies with respect to most goods imported into Mongolia, except for information technology and medical equipment and pure-bred livestock, which are zero rated.

Equipment and spares imported by small and medium-size companies for the purposes of creating employment, replacing import goods, and supporting export goods are exempt from the customs tariff.

Export duties apply to certain exported goods, such as unprocessed camel wool, wood, and wooden materials.

### *Windfall profits tax*

There is currently no windfall profits tax in Mongolia. Prior to 1 January 2011, a windfall profits tax was imposed on the sale of gold and copper ore and concentrate if the prices exceeded a certain base price. The tax was levied at the rate of 68% on gold when profits reach USD 850 per ounce and on copper when profits reached USD 2,600 per ton.

### *Fees and taxes applicable to the extractive industry*

A range of fees and other taxes are payable for activities in the extractive industry. The primary ones include the following:

- Mining License Fee, which is agreed up front and stated in the mining license.
- Royalties, which are paid on the sale of mining products. The rate depends on the product being mined and the level of processing being performed in Mongolia.
- Air Pollution Fees.
- Land Use Fee.

## *Branch income*

The repatriation of profits from branches of foreign legal entities is subject to branch profits tax at a rate of 20%.

Please note that it appears it is no longer possible for foreign legal entities to establish a branch in Mongolia. However, the above provision remains in place for branches that were previously established in Mongolia.

## Income determination

Mongolian resident economic entities are taxable on aggregate annual income earned worldwide. Non-resident economic entities carrying out business activities in Mongolia are taxable only on the income earned in the territory of Mongolia.

### Inventory valuation

There is no specific provision in the tax law for inventory valuation.

### Capital gains

Capital and ordinary transactions are treated the same for tax purposes (i.e. included in annual taxable income). An exception is provided for income from sales of immovable property which is subject to tax of 2% on gross sales proceeds.

### Dividend income

Dividend income earned by a Mongolian resident entity is subject to WHT of 10%. Dividend income to be remitted out of the country to a foreign tax resident is subject to WHT at 20% but may be reduced by an applicable double taxation treaty (DTT).

### Interest income

Interest income is subject to a special income tax of 10%.

### Partnership income

Partnership income is treated as ordinary income to the partner.

### Rents/royalties income

Rent income is included in taxable income for tax determination whereas royalty income is taxed at a special rate of 10%.

### Unrealised currency exchange gains/losses

Unrealised currency exchange gains are not considered as taxable income, and, at the same time, losses are not deductible from taxable income.

### Foreign investment

Tax stability is available for foreign investments of a certain level.

### Foreign income

Unremitted earnings are taxed the same as ordinary earnings.

## Deductions

Expenses mostly associated with generating aggregate annual income are deductible for corporate income tax purposes (provided proper documentation is in place), and a list of these is provided in the legislation. Expenses not on this list are not deductable.

The corporate income tax law stipulates that finance lease payments (except interest) and fines and penalties are not deductible for tax purposes.

### Accrued expenses

Accrued expenses are tax-deductible.

### Contingent liabilities

Contingent liabilities are not tax-deductible.

### *Depreciation and amortisation*
Depreciation of fixed assets and amortisation of intangibles are tax-deductible. A straight-line method is used and the years of usage are determined for tax purposes.

### *Goodwill*
There is no specific provision in the tax law regarding the deductibility of goodwill.

### *Organisational and start-up expenses*
Organisational and start-up expenses are tax-deductible.

### *Interest expense*
Interest expenses are deductible. However, there are limits with respect to the deductibility of interest expense. *See Thin capitalisation in the Group taxation section for more information.*

### *Bad debt*
Bad debt is not tax-deductible.

### *Charitable contributions*
Charitable contributions are not tax-deductible except for donations to the fund of vocational training.

### *Pension expenses*
Compulsory pension insurance premiums paid to the Social Security Authority of Mongolia are deductible. Additional voluntary insurance premiums are tax-deductible but shall not exceed 15% of taxable income. Pension provisions or internal pension fund expenses are not deductible.

### *Payment for directors*
If a payment for directors is a salary payment on which social insurance and personal income tax is levied, it is considered as deductible.

### *Bribes, kickbacks, and illegal payments*
Bribes, kickbacks, and illegal payments are not in the list of permitted deductions. Per anti-corruption law, monetary amounts involved with respect to such payments will be confiscated and criminal proceedings will be instituted.

### *Net operating losses*
Net operating losses generally may be carried forward for up to two years. However, the annual amount of carried forward losses deductible from taxable income may not exceed 50% of the taxable income in the tax year.

Legal entities involved in the infrastructure and mining industries may carry forward 100% of their losses for up to four to eight years, depending on their investment period and based on government regulations.

There is no provision for the carryback of losses.

### *Payments to foreign affiliates*
Deductibility of payments to foreign affiliates depends on the nature of the payment:

- Interest payments are deductible but with restrictions (i.e. thin capitalisation rule may apply, interest paid on loan for construction of building and installation of equipments need to be capitalised during that period).

- Dividend payments are not deductible.
- Technical assistance service payments are deductible.
- Payments for other services are deductible.

## *Group taxation*

There are no rules permitting grouping for tax purposes in Mongolia.

### *Thin capitalisation*

A thin capitalisation rule (debt to equity ratio is 3:1) applies, and interest paid in excess of this ratio is not deductible and is treated as a dividend. This is applied on a shareholder by shareholder basis as opposed to the company as a whole; no restriction applies to interest that is not paid to a shareholder.

## *Tax credits and incentives*

A 50% tax credit is available for an economic entity that produces or grows the following products:

- Cereal, potatoes, and vegetables.
- Milk.
- Fruits and berries.
- Fodder plants.



## *Withholding taxes*

Dividends, interest, and royalties paid; goods sold; and work/services provided to non-residents are subject to WHT at a 20% rate. Dividends, interest, and royalties paid to resident companies are all subject to WHT at 10%. Dividends, interest, and royalties paid to resident individuals are subject to WHT at a 10% rate, but WHT on dividends and interest to individuals will only be effective as of 1 January 2013.

### *Current double taxation treaties (DTTs)*

| | Beneficial WHT rates (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Dividends** | **Interest** | **Royalties** | **Technical fees** |
| Austria | 5/10 | 10 | 10 | N/A |
| Belgium | 5/15 | 10 | 5 | N/A |
| Bulgaria | 10 | 10 | 10 | N/A |
| Canada | 5/15 | 10 | 5/10 | 5 |
| China | 5 | 10 | 10 | N/A |
| Czech | 10 | 10 | 10 | N/A |
| France | 5/15 | 10 | 5 | N/A |
| Germany | 5/10 | 10 | 10 | N/A |
| Hungary | 5/15 | 10 | 5 | N/A |
| India | 15 | 15 | 15 | 15 |
| Indonesia | 10 | 10 | 10 | N/A |
| Kazakhstan | 10 | 10 | 10 | N/A |
| Korea | 5 | 5 | 10 | N/A |

| | Beneficial WHT rates (%) | | | |
|---|---|---|---|---|
| Recipient | Dividends | Interest | Royalties | Technical fees |
| Kuwait | 5 | 5 | 10 | N/A |
| Kyrgyzstan | 10 | 10 | 10 | N/A |
| Luxemburg | 5/15 | 10 | 5 | 5 |
| Malaysia | 10 | 10 | 10 | 10 |
| Netherlands | 15 | 0/10 | 10 | 5 |
| Poland | 10 | 10 | 5 | N/A |
| Russia | 10 | 10 | In accordance with domestic legislation | N/A |
| Singapore | 5/10 | 0/5/10 | 5 | N/A |
| Switzerland | 5/15 | 10 | 5 | N/A |
| Turkey | 10 | 10 | 10 | N/A |
| Ukraine | 10 | 10 | 10 | N/A |
| United Arab Emirates | 0 | 0 | 10 | N/A |
| United Kingdom | 5/15 | 10 | 5 | N/A |
| Vietnam | 10 | 10 | 10 | 10 |

### *Pending DTTs*

- Belarus – Mongolia
- Egypt – Mongolia
- Italy – Mongolia
- North Korea – Mongolia
- Thailand – Mongolia

## *Tax administration*

### *Tax returns and assessment*

The tax year is the calendar year. Companies must submit a quarterly return by the twentieth day of the month following the end of each quarter.

An economic entity or organisation that has withheld tax from a payment of dividends, royalties, sale of rights, or a payment of income to a taxpayer should transfer the WHT to the tax authorities within seven working days. Tax withheld relating to the sale of immovable property should be transferred to the tax authorities within ten working days. A withholder must prepare and submit a quarterly return of the tax deducted by the twentieth day of the first month of the following quarter and an annual return by 10 February after the end of the tax year.

### *Payment of tax*

Tax is paid in advance by the 25th day of each month based on the estimated schedule of the current year provided by the tax authorities towards the end of the prior year. In practice, the Mongolian tax authorities allow concessions as follows:

Where total tax paid exceeds the tax liability, the excess may be credited against other taxes due or credited against future tax payments. The overpayment also may, theoretically, be refunded; however, the practice of refunding in Mongolia is not clear or consistent.

# Montenegro

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## Significant developments

The last changes to the corporate profit tax (CPT) law, effective beginning 1 January 2010, introduced taxation of 100% rather than 50% of capital gains. The amendments also reduced a number of tax incentives, including abolishing tax deductions for newly employed staff and tax incentives for investment in efficient production of energy.

## Taxes on corporate income

Entities operating in Montenegro are subject to a 9% tax on profits. No local corporate income taxes exist.

Resident taxpayers are taxed on their worldwide profit, while non-resident taxpayers are taxed on their Montenegrin sourced income, or income attributed to their Montenegrin permanent establishment (PE). Non-residents are also subject to withholding tax (WHT) on income sourced in Montenegro. *See the Withholding taxes section for more information.*



## Corporate residence

The Montenegrin Corporate Tax Law prescribes that taxpayers are considered to be:

- entities established in Montenegro, or effectively managed and controlled in Montenegro (resident taxpayers), and
- entities with a place of effective management outside of Montenegro, which conduct business through a permanent establishment (non-resident taxpayers).

A legal entity is considered to be a tax resident if it is incorporated in Montenegro. In addition, a foreign corporation may also be deemed a Montenegrin tax resident if the corporation has a place of effective management in Montenegro. No explicit rules exist for determination of effective management. In practice, it usually is the place where key managerial decisions are made or where the board of directors sit.

### Permanent establishment (PE)

Montenegrin tax legislation contains very basic PE rules following, in main features, the guidelines set out in the Commentary to the Organisation for Economic Co-operation and Development (OECD) Model Tax Treaty. PE is defined as a fixed place of business through which a non-resident carries out business in Montenegro. PE is deemed to exist in case of a non-resident having one of the following in Montenegro: place of management, branch office, office, factory, workshop, mine, gas or oil site, stone pit, or any other place of natural resources exploitation in Montenegro. A construction site constitutes a PE only if construction activities last longer than six months.

PE is not deemed to exist in case of a non-resident having storage of inventory in Montenegro only for the purpose of delivery of goods or having operations in Montenegro that are of a preparatory or auxiliary nature.

## *Other taxes*

### *Value-added tax (VAT)*

The main principles of the Montenegrin VAT are in line with the European Union Sixth Directive guidelines. Taxable supplies are subject to a general 17% VAT rate; however, certain supplies are taxed at a reduced 7% rate (e.g. bread, milk, books, medicines, computers) and 0% rate (e.g. export of goods, supply of gasoline for vessels in international traffic).

In principle, the VAT base is comprised of consideration (in cash, goods, or services) received for supplies, including taxes except VAT (e.g. customs, excise duty) and direct costs (e.g. commissions, cost of packing, transport). If the consideration is not paid in cash, or if an exchange of goods for services takes place, the tax base will be the market value of the goods or services received at the time of supply.

Registration for VAT in Montenegro may be either as voluntary or mandatory. Voluntary VAT registration is possible for small taxpayers who have not realised turnover exceeding 18,000 euros (EUR) in the last 12-month period. Once registered, a company may not apply for deregistration for at least three years. VAT registration is mandatory for an entity that realises turnover exceeding the EUR 18,000 threshold in any 12-month period.

VAT is calculated and paid on a calendar-month basis (i.e. a VAT return must be submitted and VAT liability cleared monthly). VAT calculated on imports is paid along with custom duties.

### *Payroll tax*

Employment income includes all receipts paid or given to an individual based on employment (salaries, pensions, benefits in kind, insurance premiums, benefits, and awards above the non-taxable thresholds). Income generated through other types of personal engagements similar to employment (e.g. temporary jobs) is also considered employment income.

While employees are the taxpayers, the employer is responsible for calculating and withholding personal income tax on behalf of its employees.

Employment income is subject to WHT at a flat rate of 9% beginning 1 January 2010.

### *Social security contributions*

Social security contributions for pension and disability insurance, health insurance, and unemployment insurance are calculated and withheld by an employer from the salary paid to an employee. Unlike the other two types of social security contributions, pension and disability insurance contributions are subject to a specific annual cap (EUR 31,015.60 for 2010).

Social security contributions are payable by the employer and employee at different rates. The amount borne by the employer is treated as an operating cost while the portion payable by the employee is taken from the gross salary.

The rates paid by the employer are as follows:

- Pension and disability insurance 5.5%.
- Health insurance 3.8%.
- Unemployment insurance 0.5%.

The rates paid by the employee are as follows:

- Pension and disability insurance 15%.
- Health insurance 8.5%.
- Unemployment insurance 0.5%.

### *Excise duty*
Legal entities that are importers or producers of the following products are subject to the excise duty:

- Alcohol and alcohol beverages.
- Tobacco products.
- Mineral oils, their derivatives, and substitutes.

When excise duty is paid for these products, no distinction is made with respect to the origin of the product (i.e. whether it is local or imported). Excise duty can be prescribed as a fixed amount and/or as a certain percentage *(ad valorem)*.

### *Environmental charges*
Legal entities are subject to environmental charges for the following:

- Use of firing or electrical feed equipment with power greater than 1MW.
- Import of substances harmful to the atmosphere.
- Production or deposit of dangerous waste.
- Tax for use of road vehicles (Vignettes).

### *Property tax*
Property tax is payable by legal entities who own or have user rights over real estate located in Montenegro. The tax is levied at proportional rates, ranging from 0.1% to 1% on the market value of assets as of 1 January of the current year. A taxpayer is obliged to submit a tax return to the tax authorities within 30 days from the acquisition date. Tax is payable in two instalments, based on decisions issued by the tax authorities.

### *Property transfer tax*
Transfer tax of 3% is payable on the acquisition of ownership rights over immovable property.

The taxable base is the market value of the immovable property at the time of the acquisition. A taxpayer (i.e. the acquirer of immovable property) is obliged to submit a tax return within 15 days from the contract date. The liability is payable within 15 days from the receipt of the tax administration decision.

## *Branch income*

Non-residents carrying out business in Montenegro through a PE are taxed on their Montenegrin source income at a rate of 9%. A branch is considered to be a PE.

## Income determination

Taxable profit is calculated by adjusting the accounting profit (determined in accordance with IFRS and accounting legislation) in accordance with the provisions of the CPT law.

### Inventory valuation

Inventory is valued by applying the average-weighted-cost method or the first in first out (FIFO) method. If another method is used for book purposes, an adjustment for tax purposes should be made.

### Capital gains

Capital gains realised by the sale or transfer of real estate or other property rights, as well as shares and other securities, are subject to the 9% CPT rate. As of 1 January 2010, the tax is levied on 100% of the capital gains amount. Prior to 1 January 2010, the tax was levied on 50% of the capital gains amount.

Capital gains may be offset against capital losses occurring in the same period. A capital loss may be carried forward for five years.

### Dividend income

Dividend income of the recipient is exempt from corporate taxation in Montenegro if the distributor is a Montenegrin corporate taxpayer.

## Deductions

The following expenditures are recognised for CPT purposes, up to the prescribed threshold:

- Depreciation computed in accordance with tax legislation.
- Expenses for health care, scientific, educational, humanitarian, religious, environmental protection, and sports-related purposes, up to 3.5% of total revenue.
- Entertaining expenses, up to 1% of total revenue.
- Membership fees paid to chambers of commerce and other associations (except political parties), up to 0.1% of gross revenue.
- Provisions for redundancy payments and jubilee awards recognised as expenditures, up to the amount prescribed by the labour law.
- Provisions made by banks and insurance companies, in an amount not exceeding the amount prescribed by the legislation that regulates operation of these entities.
- Provisions for special risks of brokers and dealers, up to amount prescribed by the securities law.
- Provisions for renewable natural resources, warranties for the sale of goods and services (guarantee period), and the expected loss from court process (delicate agreements) if accounted for in accordance with the accounting legislation.

### Bad debts

Write-offs and provisions for doubtful debts are considered deductible, provided that:

- written-off/provided receivables were previously included in taxpayer's revenues
- doubtful debts were written-off/provided as uncollectible, and
- proof of unsuccessful collection of these debts exists.

### *Depreciation and depletion*
Depreciable assets are tangible and intangible assets with a useful life of at least one year and an individual acquisition value of at least EUR 300.

Intangible and fixed assets are divided into five depreciation groups, with depreciation rates prescribed for each group (I – 5%, II – 15%, III – 20%, IV – 25%, and V – 30%). A straight-line depreciation method is prescribed for assets classified in the first group (real estate), while a declining-balance method is applicable for assets classified in the other groups.

### *Net operating losses*
The taxpayer is entitled to carry forward losses incurred in an accounting period over the following five years. Carryback of losses is not allowed.

### *Payments to foreign affiliates*
Supplies of goods or services from a foreign group entity not established in Montenegro to a Montenegrin entity must be valued at arm's length. Excess expenses recorded over market value are treated as non-deductible expenses.

With respect to payment of charges of a PE, CPT law provides that administrative costs charged by the non-resident head office are non-deductible for CPT at the level of PE.

### *Taxes*
The basic deductibility rule is that business expenses incurred for business purposes are CPT deductible. Following that rule, CPT law provides for full deductibility of taxes. However, penalty interest for late payment of taxes is not CPT deductible.



## *Group taxation*

Tax consolidation is permitted for a group of companies in which all of the members are Montenegrin residents and the parent company directly or indirectly controls at least 75% of the shares in the other companies. Each company files its own tax return and the parent company files a consolidated tax return for the entire group.

Each company is taxed based on its contribution to the consolidated taxable profit (or loss) of the group.

Tax consolidation is binding for at least five years.

## *Tax credits and incentives*

The CPT law provides only three tax incentives related to businesses: one for newly established businesses in non-developed municipalities, one for non-governmental organisations, and a foreign tax credit. The 2010 amendments to the CPT law greatly reduced the incentives available, including abolishing the tax incentives for newly employed staff and energy-efficient production.

### *Tax exemption / tax credit for newly established business in non-developed municipalities*
Newly established production companies located in non-developed municipalities are entitled to a three-year tax exemption on the profits attributable to operations in these municipalities. The exemption period starts from the year in which production began.

### *Tax exemption for non-governmental organisations*
Non-governmental organisations (NGO) registered for business activity are permitted to decrease the corporate tax base by EUR 4,000 with the condition that this money is used for realisation of the main goals of an NGO.

### *Foreign tax credit*
Resident taxpayers are entitled to a tax credit up to the amount of corporate tax paid in another country on income realised in that country. This tax credit is equal to the tax paid in another country but may not exceed the amount of the tax that would have been paid in Montenegro.

## *Withholding taxes*

Montenegrin CPT law imposes WHT on income realised from a Montenegrin source and distributed to a non-resident. The scope of the WHT applies to dividends and profit distribution, capital gains, interest, royalties, intellectual property rights fees, and rental income, as well as fees for consulting, marketing, and audit services.

Distributions of dividends and share of profits are also subject to WHT if the recipient is a Montenegrin resident (either individual or legal entity).

The general WHT rate is 9%.

Application of a double-tax treaty may reduce or eliminate Montenegrin WHT. To qualify for the beneficial rates prescribed by the treaty, a non-resident must prove tax residency of a relevant treaty country and beneficial ownership over the income. No further guidance has been issued up to date.

Although Serbia is regarded as the legal successor of the Serbia and Montenegro State Union which ceased to exist in June 2006, the Republic of Montenegro, upon its Decision on Independence (dated 3 June 2006), continues to honour international treaties which were applicable in the State Union, including those executed by State Union's legal predecessors (Federal Republic of Yugoslavia and Socialist Federal Republic of Yugoslavia, i.e. former Yugoslavia). However, a quite low statutory WHT rate of 9%, which was enacted after the most of the treaties had been introduced, is usually more beneficial than treaty rates.

The list of the treaties is provided below:

| Recipient | Dividends (1) (%) | Interest (%) | Royalties (%) | Applicable from |
|---|---:|---:|---:|---:|
| Non-treaty | 9 | 9 | 9 | |
| Albania | 15/5 | 10 | 10 | 2006 |
| Belgium | 15/10 | 15 | 10 | 1982 |
| Belorussia | 15/5 | 8 | 10 | 1999 |
| Bosnia and Herzegovina | 10/5 | 10 | 10 | 2006 |
| Bulgaria | 15/5 | 10 | 10 | 2001 |
| China | 5 | 10 | 10 | 1998 |
| Croatia | 10/5 | 10 | 10 | 2005 |

| Recipient | Dividends (1) (%) | Interest (%) | Royalties (%) | Applicable from |
|---|---|---|---|---|
| Cyprus | 10 | 10 | 10 | 1987 |
| Czech Republic | 10 | 10 | 10/5 | 2006 |
| Korea | 10 | 10 | 10 | 2002 |
| Denmark | 15/5 | 0 | 10 | 1983 |
| Egypt (2) | 15/5 | 15 | 15 | 1989 |
| Finland | 15/5 | 0 | 10 | 1988 |
| France | 15/5 | 0 | 0 | 1976 |
| Ghana (3) | 15/5 | 10 | 10 | N/A |
| Germany | 15 | 0 | 10 | 1989 |
| Hungary | 15/5 | 10 | 10 | 2003 |
| India (3) | 15/5 | 10 | 10 | N/A |
| Italy | 10 | 10 | 10 | 1986 |
| Iran (3) | 10 | 10 | 10 | N/A |
| Kuwait | 10/5 | 10 | 10 | 2004 |
| Latvia | 10/5 | 10 | 10/5 (5) | 2006 |
| Macedonia | 15/5 | 10 | 10 | 1998 |
| Malaysia | 0 (6) | 10 | 10 | 1991 |
| Malta | 10/5 | 10 | 10/5 (5) | N/A |
| Moldova (4) | 15/5 | 10 | 10 | N/A |
| Netherlands | 15/5 | 0 | 10 | 1983 |
| Norway | 15 | 0 | 10 | 1986 |
| Poland | 15/5 | 10 | 10 | 1999 |
| Romania | 10 | 10 | 10 | 1998 |
| Russia | 15/5 | 10 | 10 | 1998 |
| Slovak Republic | 15/5 | 10 | 10 | 2002 |
| Slovenia | 10/5 | 10 | 10/5 (7) | 2004 |
| Sri Lanka | 12.5 | 10 | 10 | 1987 |
| Sweden | 15/5 | 0 | 0 | 1982 |
| Switzerland | 15/5 | 10 | 10 | 2006 |
| Turkey (4) | 15/5 | 10 | 10 | N/A |
| Ukraine | 10/5 | 10/0 (8) | 10 | 2002 |
| United Kingdom | 15/5 | 10 | 10 | 1983 |
| Zimbabwe (3) | 15/5 | 10 | 10 | N/A |

Notes

1. If the recipient company owns/controls at least 25% of the equity of the paying company, the lower of the two rates applies.
2. A new double taxation treaty was signed with Egypt in 2005, but it is not applicable yet. Meanwhile, the old treaty is still applicable.
3. Instruments of ratification have not been exchanged between the two countries.
4. The contract was signed, ratified, and should become applicable after the exchange of ratification instruments by the signatories.
5. A tax rate of 5% will be applicable to literary, scientific, and work of art, films and works created like films, or other sources of reproduction tone or picture. A tax rate of 10% will be applicable to patents, petty patents, brands, models and samples, technical innovations, secret formulas, or technical procedure.
6. Only in cases when dividends are to be paid to Montenegrin residents. If paid to Malaysian residents, they are taxable at 20% in Montenegro.
7. A 5% rate is applicable for intellectual property and 10% rate for industrial property.
8. A 0% rate is applicable in cases when the income recipient is the government or government owned banks.

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## *Tax administration*

### *Returns*

The tax year in Montenegro is the calendar year. Tax returns and supplementary documents (e.g. tax depreciation form) must be filed with the tax authorities by the end of March of the following year.

### *Payment of tax*

Amendments to the CPT applicable beginning 1 January 2010 abolished monthly advance payments of the CPT and introduced the annual payment of taxes. CPT is paid by the end of March of the following year for the previous year. Alternatively, CPT may be paid in six annual instalments at the taxpayer's request.

# Morocco

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## Significant developments

### Casablanca Finance City (CFC)

Law No. 44-10 has been enacted and published in the official Bulletin number 5904. The Law sets the rules for the setting up of a finance area in Casablanca and the conditions for companies to benefit from the CFC statute.

Finance Law 2011 has provided several corporate tax incentives for companies having CFC statute.

Entities established in Casablanca Finance City are exempt, for their export turnover, from corporate income tax (CIT) during the first five years following the date they obtain CFC statute. These companies benefit, for the export turnover, from a reduced rate of 8.75% in subsequent years.



### Small companies

The dispositions of Finance Law 2011 have set a reduced rate of 15% for small companies realizing a turnover equal to or less than 3 million Moroccan dirhams (MAD).

### Capital increase

Finance Law 2011 has extended the dispositions of Finance Law 2009, which granted a reduction of CIT equal to 20% of the amount of the capital increase, until 31 December 2012.

### Publication of tax guidelines

The tax authorities have published a tax guideline describing their interpretation of the Moroccan tax code.

The guideline is legally enforceable against tax authorities.

## Taxes on corporate income

In general, the Moroccan tax code considers that all revenues and capital gains generated in Morocco are subject to Moroccan taxation.

Companies are taxed on the difference between their trading income and expenditure. Business expenses incurred in the operation of the business are generally deductible unless specifically excluded.

The standard CIT rate is 30%. A higher rate of 37% applies to leasing companies and credit institutions.

A reduced rate of 15% applies to small companies realizing a turnover equal to or less than MAD 3 million.

Non-resident companies can, under certain conditions, opt for an alternative tax at the rate of 8% of the amount of their contract, whatever the taxable income is.

### *Minimum contribution*

CIT cannot be lower than a minimum contribution of 0.5% (or 0.25% for specific products) levied on the turnover and other specific revenues. The minimum contribution is not due during the first 36 months following the beginning of activities.

The minimum contribution paid in case of loss or the portion of minimum contribution that exceeds the amount of CIT may be offset against the portion of CIT that exceeds the minimum contribution until the third year.

## *Corporate residence*

Companies, whether or not established in Morocco, will be subject to CIT on all profits or income relating to property which they own, activities which they carry on, and profit-making transactions which they carry out in Morocco, even when these are of an occasional nature.

### *Permanent establishment (PE)*

The notion of PE is not explicitly defined under Moroccan tax law.

However, the Moroccan tax authorities apply this concept for non-resident companies according to some determined criteria that are inspired from the various tax treaties that Morocco has signed with other countries.

Indeed, the question of whether an entity will be deemed to have a PE in Morocco is a question of fact, in particular, subject to having, in Morocco, any fixed place of business through which a foreign entity conducts industrial or commercial activity for an indefinite or substantial period of time.

The term fixed place of business includes, for instance, a place of management or operations, a branch, an agency, a premises used as a sales outlet, a construction of assembly project, or a purchasing office. Also, in some specific cases, a non-resident company may be deemed as having a PE if it operates in Morocco through a dependant agent.

## *Other taxes*

### *Valued-added tax (VAT)*

VAT is levied under the Moroccan Tax Code and is due on all industrial, commercial, and handicraft transactions taking place in Morocco as well as on importation operations.

The standard rate of VAT is 20%. Lower rates of 7%, 10%, and 14% apply to specifically designated operations.

The sale of goods is considered as taking place in Morocco, and thus subject to VAT, if the goods sold are delivered in Morocco.

The sale of services is considered as taking place in Morocco, and thus subject to VAT, if the services sold are consumed or used in Morocco.

Two types of exemptions from VAT are provided. The first is an exemption with credit, equivalent to the zero tax concept. The second is an exemption without credit.

### *Customs duties/import tariffs*

Importation of goods in Morocco gives rise to payment of importation duties, the VAT on importation, and the special tax on importation called Taxe Parafiscale à l'Importation (TPI).

Customs duties are computed on the basis of the *ad valorem* value of the goods at the time of their entrance into Morocco.

Customs duties can be reduced if the imported products are covered by free trade agreements signed by Morocco or other specific regulatory dispositions.

Under Moroccan tax law, the importation operations are subject to VAT at the rate of 20%. Lower rates of 7%, 10% and 14% apply to specifically designated importations.

The Moroccan tax law also offers some economical customs regimes that provide VAT exemptions with credit (equivalent to zero rate).

The TPI rate is 0.25% levied on the value of the imported goods.

### *Excise taxes*

Excise taxes apply to specific products imported or produced in Morocco, such as tobacco, alcohol, and lubricants.

### *Registration duties*

Registration duties are due on all written or verbal conventions, such as property transfer of real estate, shares, or rights; company set up; equity increase; and goodwill transfer.

The rates of registration duties range from 1% to 6%. A flat rate of MAD 200 is also applicable to specific operations and conventions.

For information purpose, the company set up and the capital increase are subject to registration duties at the rate of 1%.

The transfer of non-listed shares is subject to registration duties at the rate of 3%. However, a 6% rate is applicable to the transfer of shares of real estate companies.

The applicable rate for the transfer of goodwill is 6%.

### *Professional tax*

A professional tax is levied on individuals and enterprises that carry out a professional activity in Morocco.

The tax consists of a tax on the rental value of business premises (rented or owned) and fixed assets. The tax rates range from 10% to 30% with exemption for the five first years of activity.

The rental value is exempted for the portion of cost exceeding MAD 50 million.

## Branch income

Non-resident entities will be subject to income tax at normal corporate rates derived from all profits or income relating to property which they own, activities which they carry on, and profit-making transactions which they carry out in Morocco.

The taxation is levied to the portion of income allocable to the branch located in Morocco.

In addition, a 10% 'branch tax' applies to a non-resident's after-tax profits. The rate at which the branch tax is levied may be reduced to the withholding tax (WHT) rate on dividends prescribed in the relevant tax treaty.

For resident entities having branches in Morocco, the income is taxable in the hands of the head office at normal corporate rates.

## Income determination

### Inventory valuation
Cost of inventory must be determined in accordance with the first in first out (FIFO) or the average cost method. The last in first out (LIFO) method is prohibited.

### Capital gains
Capital gains are taxable as a part of ordinary business income.

### Dividend income
Dividends received by corporate shareholders from Moroccan-resident entities subject to CIT must be included in business profits of the recipient company, but the dividends are 100% deductible in the computation of taxable income.

Participation exemption in Morocco is also applicable to dividends derived from foreign subsidiaries.

### Interest income
Interest income is subject to a WHT at the rate of 20%. The WHT is deductible from CIT.

### Rents/royalties income
Rents and royalties income are taxable as a part of ordinary business income.

### Foreign income
The income derived from activities carried out in a foreign country is not subject to taxation in Morocco unless the taxation is granted by treaty dispositions.

Note that the participation exemption in Morocco is also applicable to dividends derived from foreign subsidiaries.

## Deductions

### Depreciation
Fixed assets are normally depreciated according to their economical life duration according to the provision of the accounting regulation.

Depreciation is computed according to two methods: the straight-line method and the declining balance method.

The tax regulation (through administrative guidelines) has provided indicative depreciation rates applicable when the company activity or the asset to be depreciated is specific or particular.

### *Goodwill*
Under Moroccan tax law, goodwill cannot be subject to amortisation. However, a decrease of the value of goodwill is allowed to be recorded through provisions.

### *Start-up expenses*
The development as well as incorporation expenses shall be capitalized and be tax depreciated over a period of five years.

The carryforward of any loss due to the above expenses is limited to a period of four years.

### *Bad debt*
Bad debts which are definitively non-recoverable (after all recovery procedures have been undertaken) are treated, from a tax point of view, as deductible losses.

### *Charitable contributions*
Charitable contributions made by companies are deductible only if they are granted to foundations and societies explicitly provided by law.

The contributions made to the community enterprise are deductible up to 0.2% of the company turnover.



### *Fines and penalties*
Fines and penalties are not tax deductible expenses if they relate to infringements to legal and regulatory dispositions.

Tax penalties provided under Moroccan law include penalties for late return submission as well as for late payment.

### *Taxes*
Taxes constitute deductible expenses, except CIT itself and recoverable taxes.

### *Net operating losses*
Tax losses may be carried forward for a period of four years from the end of the loss-making accounting period.

However, the portion of a loss that relates to depreciation may be carried forward indefinitely.

Carryback mechanism is not allowed under Moroccan law.

### *Payments to foreign affiliates*
Payments to foreign affiliates are allowed under Moroccan law. However, such payments should respect the arm’s-length principle and foreign exchange regulations.

## Group taxation

Under Moroccan law, consolidation or group taxation is not allowed.

### Transfer pricing regime
Morocco has a general provision within its tax legislation requiring transactions between related parties to be at arm's length.

Where a Moroccan company is directly or indirectly connected with enterprises situated inside or outside Morocco, profits transferred indirectly to such enterprises, by means of increases or decreases in buying or selling prices or by any other means, must be included among taxable profits on the tax return.

In order to determine the amount to be included among taxable profits, Moroccan tax authorities will make comparisons with other similar companies carrying on normal business activities or by mean of direct assessment based on information available to the tax authorities.

### Thin capitalisation rules
No specific thin capitalisation rules exist in Morocco.

However, the tax law restricts the interest rate on debts issued by shareholders and the basis of calculating deductible interests.

Interest incurred is tax deductible if the shareholder's capital is fully paid. Additionally, the sum of the shareholder loans generating deductible interests should not exceed the equity capital subscribed, and the applicable interest rate should not exceed the official rate calculated annually on the basis of six months T-bills.

## Tax credits and incentives

The Moroccan tax law provides several tax incentives for specific sectors of activities.

### Export companies
Export companies are exempt from CIT on their profits related to their export turnover during the first five years following their first export transaction. These companies benefit from a reduced rate of 17.5% in subsequent years.

### Hotel companies
Hotel companies are fully exempt from tax on profits relating to foreign currency turnover for the first five years following their first accommodation operation in foreign currency. They also benefit from a reduced rate of 17.5% on such profits for subsequent years.

### Mining companies
Exporting mining companies, including those that sell products to export companies, benefit from a reduced CIT rate of 17.5%.

### Agricultural enterprises
Agricultural enterprises are exempt from all taxes until the year 2013.

### *Capital risk companies*
Capital risk companies are exempt from CIT on profits derived within the scope of their activities (these are profits related to purchases of companies' shares that support such companies' development and the sales of such shares thereafter).

### *Hydrocarbon companies*
Companies holding hydrocarbon exploration and exploitation permits are exempt from CIT for ten years from the beginning of hydrocarbon regular production.

### *Banks and holding companies located in offshore zones*
Banks and holding companies located in offshore zones benefit from a reduction in CIT for the first 15 years of operation.

Banks may opt for a minimum CIT of USD 25,000 or pay the tax at a reduced rate of 10%.

Holding companies pay a flat tax of USD 500 during the first 15 years.

### *Casablanca Finance City (CFC)*
A law was enacted in 2010 for the setting up of a finance area in Casablanca, called, Casablanca Finance City.

The CFC statute may be granted to specific financial institutions as well as non-financial institutions that offer such services as auditing, fiscal, legal, financial, actuarial, and human resources management advisory.

The above statute may also be granted to regional and international headquarters.

Entities established in Casablanca Finance City are exempt, for their export turnover, from CIT during the first five years following the date they obtain CFC statute. These companies benefit, for the export turnover, from a reduced rate of 8.75% in subsequent years.

### *Free trade zones (FTZs)*
The activities which must be necessarily performed by the companies established in the export free zones are mainly the followings (the activities may vary for each FTZ):

- Food processing industries.
- Textile and leather industries.
- Metallurgic, mechanic, electric, and electronic industries.
- Chemical and special chemical industries.
- Services connected with the aforementioned activities.

Entities established in FTZs are exempt, for their export turnover, from CIT during the first five years. These companies benefit, for the export turnover, from a reduced rate of 8.75% for the following 20 years.

Moreover, for entities established in FTZs, the dividends paid to non-residents relating to activities performed in the export free zone are totally exempted from the WHT on dividends.

### *Listed shares*
Non-resident entities are exempted from capital gains derived from the sale of stocks listed on the Casablanca stock exchange, excluding the shares of real estate entities.

## Withholding taxes

### WHT on interests

The standard WHT on interest paid to non-resident entities is set at 10% as provided by the Moroccan law (unless reduced by treaty).

However, the Moroccan law provides that interests on loans granted in foreign currency with a maturity exceeding ten years are exempted from WHT.

### WHT on dividends

The standard WHT rate on dividends is set at 10% according to the Moroccan law (unless reduced by treaty).

WHT does not apply to dividends paid to Moroccan companies subject to Moroccan corporate tax, subject to the delivery of a property attestation.

A branch tax of 10% applies to the net income transferred by the Moroccan branch to the foreign entities (maybe reduced by the tax treaty).

### WHT on services paid to non-resident entities

According to the Moroccan tax code, all payments of all kind of services rendered by non-resident entities are subject to WHT at the rate of 10%.

However, it shall be noted that treaties dispositions limit the scope of application of WHT only to remunerations that constitute royalties. Such dispositions overrule the domestic tax law provided by the Moroccan law.

### Treaty WHT rates

Payments to non-resident corporations and individuals are subject to WHT, as shown below.

| | Dividends (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Individuals and non-qualified companies** | **Qualifying companies** | **Interest (%) (1)** | **Royalties (%)** |
| Arab Maghreb Union (2) | (3) | (3) | (3) | (3) |
| Austria | 10 | 5 | 10 | 10 |
| Bahrain | 10 | 5 | 10 | 10 |
| Belgium | 10 | 6.5 | 10 | 10 |
| Bulgaria | 10 | 7 | 10 | 10 |
| Canada** | 10 | 10 | 10 | 5/10 (4) |
| China (People's Rep.) | 10 | 10 | 0/10 | 5/10 |
| Czech Republic | 10 | 10 | 10 | 10 |
| Denmark** | 10 | 10 | 10 | 10 |
| Egypt** | 10 | 10 | 10 | 10 |
| Finland** | 10 | 10 | 10 | 10 |
| France** | 10 | 10 | 10/10 (5) | 5/10 (4) |
| Germany** | 10 | 5 | 10 | 10 |
| Hungary** | 10 | 10 | 10 | 10 |

| Recipient | Dividends (%) Individuals and non-qualified companies | Qualifying companies | Interest (%) (1) | Royalties (%) |
|---|---|---|---|---|
| India | 10 | 10 | 10 | 10 |
| Italy** | 10 | 10 | 10 | 5/10 (4) |
| Jordan | 10 | 10 | 10 | 10 |
| Korea (Rep.) | 10 | 5 | 10 | 10 |
| Latvia | 10 | 6 | 10 | 10 |
| Lebanon | 10 | 5 | 10 | 5/10 (4) |
| Luxembourg** | 10 | 10 | 10 | 10 |
| Malaysia | 10 | 5 | 0/10 | 10 |
| Malta | 10 | 6.5 | 0/10 | 10 |
| Netherlands** | 10 | 10 | 10 | 10 |
| Norway** | 10 | 10 | 10 | 10 |
| Oman | 10 | 5 | 0/10 | 10 |
| Pakistan | 10 | 10 | 10 | 10 |
| Poland** | 10 | 7 | 10 | 10 |
| Portugal** | 10 | 10 | 10 | 10 |
| Qatar | 10 | 5 | 0/10 | 10 |
| Romania | 10 | 10 | 10 | 10 |
| Russia | 10 | 5 | 10 | 10 |
| Spain** | 10 | 10 | 10 | 5/10 (4) |
| Switzerland** | 10 | 7 | 10 | 10 |
| Syria** | 10 | 7 | 10 | 10 |
| Turkey | 10 | 7 | 10 | 10 |
| Ukraine | 10 | 10 | 10 | 10 |
| United Arab Emirates | 10 | 5 | 10 | 10 |
| United Kingdom** | 10 | 10 | 10 | 10 |
| United States** | 10 | 10 | 10 | 10 |

Notes

** In case the rate provided by the double tax treaty (DTT) is higher than the one provided by the Moroccan Tax Code, the rate provided by the Moroccan Tax Code (10%) should apply.

1. Some treaties provide for an exemption for certain types of interest (e.g. interest paid to public bodies and institutions). Such exemptions are not dealt with in this treaty chart.
2. Arab Maghreb Union, the member states of which are Algeria, Libya, Mauritania, Morocco, and Tunisia.
3. There is no limitation on WHT under the treaty.
4. The lower rate (i.e. 5%) usually applies to copyright royalties and other similar payments in respect of the production or reproduction of any literary, artistic, or dramatic work (excluding cinematographic and television films), while the 10% rate applies to other types of royalties.
5. The reduced rate applies when dividends are paid to the government of the other state.

## *Tax administration*

### *Returns*

CIT returns must be filed within three months following the closing of the fiscal year.

### *Payment of tax*
Payment of tax is made during the fiscal year by way of four instalments of 25% each based on the CIT of the previous year.

In case the CIT of the year exceeds the sum of the four instalments, the company should proceed to tax regularisation after three months following the closing of the fiscal year.

Otherwise, the exceeding tax amount can be imputed on the four following instalments. Any remaining excess is reimbursed by the tax authorities.

### *Statute of limitations*
The statute of limitations runs until the end of the following fourth year. This period may be extended in case of deficits or credits.

## *Other issues*

### *Exchange controls*
Foreign investors are allowed, following the accomplishment of some formalities, to freely transfer abroad the whole proceeds of their investments in Morocco (i.e. dividends, shares sale price, and liquidation income at the condition that the initial investment is realized in one of the foreign currencies listed by the Moroccan Central Bank).

However, some specific transfers of funds into and out of Morocco are subject to prior authorizations from the exchange control office.

### *Choice of business entity*
The legal vehicles used by foreign companies for the purpose of setting up a business in Morocco are the branch and the subsidiary.

Under subsidiary form, the foreign entities generally opt for the corporation (SA) or the limited liability company (SARL).

The SARL is most adequate for companies with low investment capital while the SA is most appropriate for companies that are investing an important amount of capital. In general, the rules relating to the organisation and functioning of an SARL are more flexible than those required for an SA.

# Mozambique

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## Significant developments

Mozambique has been undergoing major tax reform since the beginning of 2003, which has consisted of replacing the existing corporate income tax (CIT) and strengthening the tax administration by improving collection procedures and increasing enforcement capacity. Effective as of 1 January 2003, a new Corporate Income Tax Code (Código do Imposto Sobre o Rendimento das Pessoas Colectivas, or CIRPC) came into force and was further amended on 1 January 2008. In September 2009, the CIRPC was further amended again to accommodate the introduction of International Financial Reporting Standards (IFRS) rules in Mozambique.

Mozambique also introduced, with effect from 1 July 2002, a new Code of Fiscal Benefits, replacing the general tax benefits conceded under the previous Code as well as sectarian incentives granted under specific legal diplomas. In January 2009, the referred Code was amended by changing and, in some situations reducing, some of the customs and tax incentives granted under the previous Code.



## Taxes on corporate income

CIT is payable on general corporate income at a tax rate of 32%. For tax years ending prior to 1 January 2010, income arising from agricultural or cattle breeding activities was subject to a reduced rate of 10%.

CIT is levied on taxable profits, defined as accounting profits adjusted to comply with tax law rules.

Corporate entities and other entities with headquarters or permanent establishment (PE) in Mozambique are subject to CIT based on their worldwide income. On the other hand, corporate entities and other entities without headquarters or PE in Mozambique (i.e. non-resident entities) are only subject to CIT on the income earned in Mozambique.

## Corporate residence

Corporate residence is determined on the basis of a company's place of incorporation or effective management. Thus, all companies with headquarters in Mozambique, as well as any PE of non-resident entities, are considered tax residents and are liable for CIT on their worldwide income.

### *Permanent establishment (PE)*
Under the relevant internal legislation, a non-resident entity is deemed to have a PE in Mozambique whenever any of the following circumstances exists:

- It has premises or other fixed places of business through which industrial, trading, agricultural, rendering of services, or similar activities are totally or partially carried out.
- It has an office, branch, plant, workshop, mines, quarries, oil or natural gas wells, or other places of extraction of natural resources.
- It has a construction, installation, or assembly site when the duration of works exceed six months, including the activities of coordination, inspection, and supervision connected to these sites.
- It has persons or hired personnel, acting and dealing in Mozambique, who are not independent agents in the terms of the law but rather acting on behalf of the company with legal capacity to conclude contracts on its behalf and its name within the scope of the company's activities.

## *Other taxes*

### *Value-added tax (VAT)*
VAT is chargeable on the sale of most goods and services as well as on imports. The standard rate is 17%. Usually, VAT is recoverable by corporate entities, except for those engaged in special business activities (e.g. financial and insurance operations, leasing (exemption with restrictions), sale of immovable property, some exempt activities).

### *Property transfer taxes (SISA)*
In Mozambique, a property transfer tax is charged on transfers of real estate excluding the land, which is owned by the State. The rate of tax is 2% of the selling price of the building.

### *Gifts and inheritance tax*
A gifts and inheritance tax is payable on transfers of all movable and immovable property by way of gift or bequest to persons resident in Mozambique or with respect to possessions situated in Mozambique. The tax is payable by the beneficiary and the rates vary from 0% to 15%, depending on the extent of the relationship between the donor and donee and the value of goods or rights transferred.

### *Stamp taxes and service charges*
Various documents require the payment of stamp duties. Service charges are payable for the performance of certain services for official purposes, such as those rendered by public notaries. These duties have been recently amended and vary generally from 0.03% to 50% on the amount of the transaction supported by the document to be stamped. In some other cases, the stamp tax comprises fixed amounts, ranging from 0.50 Mozambican meticals (MZN) to MZN 5,000.

### *Municipality taxes*
Municipality taxes that should be considered for corporate purposes include the following:

#### Municipality tax on real estate
The municipality tax on real estate is levied on the value of immovable assets situated within the municipality and owned or possessed by corporate entities. Effective tax rates range from 0.2% to 1% of the building value, depending on the municipality.

### Municipality tax on economic activities
The municipality tax on economic activities is levied on commercial or industrial activities carried out within a municipal territory. The tax depends on the activity being carried out, adjusted by coefficients, which are based on the zone and total area of the premises in square metres. In Maputo, this tax is calculated based on the following formula:

Maputo tax on economic activities = Basis rate x Index of category x Index of location x Index of area occupied

Where the basis rate is the applicable maximum amount of the national minimum salary (MZN 3,500, approximately USD 110).

Where the index of the location varies from 1.3 to 1.5 depending on the location of the premises within the municipality.

Where the index of the area occupied varies from 1.2 to 1.5 depending on the nature of the activities and the space occupied by the premises.

### Municipal surtax
The local surtax (called Derrama) may be imposed by the municipalities at a rate of up to 15% of the following taxes: (i) CIT or (ii) tax on real estate.

The local surtax is levied in relation to profits derived from activities carried out in the territory of each municipality.

When the municipalities decide to impose the surtax, the final CIT will be increased by adding the surtax (at a rate of up to a maximum of 15%) to direct taxes (i.e. CIT). For example, 32% normal CIT plus 15% municipal surtax equals 36.8% (32% + 4.8%) final CIT rate.



## *Branch income*

From a tax perspective, branches are liable for Mozambican CIT as a separate entity; therefore, the regime is the same that would apply to a Mozambican resident company. However, on the grounds that branches do not distribute dividends, the 20% withholding tax (WHT) does not apply to the after-tax profits arising in Mozambique.

## *Income determination*

### *Inventory valuation*
Special rules regarding valuation of inventories are waiting for approval from the Minister of Finance. In the meantime, all inventory valuation methods generally accepted and according to international accounting principles are permitted for tax purposes, provided that the method is:

- used by the taxpayer consistently and
- based on arm's-length prices duly documented and effectively exercised.

Based on the above assumptions, last in first out (LIFO) and first in first out (FIFO) methods are allowed. Write-downs and depreciation of inventories are not allowed. Conformity between book and tax reporting is required.

In principle, large companies began adopting IFRS in 2010.

### *Capital gains*

Capital gains less any capital losses derived from the sale or disposal of tangible fixed assets, including insurance indemnities received in case of accident, are taxed as part of normal income. If a taxpayer reinvests the sale proceeds within three tax years following the year of sale, the gain may be deferred until the end of the third year. A four-year reinvestment period may be accepted provided a prior application is submitted to the Minister of Finance. However, if the taxpayer does not realise the reinvestment, the CIT that was not assessed during the three-year period will be assessed, along with compensatory interest.

### *Inter-company dividends*

In the case of resident companies, income arising from dividends is excluded from taxable income, provided that the shares that a resident company holds in another resident company represents at least 25% of the total capital and are held for at least two consecutive years (or with an undertaking to hold the shares for this period). The same applies to income arising from risk capital companies and holding companies (Sociedade Gestora de Participações Sociais or SGPSs) or from subsidiaries as a result of the application of technical reserves in insurance companies. However, in the case of holdings, the percentage of share capital decreases to 10% and shares should be held for at least one year.

If the shareholding falls outside the parameters indicated above, the tax withheld (20%) constitutes a payment on account. A tax credit corresponding to 62.5% of the CIT is attributable to the gross-up dividend.

### *Foreign income*

Mozambican resident companies are taxed on the total income earned on a worldwide basis. Double taxation treaties allow tax paid abroad to offset Mozambican CIT. Mozambique has signed double tax treaties (DTT) with Portugal, Mauritius, Italy, the United Arab Emirates, South Africa, and Macau. A DTT with Vietnam was also signed; however, it is not yet in force.

## *Deductions*

### *Depreciation and depletion*

Depreciation is a deductible cost for CIT purposes, according to the regulations of the Corporate Income Tax Code, subject to restrictive and specific rules. Depreciation rules are contained in a specific legal diploma, which is Portaria nº 20 817, of 27 January 1968, which established the rates and limits legally allowed for depreciation purposes.

The main legal principles regarding depreciation are as follows:

- The establishment of the applicable rates falls under the competence of the Ministry of Finance.
- The calculation is carried out on a straight-line basis in accordance with the rates applicable.

The main depreciation rates are:

| Assets | Rate (%) |
|---|---|
| Tangible assets: | |
| Industrial buildings | 4 |
| Office and residential buildings | 2 |
| Machinery and installations, air conditioning, and telephone equipment | 10 |
| Lifts | 8.33 |
| Tools | 25 |
| Laboratory equipment | 12.5 |
| Telex and interior equipment | 10 |
| Furniture and filing systems | 10 |
| Typewriters and accounting machines | 14.28 |
| Computer hardware | 16.66 |
| Warehouse and filing installations: | |
| Of concrete | 5 |
| Of wood | 6.66 |
| Of steel | 8.33 |
| Trucks | 20 |
| Automobiles | 25 |
| Intangible assets: | |
| Pre-operating expenses incurred prior to the commencement of business | 33.33 |
| Deferred expenses arising in connection with increases in share capital, changes in form of business enterprises, issuance of debentures, marketing and other studies, and financial expenses incurred for the acquisition or own production of fixed assets prior to completion | 33.33 |
| Patents | 10 |
| Manufacturing licenses, concessionaire agreements, and similar rights | 5 (1) |
| Trademark or premium of taking over leases of real estate (2) | |

Notes

1. Subject to certain conditions set forth by the tax authorities.
2. Depreciation is only allowed in cases of effective reduction of value within the limits regarded as reasonable by the tax authorities.

### *Accelerated depreciation*

New immovable assets, used for the furtherance of the business, may be depreciated by increasing to 50% the normal depreciation rates approved by law. This benefit is also granted to rehabilitated immovable assets, machinery, and equipment used in agro-industrial activities.

### *Taxes*

Taxes paid in relation to the activities of a company are tax-deductible, excluding CIT itself.

### *Net operating losses*

Carryback of losses is not allowed in Mozambique. On the other hand, losses may be carried forward for a period of five consecutive years.

### *Payments to foreign affiliates*

Any payments to non-residents are allowed as deductible expenses provided that the amount does not exceed normal rates and that the taxpayer is able to prove that a business transaction was carried out with the non-resident company. The tax authorities may redetermine taxable income if, due to a special relationship between the Mozambican and non-resident companies, certain conditions existed that allowed a calculation of profit that differed from the profit that would have been calculated without the existence of such relationship (i.e. the arm's-length principle).

## Group taxation

There are no group taxation provisions available in Mozambique. Each member of a group of companies preparing consolidated accounts for accounting purposes must file separate tax returns in order to be taxed on its profits on a stand-alone basis.

### Thin capitalisation

Where loans from related foreign corporations exceed twice the corresponding equity in the borrowing Mozambican corporation, the interest on the excess borrowing is not tax-deductible. Thin capitalisation rules are in force.

According to the Mozambican thin capitalisation rules, subsidiaries are considered and treated as thinly capitalised companies if and to the extent that, as at any date of the tax period, any of their relevant debt to equity ratios exceeds a factor of two.

'Relevant debt to equity ratio', within the context of the law, means the ratio between, on one hand, the amount of direct and indirect indebtedness of a Mozambican company towards a specially related non-resident, and on the other, the amount of equity that this non-resident holds in the Mozambican company.

A 'specially related non-resident', for these purposes, is an entity with special links with another, which includes any entity that:

- holds, either directly or indirectly, at least 25% of the share capital of the Mozambican company
- though holding less than 25%, has a significant influence on its management, or
- both taxpayer and non-resident entity are under control of the same entity, which has participation in their share capital, either directly or indirectly.

Under any of these circumstances, interest paid to such specially related non-residents is not allowed as a tax deductible cost for the Mozambican company in the part that corresponds to the excessive indebtedness, unless the company can prove that it could have obtained the same level of indebtedness at comparable conditions from unrelated parties, taking into account the nature of its business, its sector of activity, dimension, and other relevant criteria.

## Tax credits and incentives

### Inbound investment incentives

In addition to the guarantees of ownership and remittance of funds abroad, the Mozambican government also guarantees the concession of tax and customs incentives. The incentives vary depending on whether a company is starting a new venture or rehabilitating one and also on the nature of the project to be developed. The incentives discussed in this section are the generic benefits applicable to standard projects. Certain specific benefits also may be applicable depending on the activities of the industry for the investment project (e.g. agriculture, tourism, science and technology).

### *Exemption from import duties*
An exemption from customs duties and VAT applies upon the importation of capital equipment, listed in Section K of the Customs Tariff Schedule.

### *Tax credit for investment*
Investments in new fixed tangible assets used in the operations of an enterprise within the Mozambican territory may benefit from an investment tax credit equal to 5% of the total investment realised, for a period of five years. This investment tax credit is offset against CIT, up to the total amount of the tax assessment. This incentive does not apply when the investment in tangible fixed assets is with respect to the construction, acquisition, restoration, or extension of buildings, passenger vehicles, furnishings, and articles of comfort and decoration, leisure equipment, advanced technology, or other assets not directly associated with the production activity carried out by the enterprise. When the project is located outside Maputo City, this tax credit is increased to 10%.

### *Advanced technology incentive*
The amount invested in specialised equipment classified as advanced technology, during the first five years from the date of commencement of activity, may be deducted from taxable income for purposes of calculating CIT, up to a maximum of 10% of taxable income.

### *Professional training incentive*
Investment expenditures for professional training of Mozambican workers shall, up to a maximum amount of 5% of the taxable income (10% in case of professional training related to new/high technology equipment), be deductible from taxable income for the purposes of calculating CIT during the first five years from the date of the commencement of such activities.



### *Exploration incentives*
During a period of five years counting from the date of exploration (i.e. the date the implementing company starts the activities approved under the investment project terms of authorization), the following expenditure may be treated as deductible expenditures for purposes of calculating CIT:

- In the case of undertakings carried out in the City of Maputo, 110% of the value of expenditures for the construction and rehabilitation of roads, railways, airports, telecommunications, water supply, electric energy, and other works of public utility is deductible for tax purposes.
- In the case of undertakings carried out in the rest of the Provinces, an amount equal to 120% of the expenditures referred to in the paragraph above is deductible for tax purposes.
- In the case of expenditures for the acquisition for personal ownership of works of art and other objects that are representative of Mozambican culture, as well as activities that contribute to the development of such works, 50% of the expenditures are deductible for tax purposes.

## *Withholding taxes*

Any non-resident entity carrying out economic activities in Mozambique, without being registered as a taxpayer, is liable to a final and definitive 20% withholding tax (WHT) that is applied on all income earned. An exception exists for telecommunications and international transport as well as the respective installation and assembly of equipment made by those same entities, which are subject to a 10% WHT rate.

Both Mozambican resident and non-resident recipients are liable to tax on dividends at a tax rate of 20%.

### Tax treaties

Mozambique has double tax treaties (DTT) in force with Portugal, Mauritius, Italy, the United Arab Emirates, South Africa, and Macau. In accordance with these DTTs, the following tax rates will be applicable to dividends, royalties, and interest:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Capital gains on shares (%) |
|---|---|---|---|---|
| Dubai | 0 | 0 | 5 | 0 |
| Italy | 15 | 10 | 10 | 0 |
| Macau | 10 | 10 | 10 | 0 |
| Mauritius | 8/10/15 (1, 2, 3) | 8 | 5 | 0 |
| Portugal | 15 | 10 | 10 | 10 |
| South Africa | 8/15 (1, 3) | 8 | 5 | 0 |

Notes

1. The 8% rate applies if the recipient of the dividends is a company which has more than 25% of the share capital in the company that distributes the dividends.
2. The 10% rate applies if the recipient of the dividends is a company which has less than 25% of the share capital in the company that distributes the dividends.
3. The 15% rate applies in all other cases.

## Tax administration

### Returns

The tax year is, as a general rule, the calendar year. A different tax year may be applied (if previously authorised by the Ministry of Finance) for companies that carry out activities that justify a different year or non-resident companies with a PE in Mozambique.

CIT assessment must be prepared by the companies on annual returns, based on the accounting records and on adjustments prescribed by the tax regulations.

The submission of the annual tax return is due by the last working day of May for companies using the calendar year as their tax year. For companies with a tax year that is not coincident with the calendar year, the presentation of the tax return is due by the last day of the fifth month subsequent to the respective year-end.

### Payments

Mozambican companies and non-resident companies with a PE in Mozambique must pay CIT in one of the two following ways:

- In three advance payments (based on 80% of the preceding tax year's CIT), due in May, July, and September of the respective tax year; or if the tax year chosen is not coincident with the calendar year, on the fifth, seventh, and ninth months of the respective tax year.
- In three special advance payments (based on 0.5% of the preceding year's turnover less the advance payments made in previous years, which cannot be less than MZN 30,000 or more than MZN 100,000) due in June, August, and October of the respective tax year; or if the tax year chosen is not coincident with the calendar year, on the sixth, eighth, and tenth months of the respective year.

# *Namibia, Republic of*

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## *Significant developments*

Namibia's Minister of Finance Mrs. Saara Kuugongelwa-Amadhila presented her 9th budget to the National Assembly on 9 March 2011.

The Minister announced no tax changes in her speech, apart from excise duties. She indicated that tax law amendments will be tabled during the course of the year.

In the budget speech, Mrs. Kuugongelwa-Amadhila said the government is currently undertaking tax policy reviews, including a review of tax administration, 'with the view to optimise revenue collection with emphasis on finding alternative sources of revenue'. She also said the process to introduce an environmental tax, based on the 'polluter pays principle', has advanced.

The excise duty increased as previously announced by the SA Minister of Finance. The increased duties took effect midnight, 23 February 2011.

### *Integrated tax system*

The Ministry of Finance is engaged in a process to improve the administration of taxes. As part of the process, technical assistance was sought. The information technology system used to support tax administration is being upgraded in order to develop a fully integrated tax administration system. Once completed, the system is expected to simplify tax administration, improve services to the taxpayer, and also improve compliance and collections.



## *Taxes on corporate income*

Namibia has a source-based tax system, which means that income from a source within Namibia or deemed to be within Namibia will be subject to tax in Namibia, unless a specific exemption is available.

Income earned by foreign companies from a source within or deemed to be within Namibia will be subject to tax in Namibia. In such cases, the foreign entity must determine whether it is obliged to register a local entity or branch. A company is required to register a branch if it has established a place of business in Namibia. A local subsidiary company may be registered as an alternative to a branch.

In the event that Namibia has entered into a double tax agreement with the country where the foreign company resides, such entity will only be taxable in Namibia if it has established a permanent establishment (PE) in Namibia. If a PE exists, only the portion of income attributable to the PE will be subject to tax in Namibia.

Non-residents who do not have a place of business in Namibia may, however, be subject to withholding tax. *See the Withholding taxes section for additional details.*

No capital gains tax is payable in Namibia.

## *Calculation of taxable income*

| | |
|---|---|
| Gross income | The total amount, in cash or otherwise, received by or accrued to any person from a source within, or deemed to be within, Namibia, excluding receipts of a capital nature (provisions for specific inclusions in gross income and amounts deemed to be from a Namibian source exist). |
| Less: Exemptions | The Act provides for certain amounts to be specifically exempt from tax. |
| Equals: Income | |
| Less: Deductions | Expenditures and losses actually incurred to generate income may be deducted, provided that these expenses are not of a capital nature. |
| | The Act specifically provides for certain expenditures to be deductible and allows a deduction for capital allowances. |
| | Only expenses incurred to generate 'income' may be deducted. Expenses incurred to generate income exempt from tax are not deductible. Apportionment should be considered when expenses are incurred to generate both income and exempt income. |
| Equals: Taxable income | Taxable income is taxed at the corporate tax rate as set out under the tax rate section below. |

## *Tax rates*

The corporate tax rates are summarised below:

| Entity | Current tax rate (%) |
|---|---|
| Domestic companies and close corporations (excluding entities mentioned below) | 34 |
| Branches of foreign companies | 34 |
| Registered manufacturers (only applicable for the first ten years of registration) | 18 |
| Diamond mining companies and companies that render services to such companies in connection with diamond mining | 55 |
| Mining companies (other than diamond mining companies) and companies that render services to such companies in connection with mining | 37.5 |
| Long-term insurers (the rate is applied to gross investment income) | 13.6 |
| Petroleum income tax rate | 35 |

## *Treaty relief*

Namibia has entered into double tax agreements with the following countries:

- Botswana
- France
- Germany
- India
- Malaysia
- Mauritius
- Romania
- Russian Federation
- South Africa

- Sweden
- United Kingdom

## *Corporate residence*

The Namibian tax system is based on source and not on residency. Income derived or deemed to be derived from sources within Namibia are subject to tax.

The source is determined as the place where income originates or is earned, not the place of payment. If goods are sold pursuant to a contract entered into within Namibia, the source of income is deemed to arise in Namibia, regardless of the place of delivery or transfer of title.

Certain types of income arising outside Namibia may, in the hands of a domestic company, be deemed to arise in Namibia and be taxed as such. Examples are interest and certain copyright royalties arising outside Namibia.

### *Permanent establishment (PE)*

A PE includes, in most cases, a fixed place of business. The establishment of a local entity or branch will usually create a PE, although the provisions of the related tax treaty should be considered.

Except for the PE concept embodied in the tax treaties, corporate residence is of little tax significance.

## *Other taxes*



### *Value-added tax (VAT)*

VAT is a transaction tax, and the implications will vary for different transactions. Some transactions are taxed at a rate of 15% or 0% while other transactions are exempt from VAT. Input tax deductions may be claimed, subject to certain provisions.

VAT is levied on every taxable supply by a registered person. A taxable supply means any supply of goods or services in the course or furtherance of a taxable activity. A taxable activity means any activity that is carried on continuously or regularly in Namibia which involves the supply of goods or services for consideration.

VAT is payable on all imports for home consumption in Namibia, subject to certain exemptions (e.g. in terms of a technical assistance agreement, donations to the State, goods of which the local supply is zero-rated).

Import VAT is payable on the greater of the free on board (FOB) value plus 10%, or the market value. The payment may be deferred in terms of an import VAT account registered with the Directorate of Inland Revenue to the twentieth day of the month following the month of importation. Penalties of 10% per month or part of a month and 20% interest on outstanding import VAT, according to the Customs Asycuda reports on import VAT account numbers, are levied by the Directorate of Inland Revenue.

A company/branch is required to register for VAT if it supplies goods or services on a regular basis for consideration and if its taxable supplies (standard rated and zero-rated supplies) exceed 200,000 Namibian dollars (NAD) in any 12-month period.

A registered VAT vendor is entitled to deduct input tax credits paid in the course of taxable supplies made to such person, provided that a tax invoice is available to support the input tax deduction. It is also important to take note of deemed input tax deductions and prohibited input deductions. Import VAT paid may be deducted only as input tax if the import was in furtherance of a taxable activity and the required documentation (e.g. stamped customs entries) is held by the importer.

### *Customs and excise duties*
Namibia is a member of the Southern African Customs Union (SACU), and customs duties are not levied on intra SACU trade (i.e. between Botswana, Lesotho, Namibia, South Africa, and Swaziland).

Customs duties are payable according to the Common Customs Tariff of SACU on imports from outside SACU. Preferential duty rates apply on imports from Southern African Development Community (SADC) countries, while goods may be imported free of customs duties from Zimbabwe in terms of the Namibia-Zimbabwe Free Trade Agreement.

Excise duties are levied on local production of excisable products (e.g. cigarettes, liquor, fuel) and are included on most excisable products imported from another SACU country in terms of the duty at source procedures. Identical excise duty rates are applied throughout the SACU. Importation of excisable products from outside the SACU is subject to customs duties and specific customs duties. *Ad valorem* duties are levied on certain products (e.g. motor vehicles, perfumes) in addition to the normal customs duties.

Fuel levies are payable on petrol, diesel, and illuminating kerosene and may be claimed back for certain non-road operations (e.g. mining, farming, and construction).

Surety in the form of a provisional payment, bank, or insurance guarantee is required by Customs on all temporary importations to cover import VAT and customs duties (if applicable).

It is possible to import goods that are subject to customs duties into registered Customs' bonded warehouses, where goods are kept for later use. In this case, the payment of duties may be deferred until the goods are taken out of the bonded warehouse for home consumption or acquitted if the goods are subsequently exported.

### *Annual duty*
Annual duty is levied in terms of the Companies Act at an amount of NAD 4.00 for every NAD 10,000 (or part thereof) of the issued share capital of a company, with a minimum duty of NAD 80.00 per annum. Issued share capital includes ordinary shares, share premium, and preference shares.

Since a branch does not issue share capital, the issued share capital of the head office will be used to calculate the annual duty payable in Namibia.

### *Stamp duty*
Certain transactions may attract stamp duty. The amount of stamp duty payable differs and is based on the nature of every individual transaction.

The basic transactions can be summarised as follows:

| Transaction | Stamp duty |
|---|---|
| Agreements or contracts (other than those where duty is specifically provided for in the Act) | NAD 5 |
| Lease agreement or lease | The stamp duty will be based on lease payments, together with additional considerations specified in the lease agreement |
| Transfer or issue of marketable securities and other share transactions | Between NAD 2 and NAD 5 for every NAD 1,000 or part thereof of the value/consideration, depending on the specific transaction |

### *Transfer duty*
Transfer duty is payable at 12% of the acquisition value of real property acquired. While it is normally payable by the buyer, the agreement for the sale of the property may determine the person liable to pay these costs.

## *Branch income*

Branch income that is received or accrued from a source within, or deemed to be within, Namibia is taxable in Namibia based on the normal corporate tax rules.

A branch is regarded as an extension of its foreign head office. A branch may, therefore, not deduct fees paid to its foreign head office (unless a tax treaty provides for such a deduction), as it is argued that a branch cannot transact with itself. Reimbursement of actual expenses may, however, be deducted, subject to the normal deduction rules.

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Transfer pricing rules apply between a branch and its foreign head office or other cross-border related parties.

## *Income determination*

### *Inventory valuation*
Inventory is valued at cost for tax purposes in Namibia.

### *Capital gains*
No capital gains tax is payable in Namibia.

### *Dividend income*
Dividends received from sources within Namibia or outside Namibia are included in the gross income of the taxpayer. Where non-resident shareholders tax (NRST) is payable, however, dividends are exempt in terms of the Income Tax Act. *For more information about NRST, see the Withholding taxes section.*

### *Interest income*
Namibian companies are taxed on interest received from a Namibian source. Persons other than a Namibian company, however, are subject to a WHT. *For more information, see the Withholding taxes section.*

### Partnership income

The relevant partners of a partnership are regarded as the responsible taxpayers and not the partnership itself.

In practice, the assessment of a partnership is treated like that of a private business. The partnership is first treated as a business entity on its own in terms of income and expenditure. The profit or loss at the end of the year is then allocated to the individual partners. If they derived a profit from the partnership, it is added to their other non-partnership income; or if the partnership made a loss, the partners have the right to deduct it from their non-partnership income.

### Rent/royalties income

Companies are taxed on rent and royalty income received from a Namibian source.

### Foreign income

Corporate tax in Namibia is determined on the source basis, therefore, only income from a Namibian source or deemed Namibian source is subject to corporate tax.

## Deductions

### Capital allowances

The cost (including finance charges) of machinery, equipment, and other articles used by the taxpayer to generate income is deductible in three equal annual allowances. No apportionment is required where an asset is held for less than 12 months.

Buildings used by the taxpayer to generate income qualify for an initial allowance of 20% of erection costs in the year they are first brought into use. Thereafter, an annual allowance of 4% is deductible for each year following the year of erection. Additions to existing buildings (not alterations or repairs) qualify for the same 20% and 4% deductions. Note that the allowance is calculated on the cost of erection and not the cost of acquisition. The allowance is also only calculated for a period of 21 years from the date of erection.

Mining exploration expenditures incurred before commencement of production are deductible in full in the first year that income is generated from the mine. Subsequent developmental expenditures are written off in three equal annual allowances.

Capital allowances may also be deducted with respect to patents, trademarks, leasehold improvements, etc.

A recovery or recapture of allowances previously claimed should be included in the gross income of a taxpayer in the event that the allowance is recovered or recaptured by way of disposal, withdrawal from trade for non-trade purposes, or removal from Namibia. The recapture is calculated at the market value of the asset.

### Net operating losses

Assessed tax losses may be carried forward indefinitely provided the company continues to trade. Tax laws do not allow losses to be transferred to other members of a group, and anti-avoidance provisions may be triggered by transactions designed to transfer or exploit assessed losses.

If a company ceases to trade for a full fiscal year, its assessed losses are forfeited, regardless of subsequent activities. Assessed losses are also reduced in the event of a compromise agreement with creditors.

## Group taxation

No taxation of combined operations is allowed in Namibia where operations are conducted by more than one company.

### Transfer pricing

Namibia introduced transfer pricing legislation on 14 May 2005. The legislation was aimed at enforcing the arm's-length principle in cross-border transactions carried out between connected persons. On 5 September 2006, the Directorate of Inland Revenue issued Income Tax Practice Note 2 of 2006 that contains guidance on the application of the transfer pricing legislation. The Practice Note is based on guidance set out by the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for multinational enterprises and tax administrations.

The objective of this Practice Note is to provide taxpayers with guidelines regarding the procedures to be followed in the determination of arm's length prices, taking into account the Namibian business environment. It also sets out the Minister of Finance's views on documentation and other practical issues that are relevant in setting and reviewing transfer pricing in international agreements.

Transfer pricing legislation is essentially aimed at ensuring that cross-border transactions between companies operating in a multinational group are fairly priced and that profits are not stripped out of Namibia and taxed in lower tax jurisdictions. The legislation achieves this by giving the Minister of Finance (who essentially delegates to the Directorate of Inland Revenue) the power to adjust any non-market related prices charged or paid by Namibian entities in cross-border transactions with related parties to arm's length prices and to tax the Namibian entity as if the transactions had been carried out at market-related prices.



In terms of the normal penalty provisions of the Income Tax Act, the Directorate of Inland Revenue may levy penalties of up to 200% on any amount of underpaid tax. Consequently, the Inland Revenue may invoke such provisions in the event that a taxpayer's taxable income is understated as a result of prices that were charged in affected transactions, which were not carried out at arm's length. Further, interest will be charged on the unpaid amounts at 20% per annum.

### Thin capitalisation

The Minister may, if any amount of financial assistance provided by a foreign connected person is excessive in relation to a company's fixed capital (being share capital, share premium, accumulated profits, whether capital or not), disallow the deduction for income tax purposes of any interest or other charges payable by the Namibian person on the 'excessive portion' of the financial assistance provided by the foreigner.

There is no guidance that provides a definition for 'excessive'. Therefore, each case should be considered on the basis of the facts provided. The 3:1 ratio is applied by the Bank of Namibia for exchange control purposes and this guideline is therefore deemed suitable, until otherwise determined by Inland Revenue.

## *Tax credits and incentives*

### *Manufacturing*

The following is a high-level comparison of the different tax treatments for companies and registered manufacturing companies. This table does not consider the specific conditions that should be met in order for these incentives to be utilised.

| Tax benefit | Tax treatment for normal taxpayers | Tax incentive for manufacturers |
|---|---|---|
| Building allowance<br>A building allowance is deductible with respect to buildings used for purposes of trade. | The allowance is calculated as 20% of the cost of construction in the year in which the building enters service and 4% during the 20 years that follow the year of construction. | The allowance is calculated as 20% of the cost of construction in the year in which the building enters service and 8% during the ten years that follow the year of construction. |
| Employee allowances | Expenditures for remuneration and training of employees are deductible for tax purposes. | An additional allowance of 25% of remuneration and training of employees that are directly engaged in the manufacturing process are deductible. |
| Export expenditure allowance | Export expenditures incurred are deductible for tax purposes. | An additional allowance of 25% of costs incurred in an export country, in order to export Namibian manufactured goods to such country, may be deducted. |
| Export allowance<br>Any taxpayer that derives income from the export of manufactured goods, excluding meat or fish, may deduct an export allowance equal to 80% of the taxable income derived from the export of manufactured goods. | Gross profit derived from the export of manufactured goods as a percentage of total gross profit should be used to determine the percentage of taxable income that is used to calculate the export allowance. | |
| Transport allowance | Land-based transport costs (i.e. transport by road or rail) are deductible for tax purposes. | An additional allowance of 25% of land based transport cost in respect of material and components used in the manufacturing process or equipment imported for direct use in the manufacturing process may be deducted. |
| Preferential tax rate | The normal tax rate for companies other than mining companies or registered manufacturers is 34%. | The tax rate for a registered manufacturer for taxable income with respect to the manufacturing activity for which they are registered is 18%. This preferential rate is applicable for a period of ten years from registration as a manufacturer. |

Note that only the building allowance and preferential tax rate (as set out above) may create or increase a tax loss.

### Export Processing Zones (EPZ)

In order to become an export processing zone company, a particular entity must register with the EPZ governing body and obtain approval from Inland Revenue.

An EPZ company qualifies for the following benefits:

- The company is exempt from corporate tax.
- No VAT is payable on the sale of goods or services rendered in a zone.
- No VAT is payable on goods imported or manufactured in the zone.
- No customs or excise duty is payable on goods imported into the zone.
- No stamp duty or transfer duty is payable in relation to the transfer of movable or immovable property in a zone.
- A 75% refund of expenditures incurred in training Namibian citizens.
- Some of the provisions in the Labour Relations Act do not apply in a zone.

Enterprises must comply with the following requirements in order to qualify for EPZ status:

- Goods must be exported to countries other than countries in the SACU.
- Industrial employment must be created or increased.
- Namibia's export earnings must be increased as a result of manufactured goods exported.

EPZ companies may not be involved in retail business operations.

## Withholding taxes



Withholding taxes (WHT) are applicable where dividends and royalties or similar payments are declared or distributed to non-Namibian residents.

### Dividends

Dividends declared by a Namibian company to a non-resident holding company are subject to non-resident shareholders tax (NRST), a WHT. NRST is payable at a rate of 10% unless treaty relief is available. NRST is payable within 30 days after declaration of a dividend.

### Royalties or similar payments

WHT on royalties are payable when a Namibian company pays a royalty to a non-resident. WHT is levied at a rate of 10.2% (30% of the corporate tax rate of 34%) and is payable within 14 days after the end of the month during which the liability for payment is incurred.

A royalty includes payment for the use or right to use any patent or design, trademark, copyright, model, pattern, plan, formula or process or any other property or right of a similar nature. A royalty also includes the imparting of any scientific, technical, industrial, or commercial knowledge or information for use in Namibia. The nature of fees payable should therefore be carefully considered in order to determine whether the relevant amount represents a royalty.

### Interest

A WHT of 10%, calculated on the gross amount of interest, is payable on interest accruing to any person, other than a Namibian company, from a registered Namibian banking institution or unit trust scheme. The tax withheld is a final tax, and the financial institution is responsible to withhold the tax.

Namibian companies, however, are taxed on interest at the corporate tax rate.

It is the obligation of the financial institution to withhold the tax and pay such tax to the revenue authorities.

### *Summary of WHT payable*

The WHT rates and treaty relief for Namibian double tax agreements can be summarised as follows. Note that the tax treaties contain certain requirements that should be met before the reduced tax rate may be applied.

The definitions of dividends, royalties, and interest in the various treaties should also be considered.

| Recipient | Dividends (%) | Royalties (%) | Interest (%) |
|---|---|---|---|
| Non-treaty | 10 | 10.2 | 10* |
| Botswana | 10 | 10 | 10 |
| France | 5 | 10 | 10 |
| Germany | 10 | 10 | 0 |
| India | 10 | 10 | 10 |
| Malaysia | 5 | 5 | 10 |
| Mauritius | 5 | 5 | 10 |
| Romania | N/A | 5 | 10 |
| Russian Federation | 5 | 5 | 10 |
| South Africa | 5 | 10 | 10 |
| Sweden | 5 | 5 | 10 |
| United Kingdom | 5 | 5 | N/A |

* Namibian companies are taxed at the corporate tax rate on interest received

'N/A' means that the provisions of the tax treaty limited the rate to a rate that is higher than the local Namibian rate. It should be noted that a treaty may only provide tax relief and cannot impose a higher tax rate

### *Mining royalties*

The Minerals (Prospecting and Mining) Act levies a royalty on minerals won or mined by a licence holder in Namibia, based on the table below:

| Group of minerals | Percentage of market value of minerals leviable as a royalty (%) |
|---|---|
| Precious metals | 3 |
| Base and rare metals | 3 |
| Semi-precious stones | 2 |
| Nuclear fuel minerals | 3* |
| Industrial minerals | 2 |
| Non-nuclear fuel minerals | 2 |

* Applicable to all licence holders on nuclear fuel minerals, except Rössing Uranium Mine Ltd where a 6% royalty is applicable

## *Tax administration*

The due date for filing of returns can be summarised as follows:

| Return | Due date |
|---|---|
| Income tax return | Within seven months after the financial year-end of the company. |
| Provisional tax return – first payment | Within six months from the commencement of the respective tax year. |
| Provisional tax return – second payment | On/before the last day of the respective tax year. |
| Provisional tax return – top-up payment | Within seven months after the financial year-end of the company. |
| Employees' tax return (PAYE return) | Within 20 days following the month to which the PAYE relates. |
| PAYE reconciliation return | Within 30 days from the tax year-end for individuals (i.e. 30 March each year). |
| VAT return | Within 25 days following the month to which the VAT relates. |
| Import VAT | Within 20 days following the month to which the VAT relates. |
| WHT on dividends | Within 30 days after declaration of the dividend. |
| WHT on royalties or similar payments | Within 14 days after the end of the month during which the liability for payment of the royalty was incurred. |

### *Penalties and interest*

The penalties and interest due for late submissions and payments can be summarised as follows:

| Tax area | Reason | Penalty (%) | Interest (%) |
|---|---|---:|---:|
| 1st provisional tax | Late submission | None | None |
| | Late payment | 10 | 20 |
| 2nd provisional tax | Late submission | 20 | 20 |
| | Late payment | 10 | 20 |
| | Under-estimation | 20 | 20 |
| Income tax return | Late submission | 10 | 20 |
| | Late payment | None | 20 |
| | Omission/incorrect statement | Up to 200 | 20 |
| WHT | Late payment | 10 | 20 |
| VAT & Import VAT | Late submission | NAD 100 per day | 20 |
| | Late payment | 10 | 20 |

### *Anti-avoidance*

Note that the Income Tax Act, Act 24 of 1981, contains an anti-avoidance section, Section 95, which enables the Receiver of Revenue to disregard the implications of a transaction or scheme if it can be proven that:

- such transaction or scheme had been entered into to avoid or postpone the payment of any duty or levy imposed by the Act
- such transaction or scheme was entered into or carried out by means or in a manner that would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question, or has created rights or obligations that would not normally be

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created between persons dealing at arm's length under a transaction, operation or scheme of nature of the transaction, operation or scheme in question, and
- such transaction or scheme was entered into or carried out solely or mainly for the purposes of the avoidance or the postponement of liability for the payment of any tax duty or levy.

The Receiver of Revenue can, at its sole discretion, impose Section 95 on any transaction or scheme, which will place the onus on the taxpayer to prove that any/all of the requirements noted above will not be applicable to the transaction or scheme.

# The Netherlands

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## Significant developments

One of the most important aspects of the 2011 Dutch Tax Package was a further reduction of the standard corporate income tax (CIT) rate to 25% as of 1 January 2011. Furthermore, several important temporary tax reliefs that were introduced in previous years are now extended to also apply to 2011.

The Ministry of Finance announced its latest plans to amend the Corporate Income Tax Act on several occasions during the last few years. Recently, on 14 April 2011, the Fiscal Agenda was published with the tax plans of the State Secretary of Finance. With regard to corporate taxes, the most relevant plans include a broadening of the CIT base by dealing with the interest deduction regime for takeover companies and the import of losses of foreign permanent establishments (PEs). If these measures are proposed in the autumn of 2011, they could lead to a lowering of the main CIT rate from 25% to 24% and could take effect as of 1 January 2012. Furthermore, an amendment of the tax treatment of interest for participations will be considered.



The 2010 Tax Package already provided for an important liberalisation of the participation exemption regime in CIT and a further expansion of the patent box (now 'innovation box') as of 1 January 2010.

Since 2008, the government has taken several measures, including tax measures, in order to deal with the consequences caused by the worldwide economic crisis. New temporary provisions provide for accelerated depreciation of up to 50% a year of the value of qualifying assets bought and investments made in 2009, 2010, and 2011, under certain conditions. Furthermore, for the years 2009, 2010, and 2011, the first CIT bracket has been extended substantially. Finally, corporate taxpayers may opt for a temporary extension of the carryback period of losses.

The Netherlands pursue an active tax treaty policy in order to maintain and extend its wide tax treaty network. With respect to the avoidance of double taxation on income and capital, the Netherlands has concluded bilateral tax treaties with about 90 other countries worldwide. In 2010, the tax treaties with Azerbaijan, Bahrain, and Qatar came into force. In 2011, the new (or revised) tax treaties with the United Kingdom, the United Arab Emirates, Saudi Arabia, and Slovakia have taken effect.

Please note this information is current as of 1 June 2011. Typically, pending legislation is announced in September. Please visit the Worldwide Tax Summaries website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

# The Netherlands

## *Taxes on corporate income*

In general, a Dutch resident company is subject to CIT on its total worldwide income. However, certain income can be exempted or excluded from the tax base. Non-resident entities only have a limited tax liability with regard to income from Dutch sources.

### *Standard corporate income tax (CIT) rate*

The Dutch standard CIT rate has been reduced significantly over the past years. As of 1 January 2011, the standard CIT rate is 25% (25.5% prior to 1 January 2011). There are two taxable income brackets. A lower rate of 20% applies to the first income bracket, for taxable income up to 200,000 euros (EUR).

Prior to 2011, the standard CIT rate was 25.5% (for the years 2007 to 2010), 29.6% (2006), and 31.5% (2005). In 2010, 2009, and 2008 there were two taxable income brackets, with a lower rate of 20% applicable to the first bracket. The upper limit of the first bracket was EUR 200,000 (2009 and 2010), and EUR 275,000 (2008). In 2007, there were three tax brackets. Profits in the first bracket (up to EUR 25,000) were taxable at a 20% rate and in the second bracket (between EUR 25,000 and EUR 60,000) at a rate of 23.5%. Taxable income above EUR 60,000 was taxed at the standard rate of 25.5%.

### *Fiscal investment fund regime*

In general terms, under the existing fiscal investment fund regime, the CIT rate for fiscal investment funds is 0%, provided that their profit is made available to the shareholders and holders of certificates of participation no later than eight months after year end.

Since 2007, fiscal investment funds may also invest in real estate development (or redevelopment) activities, provided that these activities take place through a subsidiary subject to Dutch CIT and the development (or redevelopment) activities are exercised for the benefit of real estate that is (or will be) forming part of the fund's own portfolio, an affiliated fiscal investment fund's portfolio, the portfolio of a company in which the fund or the affiliated fund has a substantial interest, or for the benefit of the subsidiary's own portfolio.

### *Exempt investment fund regime*

The exempt investment fund regime exists next to the fiscal investment fund regime described above. In accordance with the exempt investment fund regime, investment funds as defined in the Dutch Financial Supervision Act ('Wet op het financieel toezicht') that meet certain conditions can request an exemption from CIT. Apart from the exempt status for CIT purposes, the exempt investment fund is not obliged to withhold dividend withholding tax (WHT) with regard to profit distributions to its shareholders.

### *Innovation box regime*

A special regime applies with respect to profits, including royalties, derived from a self-developed intangible asset (developed after 31 December 2006). In this so-called innovation box (prior to 2010 called 'patent box'), the taxpayer may opt, under certain conditions, for the application of a lower effective rate on taxable profits derived from these intangible assets. As of 1 January 2010, the effective tax rate of the innovation box is 5%. Prior to 2010, the effective tax rate was 10%.

The patent box is applicable provided that at least 30% of the profits have been originated by the patent. As of 1 January 2008, the regime has been expanded in a substantial way. Companies which have incurred certain qualified research and development (R&D) costs for the development of intellectual property for which no patent was granted are also entitled to the favourable effective tax rate. The extension of the scope is subject to the condition that these qualified R&D assets become part of the company's assets after 31 December 2007.

As of 1 January 2010, the patent box is further expanded and renamed as 'innovation box'. The effective tax rate is lowered to 5%. Furthermore, the different limits that apply to patented assets and R&D assets are cancelled, resulting in a widening of the scope of the regime and an equal treatment of all innovative activities. Prior to 2010, the low rate applied only to a maximum of four times the production costs of the patented assets (or EUR 400,000 in case of R&D assets) included in the patent box. In addition, the lower effective tax rate of 5% only applies to positive income, allowing innovation losses to be taken into account in full. Based upon a favourable decree, the latter has also been approved for innovation losses arising in 2009. As of 1 January 2011, it is also possible to include profits from an intangible asset derived in the period between the patent application and the granting of the patent in the innovation box regime (not for R&D assets).

### *Tonnage tax regime*

In order to stimulate entrepreneurs engaged in ocean shipping, a favourable regime (known as the Dutch tonnage tax regime) may be available to certain shipping companies. Under this regime, the taxable profit of a sea-going vessel is based on its registered net tonnage multiplied by a fixed amount of deemed profit per ton instead of the actual profits from the exploitation. The regime only applies to the calculation of the profit related to the qualifying shipping activities. These activities include operating vessels in international traffic (including transportation for the purpose of the exploitation of natural resources at sea), cable and pipe-laying activities at the bottom of the sea, and towing and dredging and connected activities. The profits from the qualifying activities are taxed at a deemed tonnage profit according to a five bracket regressive scale system. The tonnage tax regime applies upon request and for a fixed period of ten years or multiples of the ten-year period.



### *Provincial/municipal income taxes*

There are no provincial or municipal corporate income taxes in the Netherlands.

## *Corporate residence*

In the Netherlands, corporate residence is determined by each corporation's circumstances. Management and control are important factors in this respect. Companies incorporated under Dutch law are deemed to be residents of the Netherlands (although not with respect to certain provisions, such as the participation exemption and fiscal unity).

## *Other taxes*

### *Value-added tax (VAT)*

VAT, known in Dutch as the Belasting over de Toegevoegde Waarde or BTW, is payable on sales of goods and on services rendered in the Netherlands as well as on the importation of goods and on the 'intra-European' acquisition of goods. There are three VAT rates, which are 19%, 6%, and 0%.

The main VAT rate remains at 19%.

The reduced 6% VAT rate is applicable on certain prime necessities (and also on certain energy-saving insulation activities on houses).

The special 0% VAT rate is applicable mainly to intra-European Union (EU) supplies, exports, imports stored in bonded warehouses, services rendered in connection with the above, and certain other services.

The following are exempt from VAT:

- The supply of immovable property two years after putting it into use and lease. However, if the lessee's use of the immovable property is 90% or more for input VAT-deductible purposes, the lessor and lessee may opt to be subject to VAT on rent, in which case the lessor may deduct the VAT charged in respect of the property.
- Medical, cultural, social, and educational services.
- Services provided by banks and other financial institutions in connection with payment transactions and the granting of credit facilities.
- Insurance transactions.
- Transactions in shares.

### *Capital tax*
The Netherlands do not levy capital tax on capital transactions (e.g. issue or increase capital). The capital tax has been abolished since 1 January 2006.

### *Stamp duty*
There are no stamp duties in the Netherlands.

### *Transfer tax on immovable property*
Acquisition of economic or legal ownership of immovable property in the Netherlands is subject to a 6% transfer tax on market value. Some exemptions are available.

### *Transfer tax on acquisition of shares in a real estate entity*
The acquisition of shares in an entity that owns real estate may also be subject to transfer tax, if that entity is characterised as a so-called real estate entity. The threshold for qualifying as a real estate entity has been lowered as of 1 January 2011. In short, the threshold is met if more than 50% of the assets of the entity consist of real estate and at least 30% of Dutch immovable property. Prior to 2011, the threshold was met if more than 70% of the assets consisted of Dutch real estate.

### *Insurance tax*
An insurance tax of 9.7% is payable on insurance premiums if the insured is a resident of the Netherlands or if the insured object is in the Netherlands. Several exemptions are available.

### *Immovable property tax*
Municipalities impose an annual immovable property tax on the owners of immovable property. The rates depend on the municipality. The taxable basis is the market value of the immovable property. Please note that the (assessment of the) value is also of importance for CIT, as depreciation might be limited based on this *value (see Limited depreciation of immovable property in the Deductions section)*.

### *Customs and excise tax*
Many goods imported to the Netherlands from outside the European Union are subject to customs and excise duties. The tariffs and rates that apply to the different goods vary widely and change regularly.

An excise tax is levied on certain consumer goods (e.g. cigarettes, cigars, mineral oils, alcoholic products). If the goods are used solely as raw materials, no excise tax is levied. The excise tax is refundable if the article is exported.

### *Environmental charges on packaging*

Producers or importers have to pay taxes on packaging. The tariff depends on the type and method of packaging. An exemption is granted to companies that bring less than 50,000 kilograms of packaging materials a year on the market. A refund of the packaging tax for indirect export also is available to foreign entrepreneurs.

## *Branch income*

Rates for branch profits are the same as for other corporate profits, but no tax is withheld on transfers of profits to the head office. The tax base is, in principle, calculated on the same rules as for Dutch-resident companies.

## *Income determination*

### *Inventory valuation*

In general, stock/inventory is stated at the lower of cost or market value. Cost may be determined on the basis of first in first out (FIFO), last in first out (LIFO), base stock, or average cost. The LIFO system may be used for commercial/financial and tax purposes.

There is no requirement of conformity between commercial/financial and tax reporting.

### *Capital gains*

Capital gains are taxed as ordinary income. However, capital gains realised on disposal of shares qualifying for the participation exemption are tax exempt *(see Dividend income below)*.

The gain on disposal of depreciable assets may be carried over to a special tax deferral reinvestment reserve but must then be deducted from the acquisition cost of the later acquired assets. Except in special circumstances, the reserve cannot be maintained for more than three consecutive years. If the reserve has not been fully applied after three years, the remainder will be liable to taxation.

Capital losses are deductible, unless attributable to the disposal of a shareholding qualifying for the participation exemption.

### *Dividend income*

Subject to meeting the conditions for the participation exemption, a Dutch company or branch of a foreign company is exempt from Dutch tax on all benefits connected with a qualifying shareholding, including cash dividends, dividends in kind, bonus shares, hidden profit distributions, and capital gains.

#### Participation exemption

In general, the participation exemption will apply to a shareholding in a Dutch company, if the holding is at least 5% of the investee's capital. When the shareholder's interest is a portfolio investment in a company that is not subject to a tax rate that is considered adequate (meaning subject to a profit tax that equals at least an effective tax rate of 10% over a taxable base according to Dutch tax standards), the exemption cannot be applied.

Whether or not a shareholder's interest in a company is a portfolio investment is determined solely by the assets of that company (participation exemption regime 2007-2009). If the company's assets consist predominantly (more than 50%) of portfolio investments, the interest in the company is considered a passive participation. A distinction in this respect is made between portfolio investments held by a company in its line of business and free portfolio investments. Only the presence of free portfolio investments can lead to the qualification of a portfolio investment participation. Portfolio investments held by a company in its line of business are qualified as good assets. Assets that are used for more than 50% for intra-group financing activities are deemed to be held as free portfolio investments. This applies, unless credible evidence to the contrary can be given. In that case, the participation exemption could apply. Furthermore, participations whose assets consist of at least 90% real estate (real estate participation) are not considered low taxed portfolio investment participations, which means that the participation exemption applies.

In February 2008, the Ministry of Finance issued an important decree stating, among other things, several commitments regarding the asset test, the subject-to-tax requirement and the real estate participation.

As of 1 January 2010, the participation exemption regime has been further liberalised. As a general rule, the participation exemption is applicable as long as the participation is not held as a portfolio investment. The intention of the parent company, which can be based on particular facts and circumstances, is decisive as of 1 January 2010. Regardless of the company's intention, the participation exemption also is applicable if the new sufficient tax test, which is if the income is subject to a real profit tax of at least 10%, or the revised asset test, which has been relaxed in comparison to the asset test of the participation exemption regime 2007-2009, as discussed above, is met.

For portfolio investment participations not qualifying for the participation exemption, double taxation will be avoided by applying the tax credit method, unless the portfolio investment shareholding effectively is not subject to tax at all. For EU shareholdings, it is optional to credit the actual underlying tax.

Dividends not qualifying under the participation exemption are taxable in full at the ordinary CIT rate.

Interests of 25% or more in a company of which the assets consist (nearly) exclusively of portfolio investments should be annually valued, as an asset, at the fair market value.

Costs related to the acquisition and disposal of a participation (e.g. legal fees, compensations, notary fees) are not deductible for corporate tax.

Losses arising from the liquidation of a (foreign) subsidiary are deductible for CIT, subject to certain conditions.

Profits derived from a company that was created by converting a foreign permanent establishment (PE) only qualify for the participation exemption after they exceed the losses from the PE during the previous years insofar as those losses reduced the taxable profits in the Netherlands. Under certain circumstances, such as the alienation of (part of) the shares of the company, all non-recaptured losses will be added to the profits of the Dutch parent company at once. Note that the scope of these anti-abuse provisions has been extended by including situations in which a foreign intermediate holding company is interposed.

### *Stock dividends*

Stock dividends are taxed as dividend income to the extent that they are paid out of earned surplus. They are not taxable if paid out of share premium ('agio'), provided the share premium account was not created pursuant to a share-for-share merger, in which only Dutch companies were involved. In the case of a share-for-share merger, in which shares in foreign subsidiaries were contributed to a Dutch company, the Dutch company can distribute the difference between the fair market value and the paid-in capital of the subsidiaries being contributed as a stock dividend without triggering Dutch dividend WHT (step-up in basis), provided certain requirements are met.

### *Foreign income*

In general, a Dutch resident company is subject to corporate tax on its total worldwide income. However, certain income can be exempted (e.g. due to the application of the participation exemption described above) or excluded from the tax base.

Double taxation of certain foreign-source income, including foreign branch income, is avoided by reducing Dutch tax by the ratio of foreign income (subject to a foreign income tax and/or covered by certain tax treaty provisions) to total income, the so-called exemption method. Currency exchange profits or losses on the head office's investment in its foreign branch are not considered 'foreign income' for the purposes of these relief provisions.

Unilateral relief from double taxation for income from foreign financing branches is provided by means of a credit of 17.5% of the passive financing income for foreign taxes deemed paid or the foreign tax actually paid. However, the exemption method will apply only if the taxpayer can demonstrate that the foreign branch is actively engaged in intra-group financing activities.



Double taxation of foreign dividends, interest, and royalties is relieved by a tax credit provided by Dutch tax treaties or unilaterally, if the payer of the income streams is a resident of a developing country, designated by Ministerial Order. If no treaty or unilateral relief applies, a deduction of the foreign tax paid is allowed in computing the net taxable income.

However, relief by exemption is given for dividends from foreign investments qualifying for the participation exemption, as discussed above. In that case, there is no Dutch tax to credit against taxes withheld in the subsidiary's country of residence.

In most circumstances the foreign dividend is exempt for Dutch CIT under the participation exemption, as previously discussed. As a consequence, foreign WHT cannot be credited, and thus, WHT constitute a real cost for the companies concerned. A credit of the foreign WHT is granted against Dutch dividend WHT due on the distribution to foreign parents of the Dutch company. The credit amounts to a maximum of 3% of the gross dividend paid, to the extent that it can be paid out of foreign-source dividends received that have been subject to at least a 5% WHT and the foreign company is liable for CIT. This tax credit does not result in taxable income for CIT purposes.

### *Work in progress*

Since 2007, profits with regard to work in progress should be accounted before actual completion, to the extent that the work is completed. Prior to 2007, for tax purposes, one was allowed to postpone the realisation of taxable profit until a project was fully completed ('completed contract method'). Moreover as of 2007, all project costs should be recognised as opposed to the previous rules that allowed certain costs to be deducted in the year the costs occurred.

## *Deductions*

### *Depreciation and depletion*

Generally, depreciation may be computed by a straight-line or a reducing-balance method or, in accordance with any other sound business practice, on the basis of historical cost. Depreciation is applied from the date the asset comes into use. Dutch tax law includes specific rules *(see below)* that potentially limit the depreciation of assets (e.g. immovable property, goodwill, and other fixed assets).

To meet companies' urgent need for cash due to the worldwide credit crunch, a temporary provision has been introduced, allowing accelerated depreciation *(see below)* of new investments in certain assets in 2009, 2010, and 2011.

#### Limited depreciation of immovable property

There are special provisions for depreciation of immovable property. A distinction is made between immovable property held for investment purposes and buildings used in a trade or business.

Investment property cannot be depreciated to an amount lower than the official property's fair market value for tax purposes, which is known as WOZ-waarde. In other words, a property will not be subject to depreciation unless the carrying amount of the building and the land on which it is located is higher than its value for tax purposes. This value is determined by the municipal tax authorities annually. As this value is based on the assumption that the property is free of lease, the value for tax purposes of commercial real estate may be lower than fair market value.

Alternatively, the depreciation of buildings employed in a trade or business is limited to 50% of the property's value for tax purposes. It should still be possible to value immovable property at fair market value if this is demonstrably lower than the current book value. In addition, anti-abuse measures apply to prevent the division of land and buildings into separate legal entities or to related individuals.

Note that maintenance costs continue to qualify for tax relief and any maintenance-related value increase does not lead to a compulsory upward revaluation of the property. Moreover, a property is not required to be revaluated as its value increases due to market developments.

Depreciation of land is not permitted.

The sale of depreciated assets triggers tax on the difference between the sale price and the depreciated book value unless a reinvestment reserve is set *up (see Capital gains in the Income determination section)*.

#### Limited depreciation of goodwill and other fixed assets

With regard to goodwill, the period of depreciation must be at least ten years. Furthermore, the depreciation period of other fixed assets (i.e. inventory, equipment) must be at least five years.

### Accelerated depreciation

The law provides accelerated depreciation of several specific assets. Accelerated depreciation applies to investments in assets that are in the interest of the protection of the environment in the Netherlands and that appear on the so-called VAMIL ('Vervroegde Afschrijving Milieu-investeringen') list. In 2011, 2012, and 2013, the accelerated depreciation facility for investments in environment-improving assets is temporary limited to 75% of the total (investment) costs.

Accelerated depreciation also is available for certain other designated assets, for example, investments of starting entrepreneurs.

Investment costs minus residual value of sea-vessels that are operated mainly from the Netherlands may be depreciated straight-line over five years. Instead of accelerated depreciation, these taxpayers may choose immediate taxation *(see Tonnage tax regime in the Taxes on corporate income section)*.

As a temporary provision to stimulate the economy, companies may depreciate, under certain conditions, the value of assets bought and investments made in 2009, 2010, and 2011 in two years (or more), provided that the assets are not used formerly and the assets are not meant to be mainly put at the disposal of third parties, directly or indirectly. Further, the asset has to be brought into use before 1 January 2012, 1 January 2013, or 1 January 2014, respectively.

The temporary possibility for accelerated depreciation, however, is prohibited for, among other things, buildings; ground, road, and hydraulic works; cars (except environmentally very clean and efficient cars); and intangible fixed assets. It is possible to depreciate up to 50% of the asset's value in the year of investment. The remainder may be depreciated, without the 50% limitation, in subsequent year(s). The annual amount to be depreciated before the asset has come into use is limited to the actual payments or investments made.



A depletion allowance for natural resources may be granted for tax purposes, when it conforms to sound business practice and is appropriate for accounting purposes.

### *Taxes*

Certain taxes, such as the tax on insurance transactions, are deductible. Tax paid on the transfer of immovable property must be included in the cost price and taken into account in the course of normal depreciation.

### *Anti-abuse rules regarding interest and loans*

Due to existing anti-abuse rules, the deduction for interest paid on intra-group debts relating to certain transactions is disallowed. However, if the taxpayer provides credible evidence of overriding commercial reasons for the transaction as well as the loan, or of taxation of the interest in the hands of the recipient at an effective tax rate that is considered adequate by Dutch standards, the interest may be deductible.

Furthermore, interest paid on certain profit participating loans will be qualified as a dividend and will not be tax deductible. Interest received upon these loans may meet the definitions for the participation exemption if the creditor also holds a qualifying participation in the debtor. Intra-group conduits may be denied a credit of foreign WHT with respect to royalties or interest received if no economic risk is deployed.

Until 2007, interest due on a loan from a group company related to an acquisition of a company from outside the group, which was included in a fiscal unity, was deductible only as far as the acquiring company had its own profits. Full deductibility was granted only eight years after the acquisition. This 2007 interest provision is replaced by the regular inter-company interest deduction limitations. If the interest payment to a group company relates to a loan, which is directly or indirectly, granted by a group company in order to finance an acquisition or capital contribution, the interest will be deductible only if the loan and the underlying transaction are based predominantly on sound business considerations or if the interest received is effectively and sufficiently taxed.

When the debt ultimately is financed externally (outside the group) and a direct relationship exists between the internal debt and the ultimate external financing, it can be substantiated that there are sound business reasons for the loan. Furthermore, the use of tax losses or similar relief claims by the recipient of the inter-company interest, may affect adversely the deductibility of the interest paid. Also the law states that the interest deduction related to indebted dividend distributions, paid back capital and capital contributions is not only possible in case of sound business reasons but also if the interest is taxed in the hands of the creditor at an effective tax rate that is considered adequate by Dutch standards. The latter requirement means that the interest needs to be subject to an effective tax rate of at least 10% over taxable profits determined according to Dutch standards. For the determination of 'a taxable base according to Dutch tax standards' the tax base limitation for the innovation box is not taken into account.

Since 2008, the rules for limitation of deduction of intra-group interest payments are tightened. If the taxpayer makes a reasonable case that the interest is taxable at an effective tax rate of at least 10%, the tax authorities, nevertheless, have the option to substantiate that either the liability or the corresponding transaction is not based on sound business reasons. The tax authorities also have the option to substantiate that the liability is incurred in order to compensate losses or other rights that were formed in that year or that will be formed shortly thereafter. This is also applicable to existing loans.

### *Limited deductibility of costs relating to remuneration by way of shares*

Any remunerations by way of shares, profit-sharing certificates, option rights on shares, or similar rights are not deductible. However, grandfathering rules exist for situations where option rights have been granted to employees before 24 May 2006.

Costs related to so called stock appreciation rights for employees that earn an income which exceeds EUR 500,000 are not deductible, as a result of tax legislation on 'excessive' remuneration.

### *Other deductions*

Deduction of certain expenses (e.g. costs for food, drink, and entertainment) paid by employers for employees are not deductible, in part. The non-deductable portion is 0.4% of the total taxable wages of all employees but never less than EUR 4,300 per year. Alternatively, the employer may choose to deduct only 73.5% of the actual expenses.

### *Net operating losses*

Tax losses can be carried back one year and carried forward to nine years. This also applies to start-up losses.

With regard to losses arising in the years 2009, 2010, and 2011, corporate taxpayers may opt for a temporary extension of the carryback period for losses from one to three years. This option, however, also means that the maximum period for loss carryforward will be limited to six years (instead of nine). Furthermore, the extended measure is limited to EUR 10 million loss carryback per extra year.

Complex rules may prohibit the utilisation of net operating losses after a change of 30% or more of the ultimate control in a company. Furthermore, limitations exist on loss utilisation for holding/finance companies. Based on these rules, losses incurred by a mere holding or group finance company can be offset only against holding or finance income in preceding and following years, provided that certain strict conditions are met. These conditions are meant to counter tax planning, whereby, the Dutch company concerned acquires (e.g. by way of equity contribution or exchange) other assets that enhance its income streams and its capacity to make use of the losses. Companies carrying out significant other activities (with 25 or more full-time employees) are, in principle, unaffected by these loss relief restrictions.

### *Payments to foreign affiliates*
A Dutch corporation generally can claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates, to the extent that the amounts are not in excess of what it would pay an unrelated entity (i.e. arm's-length principle). Dutch companies are obliged to produce transfer pricing documentation describing the calculation of the transfer price and the comparability of the transfer price with third party prices.

## *Group taxation*

### *Fiscal unity regime*
A parent company and its Dutch-resident subsidiaries (if the parent owns at least 95% of the shares) may, under certain conditions, file a tax return as one entity (fiscal unity). Group taxation is available for companies having their place of effective management in the Netherlands, both for Dutch tax and treaty purposes.



The main feature of the fiscal unity is that profits of one company can be offset against losses of another company forming part of that fiscal unity. Furthermore, inter-company transactions are eliminated.

In February 2010, the European Court of Justice (ECJ) decided that the Dutch fiscal unity regime does not violate EU law (the freedom of establishment), insofar as it disallows a cross-border fiscal unity. However, the ECJ has not yet explicitly dealt with the effects of the fiscal unity regime, other than cross-border loss utilisation, such as the transfer of assets between group companies without immediate taxation and the use of 'final losses'. The Dutch Supreme Court will possibly deal with those issues at a later stage.

### *Transfer pricing rules*
Based on a general transfer pricing provision in the corporation tax law, all transactions between related parties must be at arm's length. Furthermore, a specific transfer pricing provision exists with respect to the transactions of an interest and royalty conduit company. Dutch companies are obliged to produce transfer pricing documentation describing the calculation of the transfer price and the comparability of the transfer price with third party prices. If a transaction between related parties is not at arm's length, the taxable income may be corrected by the tax authorities. Moreover, transactions that do not meet the arm's-length test may constitute a contribution of informal capital or a hidden profit distribution.

On the basis of a decree of the State Secretary for Finance regarding transfer pricing, companies may request an advance tax ruling (ATR) and an advance pricing agreement (APA). An ATR may be requested on the classification of activities and an APA may be required on the classification of activities and the arm's-length character of the transfer price.

### *Thin capitalisation rules*

Thin capitalisation rules, which limit the deductibility of interest paid on intra-group debts, were introduced as of January 2004. These rules apply to all Dutch companies that are part of a domestic or international group of companies. The allowed debt-to-equity ratio is 3:1, based on the average of the tax equity at the beginning and at the end of the year. A higher ratio may apply at the request of the taxpayer if the group to which the Dutch company belongs has, according to the financial statements, a higher, worldwide debt-to-equity ratio. Interest paid on loans exceeding the 3:1 ratio is disallowed only to the extent it exceeds inter-company interest received. The deduction of interest paid on genuine third party loans is not limited by the thin capitalisation rules.

## *Tax credits and incentives*

### *Small investments*

There is a system of deductions for small investments, the so-called small scale investment deduction. To calculate this annual deduction, investments of more than EUR 450 each are totalled to determine the percentage of the deduction.

| Total of investments (EUR) | Deduction |
|---|---|
| 2,200 to 54,324 | 28% of the value of the total of small investments |
| 54,325 to 100,600 | EUR 15,211 |
| 100,601 to 301,800 | EUR 15,211 minus 7.56% of the amount exceeding EUR 100,600. |
| Above 301,800 | No deduction |

### *Investments in energy-efficient assets*

For investments in energy-efficient assets, there is a deduction from corporate income of 41.5% of the value of the total annual amount of investments exceeding EUR 2,200, up to and including EUR 116 million. From 1 June 2009 until 1 December 2010, this deduction was also possible in case of certain energy-saving investments in existing rental houses limited to a total investment of EUR 15,000.

### *Investments in environmental assets*

For investments in certain new environmental improving assets exceeding EUR 2,200 per calendar year (with a maximum of EUR 25 million per asset), a deduction from corporate income of 36%, 27%, or 13.5% exists (in 2011, 2012, and 2013), depending on the ministerial classification of the assets. Prior to 2011 and as of 2014, the deduction was/will be 40%, 30%, or 15%, depending on the type of investment.

### *New technology*

Conducting certain research and development (R&D) activities on applied new technology is subsidised by a reduction of wage tax to be paid on wages of employees engaged in R&D of technologically new products. The subsidy accrues to the employer when the employee is credited for the normal amount of wage tax. The benefit for each employer (or group of companies) may not exceed EUR 14 million per year. This amount was substantially raised for the years 2009 (retroactively), 2010, and 2011 to stimulate the economy.

To obtain the relief under the R&D incentive programme, taxpayers must file an application with the Ministry of Economic Affairs. The budget for this subsidy is fixed, so the amount of the subsidy is dependent on budget availability. Note that self-developed and utilised software falls within the scope of the R&D incentive under certain conditions.

## *Withholding taxes*

Dividends from Dutch corporations are generally subject to a 15% Dutch dividend WHT. However, this does not apply to the Dutch cooperative (i.e. 'co-op'), a widely used vehicle for holding and financing activities.

The Netherlands does not levy a WHT on interest and royalty payments.

Domestic corporations are required to withhold taxes as follows:

| Recipient | Dividends (%) (1) |
|---|---|
| Resident corporations | 0/15 |
| Resident individuals | 15 |
| Non-resident corporations and individuals: | |
| Non-treaty situations | 15 |
| Treaty: | |
| Albania | 0/5/15 (30) |
| Argentina | 10/15 (2) |
| Armenia | 0/5/15 (3) |
| Aruba | 5/7.5/8.3/15 (5, 21, 40) |
| Australia | 15 (5) |
| Austria | 0 (6) or 5/15 (3, 7) |
| Azerbaijan | 5/10 (38) |
| Bahrain | 0/10 (8) |
| Bangladesh | 10/15 (8) |
| Barbados | 0/15 (8) |
| Belarus | 0/5/15 (2, 9) |
| Belgium | 0 (6) or 5/15 (8) |
| Bosnia Herzegovina | 5/15 (2, 4) |
| Brazil | 15 (5) |
| Bulgaria | 0 (6)/5/15 (2) |
| Canada | 5/15 (10) |
| Caribbean Netherlands (Bonaire, Saint Eustatius, and Saba) | 0/15 (41) |
| China, P.R. | 10 (5, 11) |
| Croatia | 0/15 (8) |
| Curaçao | 15, 5, 7.5, or 8.3 (21, 40) |
| Czech Republic | 0 (6) or 0/10 (2) |
| Denmark | 0 (6) or 0/15 (8) |
| Egypt | 0/15 (2) |

| Recipient | Dividends (%) (1) |
|---|---|
| Estonia | 0 (6) or 5/15 (2) |
| Finland | 0 (6) or 0/15 (37) |
| France | 0 (6) or 5/15 (2, 5) |
| Georgia | 0/5/15 (31) |
| Germany | 0 (6) or 10/15 (5, 12) |
| Ghana | 10 or 5 (8) |
| Greece | 0 (6) or 5/15 (2) |
| Hungary | 0 (6) or 5/15 (2) |
| Iceland | 0/15 (8) |
| India | 10/15 (5, 32) |
| Indonesia | 10 (2) |
| Ireland, Rep. of | 0 (6) or 0/15 (13) |
| Israel | 5/15 (2) |
| Italy | 0 (6) or 5/10/15 (14) |
| Japan | 5/15 (15) |
| Jordan | 5/15 (8) |
| Kazakhstan | 0/5/15 (17) |
| Korea, Rep. of | 10/15 (2) |
| Kuwait | 0/10 (8) |
| Kyrgyzstan | 15 (5, 24) |
| Latvia | 0 (6) or 5/15 (2) |
| Lithuania | 0 (6) or 5/15 (2) |
| Luxembourg | 0 (6, 18) or 2.5/15 (2, 18) |
| Macedonia | 0/15 (8) |
| Malawi | 15 (19) |
| Malaysia | 0/15 (7) |
| Malta | 0 (6) or 5/15 (2) |
| Mexico | 5/15 (16) |
| Moldavia | 0/5/15 (20) |
| Mongolia | 0/15 (8) |
| Montenegro | 5/15 (2, 4) |
| Morocco | 10/15 (2) |
| New Zealand | 15 |
| Nigeria | 12.5/15 (8) |
| Norway | 0/15 (2) |
| Pakistan | 10/15 (2) |
| Philippines | 10/15 (8) |
| Poland | 0 (6) or 5/15 (8) |
| Portugal | 0 (6)/10 |
| Qatar | 0/10 (39) |
| Romania | 0 (6) or 0/5/15 (22) |
| Russian Federation | 5/15 (23) |
| Saint Martin | 5/7.5/8.3/15 (21, 40) |
| Saudi Arabia | 5/10 (8) |
| Serbia | 5/15 (2, 4) |
| Singapore | 0/15 (7) |

| Recipient | Dividends (%) (1) |
|---|---|
| Slovak Republic | 0 (6) or 0/10 (2) |
| Slovenia | 0 (6) or 5/15 (2) |
| South Africa | 5/10 (16) |
| Spain | 0 (6) or 5/15 (25) |
| Sri Lanka | 10/15 (2) |
| Surinam | 7.5/15 (2) |
| Sweden | 0 (6) or 0/15 (2) |
| Switzerland | 0/15 (2, 36) |
| Taiwan | 10 |
| Tajikistan | 15 (24) |
| Thailand | 5/15 (34) |
| Tunisia | 0/15 (8) |
| Turkey | 5/15 (2) |
| Turkmenistan | 15 (5, 24) |
| Uganda | 0/5/15 (35) |
| Ukraine | 0/5/15 (26) |
| United Arab Emirates | 5/10 (8) |
| United Kingdom | 0 (6) or 0/10/15 (33) |
| United States | 0/5/15 (27) |
| Uzbekistan | 0/5/15 (28) |
| Venezuela | 0/10 (2) |
| Vietnam | 5/7/15 (29) |
| Zambia | 5/15 (2) |
| Zimbabwe | 10/15 (2) |



Notes

1. A 0% WHT rate applies to payments to a resident corporation when its shareholding qualifies for the participation exemption and the shares form part of a company whose activities are carried on in the Netherlands. However, dividend WHT may be levied on certain profit participating loans.
2. The lower rate applies if the foreign company owns directly at least 25% of the capital of the Dutch company.
3. The 5% rate is applicable if the foreign company directly owns 10% of capital of the Dutch company. The 0% rate is applicable if the dividend originates from ordinary taxed profits and the dividend is tax exempt in the hands of the recipient.
4. Based upon the treaty concluded with former Yugoslavia.
5. Negotiations on (revisions of) tax treaties are currently pending with Angola, Aruba Australia, Belgium, Brazil, Chile, China, Colombia, Costa Rica, Curaçao, Germany, India, Indonesia, Kenya, and Saint Martin. Revised (new) tax treaties or protocols with Barbados (27 November 2009), Japan (25 August 2010), and Switzerland (26 February 2010) have been signed, but are not yet in force. New tax treaties (with new countries) that have been signed but not yet effective: Hong Kong (22 March 2010), Oman (5 October 2009), and Panama (6 October 2010).
6. Indicates that this country is a member state of the European Union. The EU Parent/Subsidiary Directive applies from 1 January 1992. According to the Directive, dividends paid by a Dutch company (BV or NV) to a qualifying parent company resident in another EU member state must be exempt from Dutch WHT, provided certain conditions are met. Among other things, the EU parent company must hold at least 15% (from 2009, the EU parent must hold 10%) of the Dutch dividend-paying company's capital (or, in certain cases, voting rights) for a continuous period of at least one year. A provisional exemption from dividend WHT will apply from the start of the one-year holding period. The exemption will be cancelled retroactively if, following the dividend distribution, the one-year holding requirement is not actually met. The Dutch dividend-distributing company must provide to the Dutch tax authorities a satisfactory guarantee for the payment of dividend WHT that, but for the provisional exemption, would be due. The exemption is also applicable if the parent company is a resident of a EU member state and owns at least 10% of the (voting) shares in the Dutch company but only on the basis of reciprocity (Finland, Germany, Greece, Luxembourg, Spain, and United Kingdom). Should the WHT exemption not be available under the EU Parent/Subsidiary Directive, the treaty rate(s) set out in the right-hand side of the same column (following 'or') will apply.

7. The lower rate applies if the foreign company owns, directly or indirectly, at least 25% of the capital of the Dutch company.
8. The lower rate applies if the foreign company directly owns at least 10% of the capital of the Dutch company.
9. The 0% rate applies if the foreign company directly owns at least 50% of the capital of the Dutch company, or invested more than EUR 250,000 in the Dutch company or owns directly 25% of the capital of the Dutch company and has a statement indicating that the investment in Dutch capital is, directly or indirectly, guaranteed by the government of Belarus.
10. The 5% rate applies if the foreign company owns, directly or indirectly, at least 25% of the capital or at least 10% of the voting rights in the Dutch company.
11. The treaty is not applicable for Hong Kong and Taiwan.
12. The lower rate applies if the foreign company owns at least 25% of the voting shares of the Dutch company.
13. The lower rate applies if the foreign company owns at least 25% of the voting rights in the Dutch company.
14. The 5% rate is applicable if the Italian company owns at least 50% of the voting shares in the Dutch company for a continuous period of at least 12 months prior to the date chosen for distribution of a dividend. The 10% rate is applicable if the Italian company owns at least 10% of the voting shares in the Dutch company for the continuous period mentioned above. In other cases, the dividend WHT rate is 15%.
15. The lower rate applies if the foreign company owns at least 25% of the voting shares of the Dutch company for a continuous period of at least six months immediately before the end of the book year to which the dividend distribution relates.
16. The lower rate applies if the foreign company owns, directly or indirectly, at least 10% of the capital of the Dutch company.
17. The 0% rate is applicable if the foreign company owns, directly or indirectly, at least 50% of the capital of the Dutch company or if it has invested more than USD 1 million in the Dutch company, insofar as the government of Kazakhstan has guaranteed the investment; the 5% rate applies if the recipient company owns at least 10% of the capital of the paying company.
18. These rates do not apply to dividend payments to Luxembourg ‘1929’ holding companies.
19. The dividend article of the treaty is not applicable anymore. The national WHT rate is applicable.
20. The 0% rate is applicable if the foreign company owns, directly or indirectly, at least 50% of the capital of the Dutch company and invested more than USD 300,000 in the Dutch company. The 5% rate is applicable if the foreign company owns directly 25% or more of the capital of the Dutch company. The 15% rate is applicable on portfolio investments.
21. The rate is 15% unless the dividend is paid to a company holding at least 25% of the paid-up capital in the Dutch company. In this latter case, the WHT rate will be reduced to: (i) 5% if the dividends received are subject to a profits tax in the other state of at least 5.5% on the dividend or (ii) 7.5% if the profits tax is less than 5.5%. The combined CIT of the other state and Dutch dividend WHT for participations of at least 25% must not exceed 8.3%. Depending on the tax percentage levied in the other state, the Dutch dividend WHT will be restituted accordingly.
22. The 5% rate is applicable if the recipient of the dividend is the beneficial owner and directly owns 10% of the capital of the Dutch company. The 0% rate is applicable if the recipient of the dividend is the beneficial owner and directly owns at least 25% of the capital of the Dutch company.
23. The 5% rate is applicable if the recipient of the dividend is the beneficial owner and directly owns at least 25% in the capital of the Dutch company with a minimum investment of at least EUR 75,000.
24. The Netherlands applies the treaty with the former Soviet Union unilaterally to Kyrgyzstan, Tajikistan, and Turkmenistan.
25. The lower treaty rate applies if the Spanish company owns 50% or more of the capital of the Dutch company or if the Spanish company owns 25% or more of the capital of the Dutch company and another Spanish company also owns 25% or more of that capital.
26. The 0% rate is applicable if the foreign company owns, directly or indirectly, at least 50% of the capital of the Dutch company or invested more than USD 300,000 in the Dutch company. The 5% rate is applicable if the foreign company owns directly 20% or more of the capital of the Dutch company.
27. The lower rate applies if the foreign company owns directly at least 10% of the voting rights in the Dutch company. On 8 March 2004, the Netherlands and the United States signed a protocol amending the applicable tax treaty. Based on this protocol, the WHT on dividends will be reduced to 0% if the receiving company owns 80% or more of the voting power of the distributing company, provided that certain other conditions are also met. This reduction of the dividend WHT has taken effect as of 1 January 2005.
28. The 5% rate is applicable if the foreign company owns directly 25% or more of the capital of the Dutch company. The 0% rate is applicable if the dividend for that company qualifies for the participation exemption in the Netherlands. The 15% rate is applicable to portfolio dividends.
29. The 5% rate is applicable if the foreign company owns, directly or indirectly, at least 50% of the capital of the Dutch company or invested more than USD 10 million in the Dutch company. The 7% rate applies to the foreign company owning, directly or indirectly, at least 25% of the capital of the Dutch company.
30. No dividend WHT is due provided the share in the participation is at least 50% and at least USD 250,000 capital is paid in, in the participation. A dividend WHT of 5% is due if the share in the participation is at least 25%.

31. A dividend WHT of 5% is due if the share in the participation is at least 10%. No dividend WHT is due provided the share in the participation is at least 50% and at least USD 2,000,000 capital is paid in, in the participation.
32. Based upon most-favoured nation principle.
33. The 0% rate applies if a company controls at least 10% of the voting power of the Dutch company paying the dividends. The 15% rate applies to dividends arising from income from immovable property, distributed by certain tax exempt real estate investment vehicles (e.g. REITs or FBIs).
34. In case a Thai company holds at least a 25% share in a Thai company, the Dutch dividend WHT rate is 5%.
35. If a share of at least 50% is held by a company, no dividend WHT is due. If the share the company holds is less than 50%, 5% dividend WHT is due.
36. As of 29 December 2004, Switzerland and the European Union concluded a treaty in the light of the EU savings directive. The treaty, amongst others, contains a clause that no dividend tax is withheld if certain requirements are met. The main requirements are that a shareholding of at least 25% is held directly for a period of at least two years and both corporations are not subjected to a special tax regime. Please note that even though the treatment of dividend appears to be equal to the treatment on the basis of the EU-parent subsidiary directive, the directive is in fact not applicable to Switzerland.
37. The 0% rate applies if the foreign company owns directly at least 5% of the capital of the Dutch company.
38. The 5% rate applies if the foreign company owns directly at least 25% of the capital of the Dutch company with a minimum investment of at least EUR 200,000 in the Dutch company.
39. The 0% rate applies if the foreign company directly owns at least 7.5% of the capital of the Dutch company.
40. The WHT rates are based on the Dutch ‘Belastingregeling voor het Koninkrijk’.
41. The WHT rates for the Caribbean Netherlands are based on the Dutch ‘Belastingregeling voor het land Nederland’.

## Tax administration

### Returns

Tax returns must be filed either every calendar year or every financial year. The Dutch tax authorities generally make a provisional assessment before issuing the final assessment after a full examination of the return.

### Payment of tax

The CIT assessed must be paid within two months of the date of the assessment. In addition, provisional assessments are issued for the current tax year on the basis of the prior year’s taxable income.

# New Zealand

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## Significant developments

### Corporate tax rate reduced

The recently enacted Taxation (Budget Measures) Act 2010 reduced the company tax rate from 30% to 28% with effect from the beginning of the 2011/2012 income year, which, for most companies, is 1 April 2011. The reduced rate applies to all resident and non-resident companies, including branches.

There will be a two year transition period to allow tax paid at 30% to be imputed to dividends at a rate of 30%.

### Portfolio Investment Entity (PIE) tax rates reduced

As of 1 October 2010, the top PIE tax rate was also reduced to 28%.

### Increase in Goods and Services Tax (GST)

As of 1 October 2010, the GST rate increased from 12.5% to 15%.

For transactions spanning 1 October 2010, the GST rate which applies is the rate applicable at the 'time of supply'. The 'time of supply' is generally the earlier of an invoice being issued or any payment being received. For recurring or successive supplies, the time of supply may be triggered upon each payment being made or falling due. The government has also introduced a number of amendments to the GST legislation to help businesses make the transition to the new GST rate.

### Gift duty to be abolished

The Taxation (Tax Administration and Remedial Matters) Bill introduced on 23 November 2010 repeals gift duty with effect from 1 October 2011.

### Changes to the thin capitalisation threshold

The safe harbour threshold for the inbound thin capitalisation rules has been reduced from 75% to 60% effective from the beginning of the 2011/2012 income year.

Broadly, New Zealand's inbound thin capitalisation rules limit the scope for non-residents to fund debt against their New Zealand operations and thereby reduce tax paid in New Zealand. Under the previous rules, New Zealand taxpayers controlled by non-residents were denied an interest deduction in New Zealand to the extent that their debt percentage (total group debt/total group assets) exceeded both 75% (now 60%) and 110% of the worldwide group's debt percentage.

As of 1 April 2012, the minimum prescribed percentage of equity for tax purposes for foreign owned banks will increase from 4% to 6%.

**Additional changes proposed to the thin capitalisation rules**
The Taxation (International Investment and Remedial Matters) Bill introduced to Parliament on 26 October 2010 and very likely to be enacted by September 2011 proposes several additional changes to the thin capitalisation rules, including:

- Extending the thin capitalisation rules to New Zealand residents with foreign investment fund (FIF) interests that use the attributable FIF income method (i.e. the active income exemption) or the exemption for Australian resident FIFs. The proposed changes will apply to income years beginning on or after 1 July 2011;
- Introducing a new test for low-asset companies to give certain New Zealand-based groups with high levels of arm's length debt the option of using a ratio of interest expense to pre-tax cash flows, rather than a debt-to-asset ratio under the current test. The test will apply retrospectively for income years beginning on or after 1 July 2009 so that companies that may have experienced difficulties immediately after the extension of the thin capitalisation rules can obtain relief.
- Removing the application of the thin capitalisation rules for non-resident companies that do not carry on a business through a fixed establishment in New Zealand, if all their New Zealand-sourced income that is not relieved under a double tax agreement (DTA) is non-resident passive income (i.e. dividends, royalties, or interest). The proposed changes will apply for income years beginning on or after 1 July 2011.

### *Removal of depreciation (on certain buildings and loading rates)*
The Taxation (Budget Measures) Act 2010 removed the 20% depreciation loading on new plant and equipment for assets purchased after 20 May 2010.

The depreciation rate for buildings with an estimated useful life of 50 years or more has been reduced to 0% from the 2011/2012 income year.



### *Changes to the tax treatment of qualifying companies and new 'look through companies'*
New legislation took effect, as of 1 April 2011, that does the following:

- Creates a new entity, the 'look-through company' (LTC), which is treated as a partnership for tax purposes. Income, expenses, tax credits, and losses of an LTC are able to be passed on to shareholders, subject to the application of a loss limitation rule.
- Allows existing qualifying companies (QC) and loss attributing qualifying companies (LAQCs) to continue to use the current QC rules but without the ability to attribute losses to shareholders until a review of the dividend rules for closely held companies has been completed.
- Allows existing QCs and LAQCs to elect to be subject to the new LTC rules, or to transition to a new structure such as a partnership, limited partnership, or sole trader, without incurring a tax cost.

### *GST and land*
The Taxation (GST and Remedial Matters) Bill enacted in December 2010 provides that compulsory zero-rating (GST at 0%) applies to any supply involving land between two GST-registered parties as of 1 April 2011, if:

- the purchaser acquires the land with the intention of using it to make taxable supplies, and
- the land is not intended to be used as a principal place of residence for either the purchaser or an associate.

The Bill also clarifies the change-in-use rules and the GST boundary between commercial and residential accommodation as well as the GST treatment of transactions involving nominee situations (e.g. where a named purchaser under a sale and purchase agreement directs a third party to take title).

These rules also apply as of 1 April 2011.

### *International tax rules - changes to the FIF regime*

The Taxation (International Investment and Remedial Matters) Bill, which was introduced to Parliament in October 2010 and will be enacted in 2011, proposes to align the FIF rules with the controlled foreign company (CFC) rules where a New Zealand resident has an interest of 10% or more in a FIF. If enacted, the changes will apply to income starting on or after 1 July 2011.

The Bill also proposes to repeal the availability of the branch equivalent and accounting profits methods for calculating FIF income. Taxpayers that can access the information to prepare a branch equivalent calculation will be forced into being taxed on a notional income amount, even if the FIF is making losses.

#### Proposed tax treatment of interests of 10% or more in a FIF

The Bill repeals the current grey list exemption and replaces it with an Australian exemption.

The active business test currently available for CFCs will be extended to apply to FIFs. This means that no income will be taxable for FIFs that have passive income of less than 5% of their total gross income.

If a FIF fails the active business test, only its passive income will be taxable.

The active business test may be applied to a group of foreign companies using consolidated accounting information where a FIF holds 50% or more of the voting interests in lower tier FIFs, regardless of jurisdiction. This differs from the CFC rules, which only allow CFCs in the same jurisdiction to be grouped and requires minority interests to be removed.

Investors who do not have enough information to perform the required calculations will be able to use one of the attribution methods available for FIF interests of less than 10%, subject to certain restrictions.

#### Tax treatment of interests of less than 10% in a FIF

The active income exemption will not be available. The default income attribution method will continue to be the fair dividend rate (FDR) method or the cost method if no market value is available for the FIF interest.

The comparative value (CV) method is also available for individuals and trustees. The CV method must be used for non-ordinary shares. If the CV method cannot be applied, the deemed rate of return method must be applied.

#### Revaluation of inherited FIF interests

The Bill also proposes to revalue interests in grey list companies inherited before 1 April 2007 (i.e. when the grey list was abolished) to market value at the date the Bill is enacted. The change is intended to prevent situations where a person has inherited investments in a FIF with a significant market value but is not required to attribute any

FIF income as the investments fall under the de minimis threshold because the cost to the investor was nil or less than 50,000 New Zealand dollars (NZD).

***Hong Kong - New Zealand DTA***
On 1 December 2010, a new DTA between Hong Kong and New Zealand was signed.

The agreement will bring withholding tax (WHT) rates into line with rates currently in operation with the United States and Australia. The agreement will come into effect after both governments have formally notified each other that they have completed their ratification procedures.

***Australia - New Zealand DTA***
On 19 March 2010, a new DTA between Australia and New Zealand came into force.

The new DTA lowers WHT rates on dividends, interest, and royalties.

The standard WHT rate on dividends is reduced to 5% for an investing company that has at least a 10% shareholding in the company paying the dividend. The rate reduces to 0% if the investing company holds 80% or more of the shares in the other company and meets other criteria.

The WHT rate on interest stays at 10% in the new agreement but is reduced to 0% if it is payable to eligible financial institutions.

The WHT rate on royalties is reduced from 10% to 5%.

The DTA provides that pensions exempt in the person's home country are exempt in the other country. Lump sum payments are to be taxed only in the country where the pension is sourced and not in the country in which the pensioner has retired.



For WHT, the new DTA applies from 1 May 2010. For other taxes, it applies in New Zealand to income years commencing on or after 1 April 2010.

***Singapore - New Zealand DTA***
A new DTA between Singapore and New Zealand came into force on 12 August 2010.

The new DTA lowers WHT rates on dividends, interest, and royalties.

The standard WHT rate on dividends is reduced to 5% for an investing company that has at least a 10% shareholding in the company paying the dividend.

The WHT rate on interest is reduced from the current 15% to 10%.

The WHT rate on royalties is reduced from 10% to 5%.

Other changes include the following:

- Revising the treatment of interest paid between associated persons. The interest Article in the 1973 DTA does not limit the rate of tax applicable to interest paid to an associate. The 15% rate is a minimum rate of tax, which means that the net income (after deducting expenses) must be included in the non-resident's New Zealand tax return along with all other New Zealand sourced income. The new DTA removes the associated persons restriction. Consequently, all interest paid will benefit from the 10% rate.

- Amending the definition of a 'permanent establishment'(PE) to include a building site, construction, installation, or assembly project if the project lasts more than 12 months, instead of six months as found under the prior DTA.
- Incorporating the new internationally agreed standard for the exchange of information between tax authorities.

In New Zealand, the DTA applies for WHT on interest, profits, or gains paid or credited from 1 October 2010. In respect of all other taxes, the DTA applies in New Zealand for any income year beginning on or after 1 April 2011.

### *United States - New Zealand DTA*

A protocol updating the DTA between the United States and New Zealand came into force on 12 November 2010.

The key changes include a reduction in WHT rates on dividends, interest, and royalties.

The Protocol also makes changes to the Business Profits article and Limitation of Benefits article.

The new WHT rates apply as of 1 January 2011.

### *Research and development (R&D) funding*

New R&D funding measures were announced in the 2010 Budget. Broadly, NZD 321 million of targeted funding has been allocated to research, science, and technology activities over the next four years.

The most significant measure is NZD 189.5 million of funding for technology development grants. These grants are available to medium to large research-intensive businesses that can show that their activities result in wider benefits for New Zealand. The government will contribute 20% of these businesses' expected R&D expenditure for three years, up to a set maximum. The grants are not administered through the tax system.

### *Approved issuer levy and bonds*

A Bill introduced to Parliament on 26 October 2010 and expected to be enacted by September 2011 introduces an approved issuer levy (AIL) rate of zero (instead of the usual 2%) which will apply to interest paid on qualifying bonds that meet certain requirements, including that the securities have been offered to the public, are not asset-backed securities, and are either listed on an exchange registered under the Securities Market Act 1988 or were issued to a group of at least 100 persons with no person (or group of associated persons) receiving 10% or more of the total securities.

Approved issuers may pay interest to non-residents without having to deduct non-resident withholding tax (NRWT). Generally AIL is 2% of the interest paid.

The proposed changes will apply to interest payments made on or after the date the Bill is enacted. This means the zero rate could be used in respect of future interest payments on bonds issued prior to the Bill's enactment.

### *Tax Information Exchange Agreements (TIEAs)*

New Zealand has signed TIEAs with countries such as Samoa, Vanuatu, Cook Islands, Guernsey, Jersey, Isle of Man, Cayman Islands, British Virgin Islands, Gibraltar, and the Bahamas.

The new TIEAs come into force once the countries involved in each agreement have given legal effect to them.

### *Repeal of superannuation fund withdrawal tax*
Superannuation fund withdrawal tax has been repealed as of 1 April 2011.

Broadly, the superannuation fund withdrawal tax provisions applied to make superannuation funds liable to income tax at the rate of 5% on amounts withdrawn from a superannuation fund prior to retirement to the extent they include employer contributions since 1 April 2000 (and earnings thereon).

## *Taxes on corporate income*

New Zealand resident companies are taxed on their worldwide income, and non-resident companies (including branches) are taxed on New Zealand-sourced income.

From the beginning of the 2011/2012 income year, the tax rate is 28%. Prior to the 2011/2012 income year, the income tax rate was 30%.

There are no state and municipal income taxes in New Zealand.

## *Corporate residence*

Residence is determined by place of incorporation, location of head office or centre of management, or by directors' exercising control of the company in New Zealand. As a general rule, a New Zealand resident company is taxed on their worldwide income, and a non-New Zealand resident company is taxed on their New Zealand sourced income.



### *Permanent establishment (PE)*
Generally, DTAs to which New Zealand is a party define a PE by reference to a fixed place of business through which the company's business is carried on. A PE can also exist without a fixed place of business if the employees of the overseas company habitually exercise an authority to conclude contracts in New Zealand.

## *Other taxes*

### *Goods and services tax (GST)*
GST is a form of value-added tax (VAT) that applies to most supplies of goods and services. The narrow category of exempt supplies includes financial services. As of 1 October 2010, the rate applied to taxable supplies is currently 15% (previously 12.5%) or 0%. The 0% rate applies to a few supplies only, including exports and financial services supplied to other registered businesses. As of 1 April 2011, the 0% rate also applies to the sale of land between two registered parties if the purchaser acquires the land with the intention of using it to make taxable supplies and the land is not intended to be used as a principal place of residence for the purchaser or an associate.

There is also a 'reverse charge' mechanism that requires the self assessment of GST on the value of certain services imported by GST registered persons.

### *Accident compensation levy*
A statutory-based scheme of accident insurance is funded in part by premiums payable by employers and employees.

Premiums paid by employers (including the self-employed) fund insurance for work-related accidents. Employers are liable to pay a residual claims levy and an employer levy. The employer levy payable is determined according to the industry or risk classification of the employer and the level of earnings of employees.

### *Customs duties*
Customs duty is levied on some imported goods at rates generally ranging from 1% to 10%.

### *Excise duty*
Excise duty is levied on petroleum products, tobacco, and alcohol. The excise duties are levied item by item at rates that vary considerably.

### *Fringe benefit tax (FBT)*
Employers are subject to a tax-deductible FBT on the value of non-cash fringe benefits provided to their employees. Employers can elect to pay FBT at flat rates (for the 2010/2011 income year, 55% on attributed benefits and 46% on pool benefits, i.e. those benefits which cannot be attributed to a particular employee) applied against the value of the benefit or can attribute fringe benefits to individual employees and pay FBT based on each employee's marginal tax rate. Under the attribution option, the applicable FBT rate depends on the net remuneration (including fringe benefits) paid to the employee. The attribution calculation treats the fringe benefit as if it was paid in cash and calculates FBT as the notional increase in income that otherwise would have arisen.

As of 1 April 2011, the 55% and 46% FBT rates are respectively reduced to 49% and 43%.

The multi rates for the 2011/2012 income tax year are:

| Net remuneration (NZD) | FBT rate (%) |
|---|---|
| 12,250 or less | 11.73 |
| 12,251 to 39,110 | 21.21 |
| 39,111 to 52,850 | 42.86 |
| Greater than 53,851 | 49.25 |

Fringe benefits include motor vehicles available for private use, loans at below prescribed interest rates, contributions to medical insurance schemes, and employer contributions to superannuation schemes.

In relation to motor vehicles, employers can value a vehicle on an annual basis either using 20% of the cost price or market value (GST inclusive) of the vehicle (depending on whether the vehicle is owned or leased by the employer) or 36% of the vehicle's tax written down value (GST inclusive). In each case, the FBT value must be reduced proportionately for whole days when the vehicle is not available for private use at any time.

FBT is also applicable to benefits received by an employee from a third party where there is an arrangement between the employer and the third party and where the benefit would be subject to FBT if it had been provided by the employer.

### *Stamp duty*

Stamp duty has been abolished in respect of instruments executed after 20 May 1999.

### *Gift duty*

Gift duty is payable by donors (including companies) on gifts which exceed NZD 27,000 in aggregate in any 12-month period. A gift statement must be filed when the value of the gifts exceeding NZD 12,000 in aggregate in any 12-month period. Some relief is granted from the imposition of gift duty when income tax is payable on the gift. Exemptions from gift duty include gifts to local or central government and to approved organisations.

Under draft legislation expected to be enacted by September 2011, gift duty will not be imposed on gifts made on or after 1 October 2011.

### *Property taxes*

Local authorities levy tax known as 'rates' on land within their territorial boundaries. Rates are levied on properties based on the properties' rateable value.

### *Employer superannuation contribution tax (ESCT)*

Employers' contributions to an approved superannuation fund (excludes foreign schemes) are subject to ESCT, formerly known as 'specified superannuation contribution withholding tax'. As of 1 April 2012, employer contributions of up to 2% of the employee's gross salary or wages made to a KiwiSaver scheme or a superannuation scheme will no longer be exempt from ESCT.



### *Fund withdrawal tax (FWT)*

FWT has been repealed as of 1 April 2011.

Prior to 1 April 2011, the FWT provisions made the superannuation fund liable to income tax at the rate of 5% on amounts withdrawn from a superannuation fund prior to retirement, to the extent they included employer contributions since 1 April 2000 (and earnings thereon). FWT applied where the superannuation fund member's income was above NZD 70,000.

## *Branch income*

A non-resident company is taxed on income generated by business wholly or partially carried on in New Zealand. Branch profits are subject to ordinary corporate rates of taxation, and there is no WHT on repatriated profits.

## *Income determination*

### *Inventory valuation*

Inventory must be valued by a cost-valuation method or, where market-selling value is lower than cost, may be valued at market-selling value. If the inventory is shares, it must be valued at cost. Cost is determined under generally accepted accounting principles. Acceptable cost flow methods are first in first out (FIFO) or weighted-average cost. Some valuation concessions are available to small taxpayers.

### *Capital gains*
There is no separate capital gains tax. However, the income tax legislation specifically includes various forms of gain that would otherwise be considered a capital gain within the definition of 'income'. Taxable income includes gains on the sale of real estate in certain circumstances and on personal property where the taxpayer acquired the property for resale or deals in such property or where a profit-making purpose or scheme can be deemed or imputed.

### *Dividend income*
Dividends derived from resident companies are exempt where there is 100% common ownership and the companies have the same balance date.

#### Dividends from a foreign company
For income years starting on or after 1 July 2009, a dividend derived by a company resident in New Zealand from a foreign company is treated as exempt income, unless it is:

- a dividend on a fixed rate share or a dividend for which the foreign company has received a tax deduction in its home jurisdiction, or
- a dividend from a portfolio FIF (i.e. interests under 10%) that is exempt from FIF rules (e.g. an interest in an Australian listed company).

Dividends from foreign companies derived by taxpayers other than companies are taxable (generally with a credit for any foreign withholding taxes).

#### Branch equivalent tax account (BETA)
Previously, taxpayers who were subject to tax on attributed foreign income under the CFC or FIF regimes and also taxed or liable to pay foreign dividend payments on dividends could elect to maintain a BETA. A BETA operates in a similar manner to an Imputation Credit Account and helps avoid the double taxation of attributed foreign income and foreign dividend income.

As most foreign dividends received by New Zealand companies are exempt from tax, most companies therefore no longer need to maintain BETAs. The Taxation (International Investment and Remedial Matters) Bill 2010 proposes to abolish BETAs from the income year beginning on or after 1 July 2012.

#### Other
The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 brought an end to the general availability of supplementary dividend tax credits under the foreign investor tax credit (FITC) regime.

The FITC regime effectively eliminates NRWT on fully imputed dividends. The FITC regime provided that total New Zealand tax paid on a non-resident investor's earnings through a New Zealand company could be limited to 30%. It does not operate by exemption from NRWT. Rather, where a dividend is imputed, the paying company qualifies for a reduction in its income tax if it pays a supplementary dividend. The amount of reduced company income tax is equal to the supplementary dividend. The combination of reduced income tax plus non-resident WHT on both dividends can result in total New Zealand tax on the earnings of 30%. Deemed dividends may arise from transactions between related companies where the transactions are not at market value.

Following the new DTAs with the United States, Australia, and Singapore, which all reduce the NRWT rate on dividends paid to corporate shareholders that hold 10% or more of a New Zealand company from 15% to 5% or 0%, there is no longer a need for the FITC regime in certain circumstances.

Broadly therefore:

- only portfolio investors (i.e. those with less than 10% holdings) with NRWT rates of at least 15% and supplementary dividend holding companies will qualify for relief under the supplementary dividend rules and
- a zero rate of NRWT applies to dividends paid to non-portfolio shareholders (i.e. shareholders with more than 10% holdings) and to any other dividends subject to lower tax rates, to the extent they are fully imputed.

The changes affect provisional tax calculations for taxpayers who take into account their anticipated FITC in calculating their provisional tax. Taxpayers should also consider the need to impute dividends where a tax treaty applies to reduce the NRWT rate.

The supplementary dividend regime will cease to apply to holding companies from the 2013/14 income tax year.

### *Stock dividends*
Bonus issues can be taxable or non-taxable. With a taxable bonus issue, the amount capitalised becomes available for tax-free distribution upon a subsequent share cancellation. With a non-taxable bonus issue, the amount capitalised is not available for tax-free distribution upon a subsequent share cancellation.

The government may legislate to ensure that bonus issues of shares distributed under profit distribution plans (PDPs) are taxed in the same way as shares issued under other dividend reinvestment plans.



### *Offshore portfolio equity investments*
The key features of the taxation of offshore portfolio equity investments are:

- The ‘grey list’ does not apply to investments that fall within the new regime.
- Corporate investors are generally taxable on 5% (the ‘fair dividend rate’ or ‘FDR’) of the opening market value of the investments each year.
- Shares in certain Australian resident listed companies are excluded from the rules.
- Distributions from all investments excluded from the rules (either permanently or temporarily) are taxed on a receipts basis in accordance with ordinary principles.

These rules affect investors with a shareholding or interest of less than 10% in a foreign company, unit trust, certain foreign superannuation schemes and all life insurance policies.

### *Other significant items*
The taxation of debt and debt instruments is governed by the financial arrangements rules, a specific set of timing rules. Income or expenditure (including foreign exchange gains and losses) from financial arrangements must be recognised on an accrual basis (generally, yield to maturity or other commercially acceptable method). These rules do not apply to the income or expenditure of a non-resident if the financial arrangement does not relate to a business carried on in New Zealand.

### *Foreign income*
A New Zealand corporation is taxed on foreign passive income as earned. Double taxation with respect to all types of taxable income, including interest, rents, and royalties, is avoided by the recognition of foreign tax credits. Foreign dividends received are exempt from income tax but are subject to the foreign dividend withholding payment. However, new rules exempt most foreign dividends received by New Zealand companies from domestic tax and repeals the FDP and underlying foreign tax credit rules.

New Zealand does not offer specific tax deferral rules.

## *Deductions*

### *Depreciation and depletion*
For tax purposes, depreciation of property can be computed under the diminishing value method, the straight-line method, or a pooling method. The rates of depreciation depend on the following factors:

- Type of asset.
- Whether the asset is acquired new or second-hand (i.e. used).

Taxpayers must use the economic depreciation rates prescribed by Inland Revenue, together with a 20% uplift in the case of new assets (other than buildings and imported motor vehicles) purchased on or before 20 May 2010 (the 20% uplift has been removed for assets purchased after this date). Fixed-life intangible property (including the right to use land and resource consents) is depreciable on a straight-line basis over its legal life. Any depreciation recovered on the sale of an asset (up to its original cost) is taxable in the year of sale.

The double-declining-balance (accelerated) method applies to most plant and equipment. Under the double declining balance method, equipment with an estimated useful life of ten years results in diminishing value depreciation deductions of 20% per annum (i.e. double the straight-line rate of 10% over the equipment's 10-year life). Buildings, certain motor vehicles, high-residual-value property, fixed-life intangible property, and property acquired prior to the introduction of the new rules cannot be depreciated under the double-declining-balance method.

The depreciation rate for buildings with an estimated useful life of 50 years or more is reduced to 0% as of the 2011/2012 income year pursuant to the Taxation (Budget Measures) Act 2010.

### *Interest expense*
Generally, interest incurred by most companies is deductible, subject to thin capitalisation rules *(see the Group taxation section)*.

### *Research and development (R&D)*
R&D costs are tax deductible. Expenses written off as immaterial and not tested against certain asset-recognition criteria are not automatically deductible for tax purposes.

### *Entertainment expenditure*
Entertainment expenditure is generally only 50% deductible. However, entertainment expenditure incurred overseas is 100% deductible.

### *Legal expenditure*
Legal expenditure is deductible if the expenditure is:

- incurred in deriving assessable or excluded income or
- incurred in the course of carrying on a business for the purpose of deriving assessable or excluded income.

However, the expenditure is not deductible if it is of a capital, private, or domestic nature.

The Taxation (Business Tax Measures) Act 2009 provides that from the 2009/2010 income tax years, taxpayers with business-related legal expenditure of NZD 10,000 or less are able to deduct the full amount of the expenditure in the year it is incurred, whether or not it is capital in nature.

### *Taxes*
FBT is deductible, as is GST payable on the value of a fringe benefit.

### *Net operating losses*
Losses may be carried forward indefinitely for offset against future profits, subject to the company maintaining 49% continuity of ownership. There is no loss carryback. A legislative amendment in 2002 ensures that losses of a subsidiary are preserved on a spinout (i.e. when shares in the subsidiary are transferred to shareholders of its parent company).

### *Payments to foreign affiliates*
A New Zealand corporation can claim a deduction for royalties, management service fees, and interest charges paid to non-resident associates, provided the charges satisfy the 'arm's-length principle', which forms the basis of New Zealand's transfer pricing regime.



## *Group taxation*

Companies that are 66% or more commonly owned constitute a 'group'. Group companies are able to offset losses by election as well as by subvention payment. A subvention payment is a payment made by the profit company to the loss company and is equal to the amount of loss to be offset. The payment is deductible to the profit company and assessable to the loss company. Certain companies subject to special bases of assessment (e.g. mining companies other than petroleum extraction companies) are excluded from the grouping provisions. Branches of non-resident companies may be included, provided they continue to carry on business in New Zealand through a fixed establishment.

Groups of resident companies that have 100% common ownership may elect to be subject to the consolidated group regime. The group is effectively treated as a single company and transfers of assets, dividends, interest, and management fees among members of the group are generally disregarded for tax purposes. The group files a single return and is issued a single assessment. Group members are jointly and severally liable for tax purposes.

Losses incurred by a dual-resident company are not available for offset by election or subvention payment.

### *Transfer pricing*
The transfer pricing rules are based on Organisation for Economic Co-operation and Development (OECD) principles and require taxpayers to value for tax purposes all cross-border transactions with associates on an arm's-length basis.

The transfer pricing rules apply to arrangements for the acquisition or supply of goods, services, money, intangible property, and anything else (other than non-fixed rate shares), where the supplier and acquirer are associated persons. Similar rules apply to the apportionment of branch profits.

Various methods are available for determining the 'arm's-length consideration'. The taxpayer is required to use the method that produces the most reliable measure of the amount that independent parties would have paid or received in respect of the same or similar transactions. Inland Revenue has published guidelines that make it clear that documentation is required to support a taxpayer's transfer prices.

### *Thin capitalisation*
'Inbound' thin capitalisation rules apply to New Zealand taxpayers controlled by non-residents, including branches of non-residents. The aim of the rules is to ensure that New Zealand entities or branches do not deduct a disproportionately high amount of the worldwide group's interest expense. This is achieved by deeming income in New Zealand when, and to the extent that, the New Zealand entities in the group are thinly capitalised (i.e. excessively debt funded).

The 'outbound' thin capitalisation rules are intended to operate as a base protection measure to prevent New Zealand residents with CFC investments from allocating an excessive portion of their interest cost against the New Zealand tax base.

To reduce taxpayer compliance costs, the outbound thin capitalisation rules do not apply when the New Zealand taxpayer has:

- 90% or more of their assets in New Zealand or
- less than NZD 250,000 of interest deductions.

Further concessions are available to taxpayers who do not fall below the above thresholds. If the taxpayer's interest deduction and dividends paid for fixed rate shares (the finance cost) is below NZD 1 million, no apportionment of deductible interest is required. If the finance cost is above NZD 1 million, but below NZD 2 million, the apportionment is an adjustment.

An apportionment of deductible interest is required under the thin capitalisation rules when the debt percentage (calculated as the total group debt/total group assets of a New Zealand entity or group) exceeds both:

- 75% (for 'inbound' thin capitalisation, the 75% threshold is reduced to 60% from the beginning of the 2011/2012 income year) and
- 110% of the worldwide group's debt percentage.

The use of the debt-to-asset ratio differs from most thin capitalisation models, which apply to an entity's debt-to-equity ratio. All interest (both related and unrelated party) is subject to apportionment.

Foreign-owned banks operating in New Zealand are subject to specific thin capitalisation rules that deem income if the bank does not hold a level of equity equivalent to 4% (6% as of 1 April 2012) of their New Zealand banking risk-weighted assets. In addition, banks are required to have sufficient equity to equity fund offshore investments that do not give rise to New Zealand taxable income in full.

### *Controlled foreign companies (CFCs)*

New CFC rules apply for income years beginning on or after 1 July 2009.

A key feature of the new rules is the exemption from New Zealand income tax for active income derived by New Zealand residents from interests in controlled foreign companies (CFCs). Passive income (such as dividends, interest, royalties, and rents) is taxed on an attribution basis.

For CFCs that pass an 'active business' test, no income from the CFC is attributable to the New Zealand shareholders. A CFC passes the active business test if its passive income is less than 5% of gross income. The active business test replaces the current grey list exemption. However, an exemption from attribution of income is retained for CFCs in Australia.

### *Foreign investment funds (FIFs)*

The FIF regime is an extension of the CFC regime, which subjects persons with interests in certain foreign entities (which are not CFCs) to New Zealand tax. It also applies where the investor does not have a sufficient interest in a CFC to be taxed under that regime.

Examples of investment vehicles that are commonly classified as FIFs include foreign companies (including unit trusts), foreign superannuation schemes, and life insurance policies issued by foreign entities not subject to New Zealand tax.



Generally, however, a New Zealand resident does not have an interest in a FIF when:

- the foreign entity in which the interest is held is a company or unit trust resident in a 'grey list' country (this exemption does not apply to portfolio FIF interests or interests in foreign superannuation schemes or life insurance policies)
- the total cost of FIF-type interests held by an individual does not exceed NZD 50,000
- the interest is an 'employment-related foreign superannuation scheme'
- the interest is a 'qualifying foreign private annuity', or
- a natural person acquired interests in foreign life insurance policies or foreign superannuation schemes before first becoming resident in New Zealand (these interests will be exempt from the FIF regime for the rest of the income year in which the individual first became resident and for the following three income years) and
- certain other limited exceptions apply.

The exemption includes interests in foreign employment-related superannuation schemes, interests held by returning residents, as well as new migrants arriving in New Zealand from 1 April 2006. A permanent exemption is provided for interests that a person acquired before one becomes a New Zealand resident and interests acquired within the first five years of New Zealand residence.

The choice of method is restricted by the nature of the interest held and the availability of information.

Interests in FIFs must be disclosed by taxpayers in their annual tax returns. Failure to disclose gives rise to potentially stringent penalties.

## Tax credits and incentives

### Inbound investment incentives
There are limited specific tax incentives designed to encourage the flow of investment funds into New Zealand.

Legislation enacted in 2004 encourages foreign venture capital investment into unlisted New Zealand companies. Gains derived by certain non-residents from the sale of shares (held on revenue account and owned for at least 12 months) in New Zealand unlisted companies that do not have certain prohibited activities as their main activity, are exempt from income tax. The rules apply to foreign investors who are resident in all of the countries with which New Zealand has a DTA (except Switzerland) and who invest into New Zealand venture capital opportunities.

### Capital investment incentives
Investment allowances on fixed assets are not available.

### R&D incentives
New R&D funding measures were announced in the 2010 Budget. Broadly, NZD 321 million of targeted funding has been allocated to research, science, and technology activities over the next four years.

The most significant measure is NZD 189.5 million of funding for technology development grants. These grants are available to medium to large research-intensive businesses that can show that their activities result in wider benefits for New Zealand. The government will contribute 20% of these businesses' expected R&D expenditure for three years, up to a set maximum. The grants are not administered through the tax system.

### Trans-Tasman imputation
Elective rules allow trans-Tasman groups of companies to attach both imputation credits (representing New Zealand tax paid) and franking credits (representing Australian tax paid) to dividends paid to shareholders.

### Foreign tax credits
If a New Zealand resident company derives overseas income which is subject to New Zealand income tax, generally the company is allowed a credit for the foreign income tax paid in respect of that income. Generally the credit is limited to the lesser of the actual overseas tax paid on the overseas income or the New Zealand tax applicable to the overseas income.

## Withholding taxes

Resident corporations paying certain types of income are required to withhold tax on gross income, as shown in the table below.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations | 28 (1) | 28 (1) | 0 |
| Resident individuals | 33 | max 33 | - |
| | | | |
| Non-resident corporations and individuals | (2) | (3) | |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| No treaty | 30 (4) | 15 (5) | 15 |
| Treaty: | | | |
| Australia | 0/5/15 (10) | 0/10 (10) | 5 (10) |
| Austria | 15 | 10 | 10 |
| Belgium (13) | 15 | 10 | 10 |
| Canada (12) | 15 | 15 | 15 |
| Chile | 15 | 10/15 (6) | 10 |
| China, P.R. | 15 | 10 | 10 |
| Czech Republic | 15 | 10 | 10 |
| Denmark | 15 | 10 | 10 |
| Fiji | 15 | 10 (5) | 15 |
| Finland | 15 | 10 | 10 |
| France | 15 | 10 | 10 |
| Germany | 15 | 10 | 10 |
| Hong Kong | 0/5/15 | 0/10 | 5 |
| India | 15 | 10 | 10 |
| Indonesia | 15 | 10 | 15 |
| Ireland, Rep. of | 15 | 10 | 10 |
| Italy | 15 | 10 | 10 |
| Japan | 15 | 15 (5) | 15 |
| Korea, Rep. of | 15 | 10 | 10 |
| Malaysia | 15 | 15 (5) | 15 |
| Mexico | 15 | 10 | 10 |
| Netherlands | 15 | 10 | 10 |
| Norway | 15 | 10 | 10 |
| Philippines | 15 | 10 | 15 |
| Poland | 15 | 10 | 10 |
| Russian Federation | 15 | 10 | 10 |
| Singapore (11) | 5/15 | 10 | 5 |
| South Africa | 15 | 10 | 10 |
| Spain | 15 | 10 | 10 |
| Sweden | 15 | 10 | 10 |
| Switzerland | 15 | 10 | 10 |
| Taiwan | 15 | 10 | 10 |
| Thailand | 15 | 10 | 10/15 (7) |
| United Arab Emirates | 15 | 10 | 10 |
| United Kingdom (8) | 15 | 10 | 10 |
| United States (9) | 0/5/15 (9) | 10 (9) | 5 (9) |

Notes

1. Resident WHT applies to both interest and dividends. Unless the recipient corporation holds an exemption certificate, and if the recipient provides a tax file number, the default rate of the interest WHT is 28% (33% prior to 1 April 2011). Recipients can elect for the rate of interest withholding to be 38%. The rate of interest WHT is 38% where the recipient does not provide a tax file number. The rate of WHT on dividends paid is 28%, but the tax is reduced by the aggregate imputation and withholding payment credits attached to the dividend or taxable bonus share. Interest and dividends paid between group companies and in certain other limited circumstances are exempt from the WHT.
2. The foreign investor tax credit and conduit tax relief regimes previously provided relief to companies paying dividends to non-resident investors. However, these regimes have now largely been abolished.

3. Resident corporations paying interest to non-associated, non-resident corporations and individuals need not withhold tax if they have approved-issuer status and the security under which interest is payable is registered with Inland Revenue. In this case, the resident corporation pays a 2% levy (tax deductible) on the interest payments instead of the WHT otherwise applicable.
4. Non-resident WHT is imposed on dividends at the following rates regardless of the jurisdiction to which the dividends are paid:
   - 0% for fully imputed dividends paid to a shareholder holding 10% or more of the direct voting interests in the company and fully imputed non-cash dividends.
   - 15% for fully imputed cash dividends paid to a shareholder holding less than 10%.
   - 30% in most other cases, subject to any relief available under a DTA.
5. Net interest income is subject to reassessment at the company tax rate where the payer and the recipient are 'associated persons', but WHT is the minimum liability. Non-resident WHT is not imposed where the recipient of the interest has a fixed establishment in New Zealand.
6. 10% if the interest received is derived from loans granted by banks or insurance companies. In all other cases, 15%.
7. 10% or 15%, depending on the type of royalty.
8. The Government has announced that it is re-negotiating New Zealand's DTA with the United Kingdom.
9. A Protocol to update the DTA between the United States and New Zealand came into force on 12 November 2010. The key changes include amendments to the WHT rates on dividends, interest, and royalties. The new WHT rates apply as of 1 January 2011.
   The WHT rate on dividends is reduced from 15% to a maximum of 5% for an investor who holds at least 10% of the shares in the company that pays the dividend and to 0% if the investor holds 80% or more of the shares in the company and meets other criteria.
   The WHT on royalties is reduced from 10% to 5% and the definition of 'royalties' will be revised to exclude payments for leased equipment.
   The rate on interest generally remains at 10%, although it will drop to 0% for interest paid to lending or finance businesses, provided that the 2% approved issuer levy is paid on New Zealand-sourced interest.
10. The new DTA that applies to WHT from 1 May 2010 lowers WHT rates on dividends, interest and royalties. The standard WHT on dividends is reduced to 5% for an investing company that has at least a 10% shareholding in the company paying the dividend. The rate reduces to 0% if the investing company holds 80% or more of the shares in the other company and meets other criteria. The WHT rates on interest stays at 10% in the new agreement but is reduced to 0% if it is payable to eligible financial institutions. The WHT on royalties is reduced from 10% to 5%.
11. These rates apply from 1 October 2010. The key changes to the DTA include amendments to the WHT rates on dividends, interest, and royalties. The standard WHT rate on dividends reduces to 5% for an investing company that has at least a 10% shareholding in the company paying the dividend. The WHT rate on interest is reduced from the current 15% to 10%. The WHT rate on royalties is reduced from 10% to 5%.
12. The Government has announced that the DTA with Canada will be re-negotiated.
13. The Government has signed an amending Protocol which updates the 1981 DTA between New Zealand and Belgium.

## *Tax administration*

### *Returns*

Tax returns are based on the fiscal year ending 31 March, although other fiscal year-ends are possible if permission is obtained. The system is one of self-assessment, under which the corporation files an income tax return each year. For those not linked to a tax agent, returns must be filed by 7 July for March balance dates, or by the seventh day of the fourth month following a substituted balance date. The terminal tax due date is extended by two months for taxpayers linked to a tax agent.

### *Payment of tax*

Where provisional tax paid is less than the amount of income tax deemed due on that instalment date, interest is imposed. If provisional tax is overpaid, interest is payable to the taxpayer. Interest is deductible for tax purposes by business taxpayers, and interest earned on overpaid provisional tax is gross income for tax purposes. The interest rate for unpaid tax is 8.89%, while the rate for overpaid tax is 2.18%.

The final assessed tax (terminal tax) is generally payable on the seventh day of the 11th month following the end of that income year or the13th month following if the taxpayer has a tax agent with an 'extension of time' arrangement. For a standard (31 March) balance date, this means either 7 February or 7 April of the following year.

### *Calculating provisional tax*

For the 2011/2012 income year (i.e. year ending 31 March 2012), provisional taxpayers have the following four options:

- Where the 2010/2011 return of income has been filed, 2011/2012 provisional tax can be based on 100% of the 2010/2011 residual income tax.
- Where the 2010/2011 return of income has not been filed, due to an extension of time for filing, 2011/2012 provisional tax can be based on 105% (previously 110%) of the 2009/2010 residual income tax, but only for the first two instalments. The final instalment must be calculated based on the first option above.
- Provisional tax can be based on a fair and reasonable estimate of 2011/2012 residual income tax.
- The GST ratio option.

The GST ratio method has been introduced to enable smaller taxpayers to align their provisional tax payments with their cash flow and reduce their exposure to use of money interest. The option is intended to benefit those taxpayers with declining, seasonal, or fluctuating income. This option calculates provisional tax by reference to the taxpayer's GST taxable supplies in the relevant provisional tax instalment period.

Taxpayers can also make voluntary payments. Such payments can be made to minimise exposure to use of money interest. A taxpayer choosing to estimate residual income tax is required to take reasonable care when estimating.

When the taxpayer's return of income for the year is furnished, the provisional tax paid for that year is credited against the tax assessed. This results in either a refund or further tax to pay by way of terminal tax.



### *Tax pooling*

Taxpayers are able to pool their provisional tax payments with those of other taxpayers through an arrangement with a commercial intermediary. Tax pooling allows underpayments to be offset by overpayments within the same pool and vice versa.

### *Tax penalties*

An initial late payment penalty of 1% applies if a tax payment is not made on the due date. A further 4% late payment penalty applies if the payment is not made within seven days of the due date. An incremental late payment penalty of 1% is then imposed monthly until payment is made.

Inland Revenue is required to notify a taxpayer the first time their payment is late rather than imposing an immediate late payment penalty. If payment is not made by a certain date, a late payment penalty will be imposed. Taxpayers will be entitled to one notification every two years. After receiving a first warning, the Inland Revenue will not send further notifications for two years, and an initial late payment penalty will be imposed in the normal manner.

### *Shortfall penalties*

Shortfall penalties, calculated as a percentage of the tax shortfall resulting from the action or position taken by the taxpayer in a tax return, may also apply.

There is a 50% discount on certain penalties where the taxpayer has a past record of 'good behaviour' and, in certain circumstances, a cap of NZD 50,000 on shortfall penalties for not taking reasonable care or for taking an unacceptable tax position.

## *Other issues*

### *International Financial Reporting Standards (IFRS)*

The relationship between statutory accounting and taxable income is quasi-dependent. The year of final adoption for IFRS was 2007, and the impact on significant areas of tax law is as follows.

#### Comments on tax regime

New Zealand's determination of taxable income starts with the statutory accounts' accounting profit and then specific tax adjustments are made based on rules for revenue recognition and deductible expenditure in the tax legislation. Changes have been made to the tax treatment of 'financial arrangements' (a defined tax legislative term) to allow for the alignment to the accounting recognition of fair values on such arrangements in specific cases.

#### Year of adoption cash impact

Mandatory adoption of NZ IFRS accounting standards for most entities (except for small & medium enterprises) applied for balance dates beginning 1 January 2007. Depending on the specific IFRS adoption adjustment, the resulting income or expenditure is taken into taxable income based on the ordinary statutory tax provisions. The key areas which were changed for tax under IFRS adoption are the trading stock provisions (which align tax with accounting standards subject to some provisions) and the financial arrangement rules. These rules are very broad and deal with the tax treatment of accrual income or expenditure on debt instruments, debt type instruments, derivatives, etc.

#### Thin capitalisation

The thin capitalisation rules work on a debt over assets percentage. It relies mostly on the tax legislative definition for debt and the amount disclosed in the financial statements under generally accepted accounting practice as assets (although there are some other measurement alternatives).

#### Debt versus equity classifications

The classification of debt and equity instruments for tax is dependent on the tax legislative definitions for specific purposes (such as the spreading of any deductions or income where the financial arrangement rules apply, thin capitalisation, etc). Tax applies legal form and does not strictly rely upon the classification applied under IFRS.

#### Lease versus sale determinations

There are specific tax provisions dealing with finance leases.

#### Distributable reserves

The level of distributable reserves is based on the company law requirements of solvency and not specifically on the amounts shown as reserves in the financial statements.

#### Transfer pricing determination

There have been no specific comments released yet by the New Zealand Revenue Authority on the adoption of IFRS impact for transfer pricing.

**Financial arrangements**
Specific timing rules apply to the recognition for income tax purposes of income and expenditure in relation to financial arrangements, which apply to New Zealand residents or entities carrying on business in New Zealand.

A number of changes to the financial arrangements rules have been enacted to ensure that taxpayers who adopt IFRS can continue to use tax rules that rely on accounting practice. For other taxpayers, the existing tax spreading methodologies continue to apply but without the option of using the financial reporting method.

The new rules include a combination of compulsory methods and elective methods that are available subject to the taxpayer meeting certain qualification criteria. Two new methods (the expected value method and the equity-free fair value method) have been introduced to assist in reducing exposure to volatility that might otherwise arise under IFRS fair value accounting.

# Nicaragua

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## Significant developments

Equity Tax Law Reform No. 712 and Decree No. 93-2009 on Regulation of Equity Tax Law Reform became effective as of 1 January 2010.

The main amendments introduced by the law reform and its regulations include:

- Dividend and profit remittance abroad are subject to a 10% withholding tax (WHT). Interest payments generated by loans that are provided by non-resident financial institutions are also subject to a 10% WHT.
- Interest earned on government bonds and securities is considered taxable income subject to a 10% WHT.
- A 1% definitive minimum tax is applied to gross taxable income.
- A non-creditable excise tax on tobacco cigarettes now applies on imports.

## Taxes on corporate income

Nicaragua has a territorial income tax system under which only income generated in, or that causes effects in, Nicaragua is generally subject to income tax. The corporate income tax is imposed on a corporation's profits, which consist of business/trading income, passive income, and capital gains. General business expenses are allowed as a deduction in computing taxable income.

### Income tax rates

Income tax is levied only on domestic-sourced income at a flat rate of the higher of:

- 30% of net taxable income (i.e. gross taxable income less allowed deductions) or
- A definitive minimum tax of 1% on gross income obtained during the fiscal year. If the company does not have net income, 30% of net income will not be greater than 1% of gross income.

The law establishes the following exceptions to the 1% definitive minimum tax:

- First three fiscal periods of recently incorporated entities.
- Taxpayers whose sales prices are controlled by the government.
- Taxpayers that ceased operations on account of force majeure.

## Corporate residence

Corporate residence is determined by the place of incorporation.

Residents and non-residents are taxed only on Nicaraguan-source income.

## Other taxes

### Value-added tax (VAT)

VAT is imposed at a 15% rate on the:

- sale of goods
- rendering of services
- grant of use of assets, and
- import of goods.

VAT exemptions include:

- medicine
- real estate transfer
- sale of used goods
- basic food products
- credit instruments
- tuition, and
- textbooks and educational supplies.

Taxpayers may recover VAT paid for the purchase of goods and services used to generate other goods and services subject to VAT. This is known as VAT liquidation, which is determined by subtracting VAT credits paid on transactions needed to generate taxable income for VAT purposes from VAT collected on the sales of goods or the rendering of services. Note that VAT paid on transactions to generate non-taxable income for VAT purposes are not allowed as VAT credits.

VAT returns must be filed on a monthly basis with payment due in full on the same day. Taxpayers registered as high-taxpayers (with annual income greater than 6 million Nicaraguan córdobas (NIO)) must present an advanced bi-weekly VAT return in the first five days after the 15th day of each month and a definite return in the first five days of the following month.

### Selective consumption tax

A selective consumption tax is applied to goods that are considered to be non-essential. The tax base is the cost, insurance, and freight (CIF) price for imported items, and the tax is levied and paid only at that stage (based on the list of products published as an appendix to the Fiscal Equity Law and its reforms).

### Excise taxes

A non-creditable excise tax on tobacco cigarettes applies on imports.

### Municipal sales and services tax

A monthly 1% tax is levied on all sales of goods and rendering of services in each of the municipalities of the country.

### Municipal registration tax
An annual 2% tax is levied by each municipality on the average of income received in the months of October, November, and December of the previous year. In the case of the incorporation of a new establishment or enterprise, the municipal registration tax is 1% of the capital invested.

### Real estate municipal tax
The real estate municipal tax is an annual tax that is levied at a rate of 1% on 80% of cadastral value, as recorded by the government. If the cadastral value is not available, the cost or fiscal appraisal value may be used.

### Stamp taxes
Stamp duty is levied on certain types of documents issued in Nicaragua.

## Branch income

Branch income received is subject to the general corporate income tax.

## Income determination

Taxable income is determined by the sum of all income or gains derived from Nicaraguan sources, less allowable deductions, which generally include all expenses necessary to generate taxable income. Taxable income is computed according to International Financial Reporting Standards (IFRS) and modified as required by Nicaraguan income tax law.

### Inventory valuation
Last in first out (LIFO), first in first out (FIFO), and the average cost methods are accepted for inventory valuation purposes. Tax Authorities shall authorise the change of a valuation method.

### Capital gains and losses
Capital gains and losses are treated as ordinary taxable corporate income. Capital gain transactions that require any annotation in the public registry (e.g. real estate, vehicles) will be subject to a WHT based on the amount of the transaction, as follows:

| Good value (USD) | | Rate (%) |
|---|---|---|
| From | Through | |
| 0.01 | 50,000.00 | 1 |
| 50,000.01 | 100,000.00 | 2 |
| More than 100,000.01 | | 3 |

### Foreign income
Business enterprises are subject to income tax only on Nicaraguan-source income.

### Stock dividends
Stock dividends paid by Nicaraguan entities to resident or non-resident shareholders are subject to 10% WHT.

The Equity Tax Law Reform regulations define “stock dividends” as stock dividends paid as well as the remittance of net income after income tax made by branches to headquarters and any payments considered as advance net income remittance abroad or locally.

### *Interest income*

Interest received from Nicaraguan source by residents or non-residents of Nicaragua, as well as the interest gained by resident from deposits placed in the national financial system, is subject to a 10% WHT.

Interest earned on government bonds and securities is considered taxable income subject to a 10% WHT.

## *Deductions*

### *Depreciation*

Depreciation must be computed using the straight-line method. Depending on the type of construction and the estimated life of fixed assets, annual rates for depreciation are as follows:

| Assets | Rate (%) |
|---|---|
| Buildings | 3, 5, 10 |
| Vehicles | 12.5, 20 |
| Plant and equipment | 10, 15, 20 |
| Other assets | 10, 20 |



### Alternative method of depreciation

Taxpayers under the Temporary Admission for Active Processing (TAP) regime may, at their convenience, request a different depreciation rate (i.e. accelerated depreciation) from tax authorities. Used fixed assets acquired abroad could also be subject to a different depreciation rate.

### *Interest expenses*

A deduction is allowed for any interest paid on loans with national and foreign financial institutions.

In order for interest paid to a non-resident to be deductible, the corresponding 10% WHT must be withheld and paid.

### *Bad debt*

Corporations are allowed a deduction for receivables as an allowance for doubtful accounts as long as there is supporting documentation of the credit, identification documents of the debtor and creditor, and administrative and judicial collection proof.

### *Charitable contributions*

A deduction is allowed, up to 10 % of the corporation’s income, for charitable contributions made to the government and its institutions, Red Cross, and other organisations.

### Compensation
A deduction is allowed for payments made to employees as bonuses or in addition to their salaries or wages.

### Life insurance
A deduction is allowed for employee insurance payments made.

### Fines and penalties
Penalties or charges made by tax, customs, Social Security, or municipal authorities are not deductible for income tax purposes.

### Taxes
In principle, income tax expense is not deductible for income tax purposes. Municipal or local taxes (i.e., real estate tax, monthly income tax, annual registration tax) are deductible from income taxes.

### Net operating losses
Losses may be carried forward and deducted from future profits, for up to three years. The carryback of losses is not allowed.

### Payments to foreign affiliates
Payments made from affiliates to foreign related parties are deductible for income tax purposes provided the following requirements are met:

- The expenses (i.e. royalties, interest, and services) are needed to generate taxable income.
- The expenses are duly supported (e.g. agreements, invoices, payment receipts).
- The expenses are incurred within the fiscal period.
- The WHT is applied and paid to the Tax Authorities.

## Group taxation

Section 3 of the Equity Tax Law recognises 'economic units' as a taxpayer formed by many entities of one group. However, group taxation is not permitted. Each entity is required to file a separate return.

## Tax credits and incentives

### Tourism incentives
Under present law, and on a case-by-case basis, new companies with tourist activities may request and the government may grant, during the facilities' construction phase, total exemption of customs duties and partial or total income tax exemption for a maximum period of ten years.

### Renewable energy incentives
The renewable energy sector is covered by a special law with tax benefits or exemptions in corporate income tax, VAT, customs duties, and municipal tax.

### Free trade zones
Free trade zone industries have a special law with tax benefits or exemptions in corporate income tax, VAT, customs duties, and municipal taxes.

An industrial export zone decree provides a 15 year exemption from income tax to those taxpayers located in certain free trade zones. There is a 100% exemption for the first ten years and 60% exemption for the following five years. Additional requirements and provisions apply.

In accordance with the Agreement on Subsidies and Countervailing Measures issued by the World Trade Organization (WTO), by the end of year 2015 all tax exemptions granted to free trade zones shall be eliminated. However, Nicaragua falls under the exception of section 27 of this agreement and qualifies as a country listed in Annex VII (for being a developing economy) as a country with per capita GNP of less than USD 1,000, based on World Bank estimates. Due to this exception, it is foreseen that the tax holiday will still apply to free trade zone industries in Nicaragua past 2015.

## *Withholding taxes*

### *Payments to residents*

Dividend payments to resident shareholders (corporations or individuals) are subject to 10% WHT.

Payments of royalties to resident individuals or corporations are subject to 2% WHT.

Interest paid to a resident individual or legal entity is subject to 10% WHT.

Professional services provided by an individual are subject to 10% WHT.

Payments on the local acquisition of goods and services are subject to 1% WHT.



### *Payments to non-residents*

Payments of royalties, interest, dividends, and service fees to non-resident corporations are subject to WHT, as follows:

| | Taxable income (%) | Tax rate (%) |
|---|---|---|
| Royalties | 70 | 21 |
| Dividends | – | 10 |
| Services provided in general | 35 | 10.5 |
| Interest: | | |
| Non-financial companies | – | 10 |
| Financial companies | 0 | 10 |
| TV and Radio programming or subscription | 30 | 9 |

Payments of any kind of income to non-resident individuals are subject to WHT of 20%.

## *Tax administration*

### *Returns*

Without exception, all corporations and individuals are required to file tax returns for a fiscal year within the following three months after the fiscal year end, which commonly ends on 30 June; however, companies can obtain authorisation from tax authorities in order to change or have a different year-end: 31 March, 30 September, or 31 December.

### *Payment of tax*

Corporations shall pay fiscal-year income tax in monthly advance payments. The monthly payable amount is calculated as 1% of gross income.

# Nigeria

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## Significant developments

The tax regime in Nigeria is relatively stable. The last major changes to the tax legislation came into effect in 2007; however, there is ongoing tax reform with a new National Tax Policy, a gradual move towards electronic tax filing and payments, as well as re-writing of the tax laws in plain English for ease of understanding, interpretation, and application.

Below are some of the recent developments in the tax environment and significant potential changes under consideration.

### Nigerian Content Development Act

The Nigerian Content Development Act was introduced to increase the level of Nigerian participation in the oil and gas industry. The Act introduces a levy of 1% on every contract awarded in the upstream oil and gas sector of the economy. Any violation of the Act is liable for a fine of 5% of the contract value and may result in outright cancellation of the contract.



### Petroleum Industry Bill

There is an ongoing legislative process to combine 16 different national petroleum laws into a single document called the Petroleum Industry Bill. The bill aims to ensure transparency, make industry participation more equitable, and maximise government revenue. Once enacted, a two-tier tax system consisting of a corporate income tax (CIT) and hydrocarbon tax will apply to exploration and production companies. Each tax will not be deductible for calculation of profits liable to the other tax.

### Employee Compensation Act

A new Employee Compensation Act was enacted on 18 January 2011 to replace the old Workmen Compensation Act. Under the new Act, all employers are required to contribute 1% of their payroll cost in the first two years of commencement of the Act. Subsequently, assessments will be issued by the Nigeria Social Insurance Trust Fund, the body empowered to administer and implement the Act.

### Tax exemption for all bonds

The Federal Government has issued a proposal to grant a tax waiver on interest on all bonds, including corporate and sub-national bonds. The waiver is designed to encourage more activities in the bond market and ensure cheaper and stable long-term source of funds for project finance and economic development. Currently, tax exemption is only applicable on Federal Government bonds.

### New Value-added Tax (VAT) Act

A new VAT Act is currently being drafted and is expected to be enacted into law by 2012. Some of the major changes to be introduced include enhanced input VAT claim compared to the current system where claimable input VAT is restricted to raw materials and trading stock. Also the rate of tax will increase from 5% to 10%.

### *Transfer pricing guidelines*

The Federal Inland Revenue Service (FIRS) is currently working on the introduction of formal transfer pricing guidelines which are expected to be published not later than the first quarter of 2012. The guidelines are expected to be in conformity with the Organisation for Economic Co-operation and Development (OECD) guidelines. Nigeria currently does not have specific transfer pricing guidelines.

## *Taxes on corporate income*

The corporate income tax (CIT) rate is 30%, assessed on a preceding year basis (i.e. tax is charged on profits for the accounting year ending in the year preceding assessment).

Resident companies are liable for CIT on their worldwide income while non-residents are subject to CIT on their Nigeria-source income. Investment income paid by a Nigerian resident to a non-resident is sourced in Nigeria and subject to withholding tax (WHT) at source, which serves as the final tax.

In respect of business profits, a non-resident company which has a fixed base or a permanent establishment (PE) in Nigeria is taxable on the profits attributable to that fixed based. As such, it is required to register for CIT and file its tax returns. Any WHT deducted at source from its Nigeria-source income is available as offset against the CIT liability.

### *Small company rates*

For small companies in the manufacturing industry and wholly export-oriented companies with turnover not exceeding 1 million Nigerian naira (NGN) (about USD 6,700), the CIT rate is reduced to 20% in the first five calendar years of operation.

### *Petroleum profit tax (PPT)*

PPT is a tax on the income of companies engaged in upstream petroleum operations in lieu of CIT.

The PPT rates vary as follows:

- 50% for petroleum operations under production sharing contracts (PSC) with the Nigerian National Petroleum Corporation (NNPC).
- 65.75% for non-PSC operations, including joint ventures (JVs), in the first five years during which the company has not fully amortised all pre-production capitalised expenditure.
- 85% for non-PSC operations after the first five years.

### *Education tax*

An education tax is levied on every Nigerian resident company at the rate of 2% of the assessable profit for each year of assessment. The tax is payable within two months of an assessment notice from the FIRS. In practice, many companies pay the tax on a self assessment basis along with their CIT.

For companies subject to PPT, education tax is to be treated as an allowable deduction. For other companies, income/profit taxes are not deductible in arriving at taxable income. Non-resident companies and unincorporated entities are exempt from education tax.

### *Minimum tax*
Minimum tax is payable by companies having no taxable profits for the year or where the tax on profits is below the minimum tax. However, companies in the first four calendar years of business, companies engaged in the agriculture business, or companies that have foreign equity capital of at least 25% are exempt from minimum tax.

Minimum tax payable is calculated as follows:

- Where the turnover of the company is NGN 500,000 or below, minimum tax is the highest of:
  - 0.5% of gross profits
  - 0.5% of net assets
  - 0.25% of paid up capital, or
  - 0.25% of turnover of the company for the year.
- Where the turnover is higher than NGN 500,000, minimum tax is the highest of the calculations listed above plus 0.125% of turnover in excess of NGN 500,000.

### *Alternative tax on distribution*
There is a tax on distribution where a company pays a dividend in excess of its taxable profit. Such a company will be charged tax on the dividend paid as if the dividend is the taxable profit of the company for that year of assessment.

### *Alternative tax on deemed income*
Non-resident companies are subject to tax on the income or profit derived from Nigeria. The FIRS often assesses non-resident companies on a deemed income basis. This is done by applying 20% of turnover as deemed profit and then charging CIT at 30%, resulting in an effective tax rate of 6% on turnover.



## *Corporate residence*

A company is considered resident in Nigeria if such a company is registered or incorporated under the Companies and Allied Matters Act. This means that a company formed outside Nigeria under the laws in force in the foreign territory will be considered as a non-resident company for tax purposes.

### *Permanent establishment (PE)*
Fixed base is not defined but is generally considered to be a location with a degree of permanence. The following would generally not be considered to be a fixed base:

- The use of facilities solely for the purpose of storage or display of goods or merchandise.
- The use of facilities solely for the collection of information.

Other activities that could trigger a tax presence in Nigeria include a dependent agency arrangement, execution of a turnkey project, or artificial arrangements between related parties.

## Other taxes

### Value-added tax (VAT)

The standard VAT rate is 5%, but there is a proposal to increase the rate to 10%. Zero-rated items include non-oil exports, goods and services purchased by diplomats, and goods and services purchased for use in humanitarian donor funded projects. Exempt items include plants and machinery for use in export processing zones or free trade zones, basic food items, medical products and services, pharmaceutical products, books and educational materials, and exported services.

As of 1 September 2007, oil and gas companies are required to deduct VAT at source and remit to the tax authority.

### Custom duties/Import tariffs

Customs duties in Nigeria are levied only on imports. Rates vary for different items, typically from 5% to 35%, and are assessed with reference to the prevailing Harmonized Commodity and Coding System (HS code).

### Excise taxes

Excise duty is applicable on beer and stout, wines, spirits, cigarettes, and tobacco manufactured and sold in Nigeria at rates ranging from 5% to 20%.

### Property taxes

Property taxes in Nigeria are usually levied by the state government with varying rates depending on the state and the location of the property within the state. The two major property taxes are governor's consent fee and land registration fee. In Lagos (which is the economic hub of Nigeria), governor's consent fee, land registration fees, and other levies payable to the state give rise to a total levy of 15% of the transfer value of the land. Also, Right of Occupancy fee and tenement rates are chargeable by state and local government authorities.

### Stamp taxes

Under the Stamp Duty Act, stamp duty is payable on any agreement executed in Nigeria, or relating, whatsoever, to any property situated in or to any matter or thing done in Nigeria. Instruments which are required to be stamped under the Stamp Duties Act must be stamped within 40 days of first execution.

Stamp duty is chargeable either at fixed rates or *ad valorem* (i.e. in proportion to the value of the consideration) depending on the class of instrument. Stamp duty is imposed at the rate of 0.75% on the authorised share capital at incorporation of a company or on registration of new shares.

### Capital gains tax (CGT)

Gains accruing to a chargeable person (individual or company) on the disposal of chargeable assets shall be subject to tax under the Capital Gains Tax Act at the rate of 10%. There is no distinction between long-term and short-term gains and no inflation adjustment to cost for CGT purposes.

All forms of assets, including options, debts, and foreign currency, other than those specifically exempt, are liable for CGT. The gains on the disposal of shares are exempt from CGT.

CGT is applicable on the chargeable gains received or brought into Nigeria in respect of assets situated outside Nigeria.

Capital losses are not allowed as an offset against chargeable gains accruing to a person from the disposal of any assets.

### *Information technology levy*
The National Information Technology Development Agency (NITDA) Act No. 27 was introduced in 2007 and took effect beginning from the 2008 year of assessment. The act stipulates that a company with an annual turnover of NGN 100 million or more is required to pay 1% of its profit before tax as information technology tax. This levy is tax deductible when paid (typically in the year of assessment following that in which the payment was made).

This tax is applicable to:

- Banking and other financial activities, including capital and money market operators, mortgage institutions, and micro-finance banks.
- Insurance activities, including brokerage.
- Pension fund administration, pension management, and related services.
- GSM services providers and telecommunication companies.
- Cyber and internet services providers.

### *Levy on contracts awarded in the upstream oil and gas sector*
The Nigerian Content Development Act was introduced to increase the level of Nigerian participation in the oil and gas industry. The Act introduces a levy of 1% on every contract awarded in the upstream oil and gas sector of the economy. Any violation of the Act is liable for a fine of 5% of the contract value and may result in outright cancellation of the contract.

### *Payroll contribution*
A new Employee Compensation Act was enacted on 18 January 2011 to replace the old Workmen Compensation Act. Under the new Act, all employers are required to contribute 1% of their payroll cost in the first two years of commencement of the Act. Subsequently, assessments will be issued by the Nigeria Social Insurance Trust Fund, the body empowered to administer and implement the Act.



## *Branch income*

Except in rare circumstances, it is illegal for a non-resident company to operate through a branch in Nigeria. The Nigeria-source income of a non-resident company is taxable at the CIT rate of 30% or via the alternative tax on deemed income *(see the Taxes on corporate income section for more information).*

## *Income determination*

The following income is subject to CIT in Nigeria:

- Profits accruing in, derived from, brought into, or received in Nigeria in respect of any trade or business.
- Dividends, interest, royalties, discounts, charges, or annuities.
- Rent or any premium arising from the right granted to any person for the use or occupation of any property, where applicable.
- Any source of annual profits or gain not falling within the preceding categories.
- Fees, dues, and allowances (wherever paid) for services rendered.

- Any amount of profits or gains arising from the acquisition or disposal of short-term money instruments like federal government securities, treasury bills, treasury or savings certificates, debenture certificates, and treasury bonds.

### *Inventory valuation*
The first in first out (FIFO) valuation method is commonly used. Average and standard cost methods are also allowed, but last in first out (LIFO) is not permitted. Other than the accounting requirement in the local generally accepted accounting principles (GAAP), there are no special statutory provisions for inventory valuation.

### *Capital gains*
Capital gains are not subject to CIT, but may be subject to CGT. *See Capital gains tax in the Other taxes section for more information.*

### *Dividend income*
Dividends received by a Nigerian resident company from another Nigerian resident company are taxable at source *(see Withholding taxes section for more information)* and not subject to further tax.

Dividends received from non-resident companies are taxable except if repatriated into Nigeria through government approved channels (i.e. any financial institution authorised by the Central Bank of Nigeria to deal in foreign currency transactions).

### *Stock dividends*
Stock dividends (bonus shares) are not taxable at source or included in the taxable income of the recipient company.

### *Foreign income*
A Nigerian resident company is taxable on its worldwide income. On the other hand, a non-resident company is subject to tax only on income derived from Nigeria.

Dividends, interest, rents, and royalties earned abroad and brought into Nigeria through Government approved channels are exempt from Nigerian tax; otherwise, the income is taxable at the CIT rate of 30% and education tax at 2%. Government approved channels means the Central Bank of Nigeria and any bank or financial institution authorised to carry out foreign exchange transactions.

## *Deductions*

Expenses are deductible for tax purposes if they are wholly, reasonably, exclusively, and necessarily incurred for the business or trade. Examples of such expenses are:

- Sum payable by way of interest on capital borrowed.
- Rent for the period.
- Expenses incurred in respect of salary and wages.
- Expenses incurred for repair of assets.
- Bad debt incurred in the course of trade.
- Liability incurred for purpose of trade.
- Research and development costs.
- Donations subject to the provisions of the law.

### *Depreciation*
Capital allowances are calculated on a straight-line basis. Capital allowances claimable in any year are restricted to two-third of assessable profits for all companies, except companies in the manufacturing and agricultural sectors which are excluded from this restriction.

The following are the capital allowance rates on fixed assets (qualifying expenditures):

| Qualifying expenditure | Initial allowance (%) | Annual allowance (%) |
|---|---|---|
| Building (industrial and non-industrial) | 15 | 10 |
| Furniture and fittings | 25 | 20 |
| Plant expenditure (1) | 50/95 | 0/25 |
| Mining expenditure | 95 | 0 |
| Plantation equipment | 95 | 0 |
| Motor vehicle (2) | 50/95 | 0/25 |
| Ranching and plantation expenditure | 30 | 50 |
| Housing estate expenditure | 50 | 25 |
| Research and development | 95 | 0 |

Notes

1. 95% initial allowance for plant used in agricultural production; others 50%.
2. 95% initial allowance is granted for motor vehicles used for public transportation if the company has a fleet of at least three buses; all other motor vehicles 50%.

The initial allowance is first deducted, and the balance is written off on a straight-line basis over a fixed period, depending on the rates of annual allowance. There is a requirement that assets not yet disposed of cannot be fully written off in the books. A nominal amount of NGN 10 per asset must be retained in the books till the assets are disposed of. However, where 95% has been claimed as an initial allowance, the 5% balance is the value that must be maintained in the books until the final disposal of the asset.

When assets are sold, the proceeds over the tax written-down value are taxed at 30% to the extent of the allowances already claimed.

### *Net operating losses*
Losses can be carried forward indefinitely, except for insurance companies where losses can only be carried forward for four years. Losses made from one line of business cannot be relieved against another line of business. Losses cannot be carried back.

### *Payments to foreign affiliates*
Payments considered to be artificial are not deductible for tax purposes. Royalties, management, and technical fees require the approval of the National Office for Technology Acquisition and Promotion (NOTAP) for exchange control purposes and for tax deduction. NOTAP approved royalties and technical fees are limited to a range of 1% to 5% of net sales, while management fees are limited to a range of 2% to 5% of profit before tax, and consultancy fees are limited to 5% of total project cost. Technical fees are limited to approved man-hour rates.

Trademark fees are disallowed where the trademark owner has more than 75% equity participation in the local company.

## Group taxation

There are currently no provisions for group taxation, group relief, or group filing of tax returns in Nigeria. Each legal entity within a group is treated as distinct and separate for tax purposes.

### Transfer pricing

There are no specific transfer pricing rules in Nigeria. However, the tax laws have a general anti-avoidance provision which requires transactions between related entities to be at arm's length.

The FIRS is currently working on the introduction of formal transfer pricing guidelines which are expected to be published not later than the first quarter of 2012. The guidelines are expected to be in conformity with the OECD guidelines.

### Thin capitalisation

Nigeria has no thin capitalisation rules. However, interest charged between related parties is expected to reflect arm's-length transactions. The tax authority may disallow any related party interest considered to be excessive.

## Tax credits and incentives

Nigeria has various tax incentives intended to encourage investment in key sectors of the economy as follows.

### Tax holidays

Pioneer companies investing in specified industrial activities may, on application, be granted a tax holiday for a maximum period of five years. Examples of economic activities that may be granted a tax holiday include glass and glassware manufacturing, manufacturing of fertilisers, and steel manufacturing.

A new company that engages in the mining of solid minerals is exempt from tax for the first three years of its operation.

### Rural location incentives

Certain incentives are available to companies located in rural areas. The incentives take the form of tax reductions at graduated rates for enterprises located at least 20 kilometres from available electricity, water, and tarred roads.

### Export incentives

A company that is engaged in an approved manufacturing activity in an export processing zone (EPZ) and incurs expenditures in its qualifying building and plant equipment is entitled to 100% capital allowance in that year of assessment.

In addition, a company that is 100% export oriented but located outside an EPZ will enjoy a three year tax holiday, provided the company is not formed by splitting up or reconstruction of an already existing business and the export proceeds form at least 75% of its turnover.

Profits of companies whose supplies are exclusively inputs to the manufacture of products for export are exempt from tax. Such companies are expected to obtain a certificate of purchase of the input from the exporter in order to claim tax exemption.

Where plant and machinery are transferred to a new company, the tax written down value of the asset transferred must not exceed 25% of the total value of plant and machinery in the new company. The company should also repatriate at least 75% of the export earnings to Nigeria and place it in a Nigerian domiciliary account in order to qualify for a tax holiday.

Profits of any Nigerian company in respect of goods exported from Nigeria are exempt from tax, provided that the proceeds from such exports are repatriated to Nigeria and are used exclusively for the purchase of raw materials, plant, equipments, and spare parts.

### *Gas utilisation incentives*
Companies engaged in gas utilisation are entitled to:

- A tax free period for up to five years.
- Accelerated capital allowance after the tax free period.
- Tax free dividends during the tax free period.

### *Tourism incentives*
25% of the income derived from tourism by hotels in convertible currencies is exempt from tax if such income is put in a reserve fund to be utilised within five years for expansion or construction of new hotels and other facilities for tourism development.

### *Interest incentives*
Interest accruing on deposit accounts of a non-resident company is tax-exempt, provided the deposits are made by transfer of funds to Nigeria on or after 1 January 1990 and the depositor does not become non-resident after making the deposit while in Nigeria.



Interest on foreign-currency domiciliary accounts is also tax-exempt.

Interest on any foreign loans, and interest on any loan granted by a bank for the purpose of manufacturing goods for export, is exempt from tax as follows:

| Repayment period | Moratorium | Exemption (%) |
|---|---|---|
| Over 7 years | Not less than 2 years | 100 |
| 5 to 7 years | Not less than 1.5 years | 70 |
| 2 to 4 years | Not less than 1 year | 40 |

Interest on any loan granted by a bank to a company engaged in agricultural trade, fabrication of local plant and machinery, or as working capital to any cottage industry is 100% tax free if the loan has a moratorium of not less than 18 months and the rate of interest is not more than the base lending rate.

### *Investment allowances*
An investment allowance of 10% on the cost of qualifying expenditures in respect of plant and machinery is available as a deduction from assessable profits in the year of purchase. There is no restriction to the full claim of capital allowance in any year of assessment for companies in the mining, manufacturing, and agricultural sectors.

### *Foreign tax credit*

Nigeria does not grant automatic tax credits to Nigerian companies for foreign tax on income derived from other countries. The Nigerian tax laws already provides for tax exemption for dividends, interest, and royalties.

Foreign tax credits are only granted based on the provisions of existing double taxation treaties (DTTs) and partial credits as applicable to Commonwealth countries. In this regard, full tax credits are usually provided for in the DTTs. Tax credit for members of Commonwealth countries is granted up to half the Nigerian CIT rate.

## *Withholding taxes*

WHT is applicable on specified transactions as indicated below. There is no distinction between the WHT rates for resident companies or individuals and non-resident companies or individuals.

| Types of payment | WHT for companies (%) | WHT for individuals (%) |
|---|---|---|
| Dividends, interest, and rents | 10 | 10 |
| Directors fees | N/A | 10 |
| Hire of equipment | 10 | 10 |
| Royalties | 10 | 5 |
| Commission, consultancy, technical, service fees | 10 | 5 |
| Management fees | 10 | 5 |
| Construction/building | 5 | 5 |
| Contracts other than sales in the ordinary course of business | 5 | 5 |

The period for filing WHT is 21 days after the duty to deduct arose (previously 30 days) for deductions from companies.

The penalty for failure to deduct or remit tax is now 10% (previously 200%) of the amount not deducted/remitted.

Note that companies are required to submit, in electronic form, a schedule of all their suppliers for the month showing the tax identification number (TIN), address of the suppliers, the nature of the transaction, WHT deducted, and invoice number.

### *Double tax treaties (DTTs)*

Nigeria has DTTs with Belgium, Canada, China, Czech Republic, France, the Netherlands, Pakistan, Philippines, Romania, Slovak Republic, South Africa, and the United Kingdom.

The provisions of Nigeria's DTTs allow a reduced WHT rate of 7.5% on dividends, royalties, and interest payable to a beneficiary resident in a treaty country, compared to 10% for non-treaty residents.

## Tax administration

### Returns

Companies are required to register for tax and file their audited accounts and tax computations with the FIRS within six months of their financial year end on a self-assessment basis or 18 months after incorporation (whichever comes first). A company may file an application for extension of filing tax returns for up to two months at the discretion of the FIRS.

Upon registration, a company is issued a TIN which will serve as the company's file number for all federal taxes and future correspondence with the FIRS.

The company must file the following documents with the tax authority on an annual basis:

- Tax computation for the relevant year of assessment.
- The audited financial statements for the respective period; this should be in conformity with the local GAAP.
- A duly completed and signed self-assessment form for CIT
- Evidence of remittance of the income tax liability (partly or in full).

PPT is payable on an actual year basis. Estimated tax returns must be filed within two months of the fiscal year (which runs from 1 January to 31 December). Actual tax returns should be filed within five months after the end of the accounting period, that is, not later than 31 May.

### Assessment

Nigerian companies file their tax returns based on a self-assessment system where the taxpayer prepares its annual returns and determines its tax liability. However, the FIRS may apply a best of judgment (BOJ) assessment where it is of the opinion that the tax returns filed are deliberately misstated or where no returns are filed within the stipulated period.



### Payment of tax

**CIT**

A company that files its self assessment within six months after the accounting year-end could apply to the FIRS in writing to pay its income tax in instalments. The maximum number of instalments the FIRS may approve is six. Evidence of the first instalment has to accompany the tax returns filed in order to qualify for the instalmental payment. However, all payments have to be made on or before 30 November of the year of assessment.

Assessments are made on a preceding year basis. This means that the financial statements for a period ended in 2010 will form the basis for the 2011 year of assessment.

**PPT**

Payments with respect to PPT in any accounting period of 12 months are made in 12 instalments, with a final thirteenth instalment (if there is an underpayment). The first instalment for the year is due by the end of March.

### Penalty for non-compliance

Late payment of taxes attracts a 10% penalty and interest at commercial rate.

A company that files its annual tax return late or fails to submit its accounts by the due date is liable for a nominal penalty.

Late submission of PPT returns attracts an initial penalty of NGN 10,000 and NGN 2,000 for each day such failure continues, while late payment of tax attracts a penalty of 5% of the tax not paid.

# Norway

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## Significant developments

In March 2011, the Norwegian government released a proposal for legislative amendments that would increase the opportunities for cross border reorganisations.

### Cross border share for share exchanges

According to the proposal, Norwegian shareholders may, under certain conditions, exchange their shares in a limited liability company for shares in a limited liability company on a roll-over basis. This does not relate to companies in low-tax jurisdictions outside the European Economic Area (EEA).

### Cross border mergers and demergers

The Ministry of Finance proposes that a Norwegian limited liability company may merge with a limited liability company within the EEA. A demerger of a Norwegian limited liability company may also be carried out on a tax neutral basis. Concerning a merger and demerger, any Norwegian business operations must be continued in a Norwegian branch. Companies outside Norway may merge or demerge without triggering any Norwegian tax consequences. Assets in a Norwegian branch would get a carryover tax basis if the assets are not transferred out of Norwegian tax jurisdiction.

This does not apply to companies resident in a low-tax jurisdiction outside the EEA. Companies resident in a low-tax jurisdiction within the EEA must actually be established and conduct genuine economic activity within the EEA. The government also proposes tax deferral on transfer of branch assets under certain conditions.

### Exit tax

The government proposes an exemption to the exit charge when companies are moved to another jurisdiction within the EEA. In the event the company is transferred to a low-tax jurisdiction within the EEA, the exemption is contingent on the company being actually established and conducting genuine economic activity in the new resident state after the transfer. To the extent any assets or liabilities are transferred out of Norwegian tax jurisdiction, these will be subject to a gain or loss recognition under the exit tax regime.

## Taxes on corporate income

### Corporate income tax (CIT)

A Norwegian resident company is, as a starting point, subject to CIT on its worldwide income. Non-resident companies are, as a starting point, liable for CIT in Norway when engaged in a business that is either conducted in or managed from Norway.

CIT is assessed at a rate of 28%.

As a general rule, income is taxable when the right to the benefit is earned and costs are deductible when the liability to cover the costs arises. The actual payment is not relevant.

### *Petroleum tax regime*
All upstream petroleum activity on the Norwegian Continental Shelf (NCS) is taxable to Norway.

Taxation is based on net income at a marginal tax rate of 78%, which is composed of the ordinary 28% CIT rate and a 50% special tax. All income is subject to the 28% CIT, while only income from offshore production and pipeline transportation of petroleum from the NCS (offshore tax regime) is subject to the additional 50% special tax.

All upstream activity on the NCS must be consolidated within the company. There is no ring fence per oil field, and tax consolidation against other activity is limited. Crude oil sales from most of the fields are taxed at a predetermined market price set by an official board (i.e. the norm price). A norm price may be imposed on gas sales, but this has not been implemented. Investments in installations for exploitation and production of petroleum as well as investments in pipelines are depreciated linearly over six years.

An investment-based 'supplementary depreciation' (uplift) of 30% (7.5% per year for four years) is granted on investments in installations for exploitation and production of petroleum as well as investments in pipelines. The uplift is deducted against the special tax base. Loss and unused uplift may be carried forward indefinitely with an annual interest. Both depreciation and uplift may be claimed from the year of the investment, regardless of whether title has passed or the asset has been taken into use. If the upstream activity on the NCS ceases, the tax value of loss carryforward and unused uplift may either be sold or compensated by the Norwegian state. Exploration costs are tax deductible as incurred. If a loss is created due to exploration cost, the taxpayer may claim the tax value of such loss repaid in the year following the income year in which the loss was created.

Special rules apply as to the deductibility of net interest cost in the special tax basis (50%).

A special regime ensures that transfer of licenses on NCS are tax exempt, there is no step up in basis.

Note that income taxed under the special tax is not subject to dividend WHT.

### *Hydro power tax regime*
The hydro power tax regime is applicable on taxation of income derived from production, sales, transfer, or distribution of hydro power.

Taxation is based on net income at a marginal tax rate of 58%, which is comprised of the ordinary 28% CIT rate and a 30% resource rent tax. All income is subject to the 28% CIT, while only income from hydro power production is subject to the additional 30% resource rent tax.

The resource rent is calculated per hydro power plant. The gross income is, with some exceptions, calculated based on spot market price per hour multiplied with actual production. In addition, actual income from green certificates is included in the gross income. Deductible costs will be the same as for the CIT; that is, expenses related to the power plant except for interest expenses, which are not deductible. Uplift is granted. Special rules apply to depreciations of investments in hydro power plants. Rent expenditure and depreciations related to waterfalls are not deductible, and waterfalls are not included in the basis for uplift. Tax consolidation is mandatory within the company and, provided the conditions for group taxation are fulfilled, available on a group level. Losses (negative resource rent) on a company (eventually on a group) level will be compensated by the Norwegian state.

### *Shipping tonnage tax regime*

A new tonnage tax model was introduced from the income year 2007 onwards. The new rules are in line with the tonnage tax rules found in other European Union (EU)/ EEA countries and imply that shipping income will be tax-exempt on a permanent basis, while the previous model was based on deferral of the tax liability.

Norwegian tonnage-taxed companies are allowed to keep only certain kinds of assets inside the model (legal assets) and are not allowed to have income from non-tonnage-taxed activities except financial income. If the requirements are not fulfilled, the company would fall outside the scope of the model and be taxed at ordinary rates (28%).

#### Qualifying assets

A tonnage-taxed company must own at least one qualifying asset (i.e. a vessel, for example bulk, tankers, container vessels, car carriers, tugboats, and entrepreneurial vessels and auxiliary vessels for use in the petroleum industry) new building contracts, a 3% share in another tonnage-taxed limited company, or a 3% ownership interest in a partnership or CFC company.

#### Qualifying and legal business activities/income

Qualifying business income is income from operation of the company’s own and chartered vessels. A tonnage-taxed company may, for example, charter vessels in and out on bareboat and time charter terms without limitations. Furthermore, gains upon disposal of vessels and new building contracts are exempt from taxation.



Income from related activities such as sales of goods and services onboard vessels, loading and discharging vessels or leasing out containers and operations of ticket offices is also exempt from taxation. The exemption also applies to income from the strategic and commercial management of the company’s owned and chartered vessels, as well as vessels owned or operated by group companies (more than 50% joint ownership), and vessels operated according to a pool agreement. Pure management companies are not included (i.e. all companies must have at least one qualifying asset).

Financial income is permitted except for income from shares in unlisted companies and ownership interests in partnerships that are not taxed under the tonnage tax system. The condition is that financial activities do not constitute a separate business. Net financial income is subject to ordinary taxation (28 %). Currency gains and losses are partly taxable/ deductible, and interest costs partly deductible corresponding to the proportion between the company’s finance capital and total book capital.

#### Entrance into the tonnage tax system

Entry into the new tonnage tax system is, as a starting point, optional and may take place with effect from 1 January every year, provided that the company has fulfilled the conditions for application of the tonnage tax system from the beginning of the year. Newly established companies will have direct entry and may enter into the tonnage tax system from the date of incorporation. All qualifying companies within the same group should be obliged to make the same election (tonnage taxation or ordinary taxation) with effect from the income year 2009.

Companies that enter into the tonnage tax system are subject to a formal ten-year lock-in period. If a company exits the tonnage tax system before the lock-in period expires, it will be excluded from the tonnage tax system until after the initial lock-in period has ended.

Upon entry into the tonnage tax system, the difference between market value and tax value of the company's assets (including vessels, new building contracts, ownership interests in partnerships, and shares in CFC companies/tax exempt assets) is taxed as a capital gain (28%) that can be offset to the gain and loss account and entered as income with 20 % of the balance each year (balance method). There is continuity for financial assets and assets covered by the tax-exemption rules (qualifying shares and derivatives).

**Exit from the tonnage tax system**
A shipping company may exit the regime on a voluntary basis or may be obliged to do so after breaching specific requirements for companies within the tonnage tax system. As a starting point, there is no exit charge when leaving the regime, and the tax value on the company's assets will be adjusted to market value at the time of exit. However, a possible exit while the company has untaxed gain calculated upon entry into the tonnage tax system could result in tax liability upon exit.

## *Corporate residence*

Companies incorporated in Norway in accordance with Norwegian company law and registered in Norway are, as a general rule, regarded as a tax resident in Norway and taxable for their worldwide income. If management at the board/director level is carried out outside Norway, residency in Norway for tax purposes may cease, and the company may be subject to liquidation for tax purposes. Note that several factors should be considered in order to determine whether tax residency has been moved (e.g. other management functions and the overall nexus to Norway).

Foreign corporations will be regarded as resident in Norway if the place of effective management is in Norway. The place of effective management will, for example, be deemed to be in Norway if the board of directors makes its decisions in Norway.

From a general treaty perspective, residence is determined to be the place where the company has its effective management.

## *Other taxes*

### *Value-added tax (VAT)*
The general VAT rate is 25% and applies to all supplies of goods and services not qualifying for another rate or an exemption. A reduced rate of 14% applies to supply of food and beverages, excluding tobacco, alcohol, medication, and water from waterworks. The reduced rate is not applicable to the supply of food and beverages consumed in restaurants and other food establishments.

A reduced rate of 8% applies to the television licence fee charged for broadcasting services provided by the Norwegian Broadcasting Company (NRK), domestic passenger transport services and procurement of such services, domestic ferry services related to transport of vehicles, accommodation services, and cinema tickets.

Exemptions with credit (zero-rated) include, but are not limited to, the following:

- Export of goods and services.
- Goods and services for Norwegian offshore and non-resident ships.
- Transfer of a going concern.
- Supply of newspapers and books to recipients.
- International transport services.
- Sale of vessels and aircrafts for use in taxable activity.

Exemptions without credit include, but are not limited to, the following:

- Supply of works of art owned by the artist.
- Health services.
- Social services.
- Financial services including banking, insurance, and the sale of shares.
- Educational services.
- Sale and lease of real estate (accommodation and lease of parking lots are taxable).
- Services supplied by cultural and entertainment institutions.
- Upstream activity on the NCS.

Exemptions, whereby an option to tax is available, include the letting of immovable property to VAT liable lessees following a specific VAT registration with the VAT authorities.

The registration threshold is met when VAT taxable supplies, as comprised by the Norwegian VAT legislation (including self-supplies), exceed 50,000 Norwegian kroner (NOK) during a 12-month period. For charitable and public utility institutions and organisations, the threshold is set at NOK 140,000.



### *Customs duties*
There are quite extensive customs duties on agricultural products, which must be paid upon importation. However, it is often possible to avoid customs duties on these products partly or completely by applying for an exemption from the agricultural authorities in advance. Some of these exemptions are subject to tariff quotas.

Clothes are also subject to customs duties upon importation to Norway, but imports comprised by free trade agreements (such as the EEA with the European Union) and the General System of Preferences (for developing countries) are exempt. As a result, clothes will, as a general rule, not be subject to customs duties as long as the importer presents the necessary certificates of origin.

There are no customs duties on other products than agricultural products and clothes.

### *Excise taxes*
Excise taxes are calculated on import and domestic production of the following:

- Petroleum products, including gas.
- Alcoholic beverages.
- Non-alcoholic beverages.
- Ethanol for technical purposes.
- Tobacco.

- Chocolate, candy, sugar etc.
- Maritime engines.
- Products containing the chemicals TRI/PER.
- Products containing the propellant gases HFK/PFK.

There are also excise taxes related to the following:

- Registration of vehicles.
- Use of vehicles (annual tax).
- Emissions of NOx.
- Waste treatment.
- Sale of electricity.

### *Stamp taxes*
A tax is levied on registration of change of ownership to real estate. The tax is calculated as 2.5% of the assessment value.

### *Property taxes*
Hydro power producers must pay a 0.2% to 0.7% (decided by the local municipality, usually 0.7%) property tax on the hydro power plant's capitalised value.

Real estate may, under certain conditions, be subject to property tax. It is up to the different municipalities to choose if it wants to impose property tax or not on real estate. Not all municipalities impose property tax on real estate. The applicable rate varies between 0.2% and 0.7%, which is decided by the municipality. The tax base will normally be market value with some adjustments.

### *Net wealth taxes*
There is no net wealth tax or other capital taxes for limited liability companies, investment funds, state-owned enterprises according to the state-owned enterprise act, inter-municipal companies, and companies in which somebody owns a part in or receives income from, when the responsibility for the companies' liabilities are limited to the companies' capital.

Some institutional holders (e.g. mutual insurance companies, savings banks, co operatives, taxable pension funds, self-owned finance institutions, mortgage credit associations) pay 0.30% (state) net wealth tax. Otherwise, the maximum net wealth tax rate for a corporate body is 1.00% (state and municipal tax).

Shares in limited liability companies and equity funds are valued at 100% of quoted value for net wealth tax purposes as of 1 January of the year after the relevant income year. If quoted both on Norwegian and foreign stock exchange, the Norwegian value will be applicable. If not quoted, the basis for taxation is the company's net assets for wealth tax purposes as per 1 January of the income year in question.

### *Exit tax*
The exit rules levy taxes upon the migration of assets or liabilities. The tax is calculated by reference to the accrued but unrealised gains at the time of migration at a rate of 28%. Exit charges are levied if a company:

- transfers its operational headquarters to another country
- has assets or liabilities that are transferred to a permanent establishment (PE) that is tax-exempt pursuant to a double tax treaty (DTT), or

- has assets or liabilities that are transferred from a Norwegian PE of a foreign company to the head office or a foreign PE of the same company.

Transfer of operational equipment to a PE in a country where the DTT in question is based on the credit method is, however, not regarded as a taxable event.

According to the rules, the tax treatment is different depending on the type of assets being transferred. Business-related operational equipment and financial assets being transferred out of Norwegian taxing jurisdiction are considered as taxable events, but the tax charges may be deferred if certain conditions are met. In addition, the tax charges may be completely avoided if the assets are not sold within five years after they are transferred out of Norway. Transfer of intangible assets and inventory would trigger immediate and unconditional exit charges.

Threshold rules apply when determining whether the exit tax may be levied. Exit tax on the transfer of tangible assets is applicable only if the unrealised capital gains exceed NOK 5 million. Exit tax on the transfer of other assets and liabilities is applicable only if the unrealised capital gains exceed NOK 1 million.

Exit charges at both the corporate and shareholder level will be triggered when companies migrate from Norway because these companies will be deemed to have liquidated.

Note that the exit tax regulations are currently under alteration. *Please see the Significant developments section for more information.*

### *Carbon dioxide (CO2) tax*

A CO2 tax is calculated on petroleum that is flared and natural gas emitted into the air, as well as on CO2 that is separated from petroleum and emitted into the air, on installations used for production or transportation of petroleum. The CO2 tax is regarded as a normal operating cost for CIT purposes and is a fully deductible cost both for corporate and special tax calculations.

| Type of Petroleum | NOK per l/ Sm3/kg | NOK per tonne CO2 |
|---|---|---|
| Petrol | 0.88 | 380 |
| Petroleum, high rate | 0.69 | |
| Aviation turbine kerosine | | 270 |
| Petroleum | 0.59 | |
| Light oil, diesel oil | | 222 |
| Residue | | 188 |
| Petroleum reduced rate | 0.31 | |
| Light oil, diesel oil | | 116 |
| Residue | | 99 |
| Domestic used gas | | |
| Natural gas | 0.44 | 221 |
| LPG | 0.66 | 220 |
| Continental shelf | 0.48 | |
| Light oil, diesel oil | | 180 |
| Residue | | 153 |
| Natural gas | | 205 |

### Natural resource tax

A NOK 0.013 per kWh natural resource tax applies to hydro power activities, based on 1/7 of the produced kWh for the income year in question and the six previous years. The natural resource tax is creditable against the standard CIT.

## Branch income

Branch income is taxed at the corporate rate of 28% (the same as Norwegian companies). The basis for taxation is gross income less deductible costs. Both direct and indirect costs related to the activities carried out in Norway may be deductible. In general, the same tax rules which apply for tax resident companies also apply for branches save for the 3 % rule on qualifying share income, which does not apply for branches.

There is no branch profit tax or other repatriation taxes. However, if assets and/or liabilities are transferred from a PE in Norway to the head office or another foreign PE of the same company, this may trigger exit taxation. The transfer of assets to another corporate entity is subject to regular taxation.

## Income determination

### Inventory valuation

Inventory is valued at cost. Cost is normally determined using the first in first out (FIFO) method. The last in first out (LIFO) method is not acceptable for tax purposes. Conformity between book and tax reporting is not required.

### Capital gains

Capital gains realised in the course of a business activity are almost always regarded as taxable income. Gains resulting from real estate transactions are taxed, regardless of whether they are incurred in connection with business activity. Losses may be offset against the taxpayer's other income.

Capital gains realised on both business-related and non-business-related securities are, in principle, taxable. In general, any capital gains realised on bonds at maturity are regarded as taxable income. Correspondingly, realised losses will be eligible for deductions.

### Tax exemption rules for corporate shareholders

Under the tax-exemption rules, corporate shareholders are generally exempt from tax on dividends received and capital gains on shares and on derivatives where the underlying object is qualifying shares. Correspondingly, losses on shares may, in general, only be offset against other share income and capital gains as comprised of by the said tax rules the year when the losses are incurred. All expenses related to exempt income from shares are fully tax-deductible. In order to limit the benefit of these deductions, the tax-exemption method is limited to 97% of the relevant income, and the remaining 3% is taxable for Norwegian corporate shareholders (at a 0.84% effective tax rate). The 3% taxable income is calculated on dividends and net gains/losses in the income year. Unused losses may not be carried forward.

Note that an investment in a company resident in a low-tax country in the European Economic Area (EEA) has to fulfil certain substance requirements to qualify for the tax-exemption rules. These requirements are intended to be in line with the substance requirements of the European Court of Justice's (ECJ's) decision in the Cadbury Schweppes case. A country is considered a low-tax country if the level of effective taxation is less than two-thirds of the tax that would have been due had the foreign company been resident in Norway. This is the same test used for the controlled foreign company (CFC) regime *(see the Group taxation section for more information).* The Directorate of Taxes has published a non-exhaustive list of low tax jurisdictions (black list) and non-low tax jurisdictions (white list).

However, for investments outside the EEA, the exemption applies only if a shareholder holds 10% or more of the share capital and the voting rights of the foreign company for a consecutive period of two years or more. To be able to deduct losses on realisation of shareholdings outside the EEA, the shareholder and/or a related party may not hold 10% or more of the share capital and the voting rights of the foreign company in a two-year period prior to the realisation. For dividends, the holding period of two years would not have to be met when dividends are distributed but may be met after the ex-dividend date.

Shareholdings in low-tax countries outside of the EEA do not qualify for the tax-exemption rules.

Acquisition and sales-related costs (e.g. broker fees) must be activated (i.e. added to the cost price of the shares for tax purposes). Costs incurred to manage acquired tax-exempt shares are, however, tax-deductible.

Norway's internal tax rules do not allow taxation of a non-resident's capital gain on disposal of financial instruments including, among others, shares in Norwegian companies, unless the non-resident has a PE to which the financial instrument may be allocated.



### Stock dividends

Stock dividends (bonus shares) are not taxable on receipt, provided that the dividends have been distributed in accordance with the Limited Liability Company Acts and distributed in proportion with the ownership level of the shares.

### Foreign income

A Norwegian resident company is subject to CIT on its worldwide income. Double taxation of foreign-source income, including foreign branch income and CFC income, is avoided either through tax treaties or domestic tax provisions. A deduction for foreign tax may either be claimed as an expense or as a credit against Norwegian tax payable on that income. In most circumstances, foreign dividends are exempt according to the tax-exemption rules. As a consequence, foreign withholding taxes (WHT) may not be credited and constitute a real cost for the companies concerned.

## Deductions

### Depreciation

For depreciation, the declining-balance method is mandatory. The depreciation rates given below are the maximum rates.

There is a duty to capitalise if the value of an asset subject to declining-balance method of depreciation is NOK 15,000 or higher and has an economic life of at least three years.

| Asset | Rate (%) |
|---|---|
| Office machines, etc. | 30 |
| Acquired goodwill/business value | 20 |
| Trucks, lorries, buses, taxicabs, vehicles for persons with disabilities | 20 |
| Cars, tractors, other vehicular machinery, instruments, fixtures and furniture, etc. | 20 |
| Ships, vessels, offshore rigs, etc. | 14 |
| Aircraft, helicopters | 12 |
| Construction for transmission and distribution of electric power and electronic equipment in a power company | 5 |
| Buildings and construction, hotels, hostels, inns, etc. | 4 (8)* |
| Office buildings | 2 |
| Fixed technical installations in buildings, including heating plant, cooling and freezing plant, electrical installation, sanitary installation, elevator, etc. | 10 |

* The applicable rate is 8% if, from the date of its erection, the structure has an economic life of 20 years or less.

Special depreciation rules apply to assets moved in and out of Norwegian jurisdiction to and from companies resident outside the EEA.

### *Goodwill*

Acquired goodwill may be depreciated according to the declining-balance method at a maximum of 20% per annum. The tax authorities have, however, on several occasions recently questioned the allocation to goodwill and claimed that a part of the purchase price should be allocated to brand and firm names, etc. (which may, as a rule, not be depreciated unless it is of a time-limited nature). Other intangibles are depreciable on condition that they are subject to an evident loss in value or if they are time-limited.

### *Taxes*

Real estate tax, as well as foreign income and capital taxes paid by the taxpayer, is deductible in determining corporate income. Foreign taxes are deductible only if they have not been credited against Norwegian payable tax.

### *Net operating losses*

Losses may be carried forward indefinitely. Losses incurred in the year of ceasing business may be carried back for a period of two years. If a loss is incurred in the next to last year, it may be carried back to the preceding year.

### *Payments to foreign affiliates*

Royalties and service fees paid to related foreign companies are fully deductible, provided they meet the arm's-length standard. There are no formal thin-capitalisation or income-stripping rules in Norway. In practice, the tax authorities require that the entity in question is able to service its debts. In addition, any loan terms should be comparable to those that would have been agreed upon by unrelated parties. Interest on financing, to the extent that these rules are not satisfied, may be regarded as dividends and thus non-deductible and, in addition, may be subject to Norwegian WHT.

## *Group taxation*

Income taxes are assessed on companies individually, not on a consolidated basis. This may be avoided through group contributions between Norwegian companies, provided common direct or indirect (including foreign) ownership and voting rights is more than 90%. Furthermore, the Norwegian group contribution rules are, under certain conditions, also applicable to branches of companies that are resident within the EEA. Note that group contributions are not deductible for companies engaged in oil and gas-producing activities subject to the Petroleum Tax Act.

Assets may be transferred tax-free between group companies at tax book value for tax purposes and at market value for financial book purposes. Payment in this respect must equal market value of the assets transferred for tax and financial book purposes. The same applies to payment in shares. If the transferee loses the affiliation with the tax group while still owning the transferred assets, the transferor will be taxed for the difference between the tax book value and the market value of the assets.

### *Transfer pricing*

In Norway, the arm's-length standard for related party transactions is incorporated into the Tax Act. The transfer pricing provision of the Tax Act makes reference to the Organisation for Economic Co-operation and Development (OECD) Guidelines; it is stated that the OECD Guidelines 'shall be taken into account' when addressing transfer pricing issues under Norwegian law.

Until recently, the resources of the Norwegian tax authorities were limited, and their interest tended to focus on intra-group services and the financing of operations. However, this has changed considerably as transfer pricing has increasingly become the focus of revenue attentions, and the resource issues have been addressed. Through extensive hiring and knowledge investments, the Norwegian tax authorities are rapidly becoming more sophisticated on transfer pricing issues. It is fairly common for the Norwegian tax authorities to pick test cases that are subject to substantial investment. Such cases may easily end up in court, as settlements are uncommon. During the most recent years, focus has been inter alia on business restructuring and commissionaire arrangements.



Norway does not yet have an advance pricing agreement regime. Nevertheless, it is becoming more common to discuss complex cases with the tax authorities in advance of implementation or before assessment. Furthermore, there are no safe harbour rules or any other official guidance of how to price specific transactions, etc. save for the arm's length principle.

### *Thin capitalisation*

There is no fixed debt to equity ratio requirement in Norwegian tax law. However, if Norwegian income from a subsidiary is reduced due to the affiliation between the Norwegian company and a foreign company, adjustments may be made under the arm's-length provisions. Generally, these provisions apply only if the company has obtained a larger loan from a group company than an independent credit institution would have granted, or if the agreed level of interest is higher than an independent credit institution would have required. As a rule of thumb, 25% to 30% equity is feasible. Naturally, this analysis will vary based on the actual company's credit worthiness, which would consist of several elements such as the nature of the business, financial status, future income possibilities, and group relationship. The company must also be able to service its debts.

If a Norwegian entity is regarded as being thinly capitalised, part of the entity's interest and debts will be reclassified to dividend and equity. Such dividend will not be covered by the participation exemption rules as they are not distributed in accordance with the rules and regulations of the Limited Liability Companies Acts.

### Controlled foreign company (CFC) regime
Norwegian residents are taxed directly for their allocable part of the profits from a CFC's income if the company is resident in a low-tax country, irrespective of whether income is distributed to the Norwegian investor. A low-tax country in this respect is a country where the assessed foreign income tax on the company's profits is less than two-thirds of assessed taxes calculated according to Norwegian tax rules as if the company had been a resident in Norway. A condition for such taxation is that 50% or more of the foreign company's shares or capital is held or controlled, directly or indirectly, by Norwegian taxpayers (alone or together), based on ownership status at the beginning and end of the income year in question.

Note that if Norwegian taxpayers own or control more than 60% of the shares or capital at the end of the income year, Norwegian control exists irrespective of the level of control at the beginning of the year. Norwegian control ceases to exist if Norwegian taxpayers own or control less than 50% of the shares or capital at both the beginning and end of the income year or less than 40% of the shares or capital at the end of the income year.

On condition that Norway has signed a tax treaty with the country involved and the company in question is covered by the treaty, the CFC rules will be applicable only if the income of the entity in question is mainly of a passive nature. Furthermore, CFC taxation may also be prohibited if the company in question is resident within the EEA and cannot be deemed as a wholly artificial arrangement as outlined in the ECJ's decision in the Cadbury Schweppes case. Hence, CFC taxation will be avoided for EEA companies that fulfil certain substance requirements.

## Tax credits and incentives

### Foreign tax credit
Norwegian limited liability companies that have paid taxes on foreign source income and wealth may offset the Norwegian tax against the tax paid on the same income or wealth in the source state. The Norwegian tax credit is limited to the tax paid on the same income and period in the other state. It is possible to carry forward credit for five years. Credit claimed in accordance with the regulations stated above, may not be used in addition with other rules and regulations. If credit is claimed in accordance with a tax treaty, it is not possible to claim credit according to the tax credit regulations stated above. These rules are very technical, and it should be noted that there are three different 'baskets' of income.

### Roll-over regulations
The Ministry of Finance has the authority to grant a tax relief in case of transfer of assets within a corporation upon application. The transfer may be carried out between group companies or partnerships with mainly the same owners. If a tax relief is granted, the transfer would not trigger any taxation at the time of the transfer, but all tax positions, including tax basis of the transferred assets, will be transferred to the acquiring company. A condition for the tax relief is normally that the companies remain within the group.

The Ministry of Finance also has the authority to grant a tax relief in case of reorganisation. The reorganisation must improve the efficiency of the business to qualify for tax relief; accordingly, administrative effects would not be sufficient. The tax relief must also ease the reorganisation. In addition, the tax relief must not erode the Norwegian tax base; the tax positions would be transferred to the new taxpayer.

Please note that the Norwegian government released a proposal for legislative changes in March 2011 suggesting a liberalisation of the roll-over regimes.

## *Withholding taxes*

Norway does not levy WHT on payments of royalties and interest except interest derived from primary capital certificates ('No. Egenkapitalbevis').

The internal WHT rate is 25%, which either may be reduced under the tax-exemption rules or an applicable tax treaty. To qualify for the tax-exemption rule, the recipient of the dividends has to be a corporate investor resident in an EEA country and also fulfil certain substance requirements. If these requirements are met, no dividend WHT is imposed.

### *Dividends*

| Recipient | Regular rate (%) | Parent/subsidiary rate (%) |
|---|---|---|
| Non-treaty | 25 | 25 |
| Treaty: | | |
| Albania | 15 | 5 (1) |
| Argentina | 15 | 10 (1) |
| Australia | 15 | 0 (10) /5 (4) |
| Austria | 15 | 0 (1) |
| Azerbaijan | 15 | 10 (2) |
| Bangladesh | 15 | 10 (3) |
| Barbados | 15 | 5 (3) |
| Belgium | 15 | 5 (1) |
| Benin | 20 | 20 |
| Bosnia and Herzegovina | 15 | 15 |
| Brazil | 25 | 25 (8) |
| Bulgaria | 15 | 15 |
| Canada | 15 | 5 (4) |
| Chile | 15 | 5 (5) |
| China, P.R. | 15 | 15 |
| Croatia | 15 | 15 |
| Cyprus | 5 | 0 (6) |
| Czech Republic | 15 | 0 (3) |
| Denmark | 15 | 0 (3) |
| Egypt | 15 | 15 |
| Estonia | 15 | 5 (1) |
| Faroe Islands | 15 | 0 (3) |
| Finland | 15 | 0 (3) |
| France | 15 | 5 (3) /0 (1) |
| Gambia | 15 | 5 (1) |
| Germany | 15 | 0 (1) |
| Greece | 20 | 20 |
| Greenland | 15 | 5 (3) |
| Hungary | 10 | 10 |
| Iceland | 15 | 0 (3) |
| India | 25 | 15 (1) |

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# Norway

| Recipient | Regular rate (%) | Parent/subsidiary rate (%) |
|---|---|---|
| Indonesia | 15 | 15 |
| Ireland, Rep. of | 15 | 5 (3) |
| Israel | 15 | 5 (6) |
| Italy | 15 | 15 |
| Ivory Coast (Côte d'Ivoire) | 15 | 15 |
| Jamaica | 15 | 15 |
| Japan | 15 | 5 (5) |
| Kazakhstan | 15 | 5 (3) |
| Kenya | 25 | 15 (5) |
| Korea, Rep. of | 15 | 15 |
| Latvia | 15 | 5 (1) |
| Lithuania | 15 | 5 (1) |
| Luxembourg | 15 | 5 (1) |
| Malawi | 5 | 0 (6) |
| Malaysia | 0 | 0 |
| Malta | 15 | 15 |
| Mexico | 15 | 0 (1) |
| Morocco | 15 | 15 |
| Nepal | 15 | 5 (1)/10 (3) |
| Netherlands | 15 | 0 (1) |
| Netherlands Antilles | 15 | 5 (1) |
| New Zealand | 15 | 15 |
| Nordic Treaty | 15 | 0 (3) |
| Pakistan | 15 | 15 |
| Philippines | 25 | 15 (3) |
| Poland | 15 | 5 (1) |
| Portugal | 15 | 10 (1) |
| Qatar | 15 | 5 (3) |
| Romania | 10 | 10 |
| Russia | 10 | 10 |
| Senegal | 16 | 16 |
| Serbia (not Montenegro) | 15 | 15 |
| Sierra Leone | 5 | 0 (6) |
| Singapore | 15 | 5 (1) |
| Slovak Republic | 15 | 5 (1) |
| Slovenia | 15 | 0 (9) |
| South Africa | 15 | 5 (1) |
| Spain | 15 | 10 (1) |
| Sri Lanka | 15 | 15 |
| Sweden | 15 | 0 (3) |
| Switzerland | 15 | 0 (3) |
| Tanzania | 20 | 20 |
| Thailand | 15 | 10 (3) |
| Trinidad and Tobago | 20 | 10 (5) |
| Tunisia | 20 | 20 |
| Turkey | 25 | 20 (1) |
| Uganda, Republic of | 15 | 10 (1) |

| Recipient | Regular rate (%) | Parent/subsidiary rate (%) |
|---|---|---|
| Ukraine | 15 | 5 (1) |
| United Kingdom | 15 | 5 (4) |
| United States | 15 | 15 |
| Venezuela | 10 | 5 (3) |
| Vietnam | 15 | 5/10 (7) |
| Zambia | 15 | 15 |
| Zimbabwe | 20 | 15 (1) |

Notes

1. 25% of the capital.
2. 30% of the capital and an investment of no less than USD 100,000.
3. 10% of the capital.
4. 10% of the voting rights.
5. 25% of the voting rights.
6. 50% of the voting rights.
7. 5% for over 70% of the capital; 10% for 25% to 70% of the capital.
8. Internal Norwegian WHT rate (i.e. 25%).
9. 15% of the capital.

## *Tax administration*

### *Returns*

The income tax year normally runs from 1 January to 31 December, with assessments being issued in early autumn of the following calendar year. Companies are liable for both advance payments and final settlements in the calendar year of assessment. Companies with a financial year other than the calendar year may, if they belong to a foreign group with a deviating accounting year, use the financial year of the group for tax purposes.



Companies are required to file their tax returns by the end of March in the year following their financial year. If filed electronically, the return must be filed by the end of May. Upon application, an extension of the time limit to file normally will be granted. The tax returns and the basic attachments are obligatory for all corporate taxpayers. Additional requirements might apply for specific business sectors, such as hydro power production. Under the petroleum tax regime, the filing deadline is end of April, regardless of whether filed electronically or not.

The annual assessment is made by five regional departments of tax authorities and independent, locally elected boards, which notify the taxpayer if taxable income is determined to deviate from what was submitted in the tax return.

### *Payment of tax*

Companies are required to make advance payments of tax on 15 February and 15 April in the year following the income year. The two payments should together cover all of the expected CIT to be assessed. Any balance must be paid three weeks after the assessment has been made public (i.e. in early autumn of the year following the relevant accounting year).

The above applies to all corporate taxpayers, except for taxpayers under the petroleum tax regime, where tax shall be paid in six instalments.

# Oman

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## Significant developments

There have been no significant corporate tax developments in Oman during the past year.

## Taxes on corporate income

As of 1 January 2010, the rate of income tax has been made uniform for all types of business entities, regardless of whether it is a corporate entity and/or whether it is registered or not.

The Income Tax Law seeks to tax worldwide income of entities formed in Oman and the Oman-source income of branches and other forms of permanent establishment (PE).

The income tax rate is as follows:

| Taxable profits (OMR*) | Rate (%) |
|---|---|
| First 30,000 | 0 |
| Over 30,000 | 12 |

* Oman rial

### Petroleum income tax

Special provisions are applicable to the taxation of income derived from the sale of petroleum. The tax rate specified for such companies is 55%. However, the tax rates are applied on income as determined by the individual Exploration and Production Sharing Agreement entered into between the government of Oman and the company engaged in the sale of petroleum. Under these agreements, the government pays the company's share of income tax from amounts withheld from the government's share of production. Therefore, the income tax is not actually borne by the company.

## Corporate residence

The term 'resident' is not defined in the tax law.

### Permanent establishment (PE)

PE is defined in very broad terms and includes places of sale, places of management, branches, offices, factories, workshops, mines, quarries, and building sites for construction. However, the mere use of storage or display facilities does not constitute a PE. The definition of PE references carrying on business in Oman, either directly or through a dependent agent.

Additionally, the definition stipulates that a total stay of 90 days during a 12-month period creates a PE in Oman. However, this 90 day period applies to rendering of consultancy services or other services only. Under this definition, while the sale of goods into Oman will not be deemed to be a taxable activity, a contract for the supply and installation of equipment is likely to attract tax. By the same criterion, services rendered by personnel visiting Oman will be treated as taxable activities, applying the 90 day rule.

## Other taxes

### Value-added tax (VAT)
There is no VAT or sales tax in Oman.

### Customs duty
Customs duty of 5% of cost, insurance, and freight (CIF) value applies to most non-GCC source goods. Exemptions apply for certain food items, medical supplies, etc.

### Excise taxes
There are no excise taxes in Oman.

### Property taxes
There are no property taxes in Oman.

### Transfer taxes
There are no transfer taxes in Oman.

### Municipal taxes
Municipal taxes apply to the following items:

- Property rents: 3%.
- Hotel occupancy: 5%.
- Leisure and cinema houses: 10%.



## Branch income

Branches of foreign entities (regardless of country) are subject to tax at the rate of 12% on income over OMR 30,000.

Rules for the deduction of head office expenses for branches are expected to be changed. New executive regulations providing guidance are expected.

## Income determination

### Inventory valuation
Inventory should be valued using a method that complies with International Accounting Standards.

### *Capital gains*
Gains on sales of securities listed on the Muscat Securities Market are exempt from taxation. A recent Supreme Court ruling held that gains on transfers of other assets are taxable as ordinary income.

### *Dividend income*
Dividends received from Omani entities are exempt from taxation. Foreign source dividends are taxable. Foreign source dividends are taxed as the same rates as corporate income.

### *Stock dividends*
There are no provisions in the tax law which address stock dividends.

### *Interest income*
Interest income is taxable as business income.

### *Rent/royalty income*
Rental income and royalties are taxed as business income.

### *Unrealised exchange gains/losses*
Unrealised exchange gains are not taxable. Similarly, any unrealised loss is not deductible from the total taxable income.

### *Foreign income*
Worldwide income of an entity formed in Oman is taxed in Oman. Credit for foreign taxes paid is given under the law; however, this may not exceed the amount of Omani tax payable on such income.

The Oman tax law does not contain rules on deferral of foreign income.

## *Deductions*

### *Depreciation*
Depreciation is taken on a straight-line basis on the following classes of assets at the annual rates shown.

| Asset | Rate (%) |
|---|---|
| Permanent buildings | 4 |
| Semi-permanent buildings | 15 |
| Docks, sea barriers in ports, pipelines, roads, and railway lines | 10 |
| Aircraft and ships | 15 |
| Hospital buildings, educational establishments, and equipment for scientific research | 100 |

The rate of depreciation allowed is doubled in the case of buildings used for industrial purposes.

The tax law now provides for calculation of depreciation on a net book value basis for the following class of assets. A ‘pooling’ concept has been introduced, whereby assets subject to same rate of depreciation may be pooled together for purposes of depreciation.

| Pool | Rate (%) |
|---|---|
| First pool is comprised of machinery and equipment, including computer software installations, furniture and fixtures, and vehicles | 33.33 |
| Second pool is comprised of drilling equipment | 10 |
| Third pool is comprised of 'other machinery and equipment' not included above | 15 |

### *Social security payments*
Social security contributions paid by employers in respect of employees may also be deducted.

### *Start-up expenses*
Expenses incurred before the commencement of business are allowed as a deduction in the first taxable year (or period).

### *Interest expenses*
Deduction of expenses incurred for the purpose of earning income is generally allowed. Interest expense is allowed for loans from unrelated parties or on loans from banks. Interest paid to related parties is allowed only to the extent the loan terms are at arm's length.

### *Charitable contributions*
Charitable donations are limited to specified institutions and organisations and are subject to an overall limitation of 5% of total income.

### *Meals, entertainment, officers compensation, etc*
All expenses incurred for the generation of gross total income are allowed. There are no specific restrictions on deduction for expenses like meals and entertainment, compensation for officers, and life insurance payments for employees. There are limits on the deductibility of directors' fees.



### *Illegal payments*
Payments of bribes or kickbacks, and other illegal payments, are not deductible.

### *Pension payments*
The law provides a deduction for contributions towards pension funds, subject to the executive regulations that are expected to be issued.

### *Fines and penalties*
Civil fines and penalties are not deductible.

### *Other significant items/restrictions on allowable expenses*
The tax law has imposed restrictions on the deductibility of certain expenses. The principal items affected are the following:

- Sponsorship fees paid to Omani sponsors are restricted to 5% of net taxable income before sponsorship fees. Net taxable income is determined after offsetting any losses carried forward.
- Charges or expenses allocated from the head office or other group companies are currently restricted to the lower of the following:
  - Expenses allocated to Oman operations.
  - Average of such expenses approved for the Oman operations during the three years immediately preceding the most recent taxable year subject to assessment.

  - 3% of the total income derived from Oman operations during the year subject to assessment. This percentage is increased to 5% in respect of branches of foreign banks and insurance companies and to 10% in respect of operations of major industrial companies that use the latest and most advanced production techniques, pursue scientific research, provide technical assistance, or use patents that require exchange of information and technical assistance with their associates. The Minister of Finance has discretionary authority to increase this percentage above 10%, but such authority is exercised very rarely.

  Executive regulations on head office expenses are expected to be issued. These regulations may change the treatment and percentages described above.
- Commissions paid by insurance companies are restricted to 25% of net premiums collected.
- Amounts charged to the profit and loss account for creating provisions in respect of bad debts, stock obsolescence, warranties, and similar types of contingencies are not tax deductible. Deduction is allowed only at the time of write-off. However, provisions created by licensed banks in respect of bad debts are allowable within the limits approved/required by the Central Bank of Oman.
- Leasing companies are treated at par with banks as far as deduction for loan loss provision is concerned. Leasing companies are allowed deductions for loan loss provisions subject to the limits or recommendations of the Central Bank of Oman.
- Losses arising on sale of investments listed on the Muscat Security Market are not allowed as a deduction from taxable income.
- Any expense or costs which have been incurred to generate income exempted from tax are not allowed as a deduction from taxable income.
- Amounts paid as tax consultancy or advisory fees are disallowed.

### Net operating losses
Carryforward of losses is limited to five years, except in the case of companies that incurred losses during a mandatory tax-exempt period, where the losses may be carried forward indefinitely for offset against future profits.

Carryback of losses is not allowed.

### Payments to foreign affiliates
Payments to foreign affiliates normally receive in-depth scrutiny from the tax authorities. Accordingly, proper documentation should be obtained in order to establish that these transactions are made at an arm's-length basis.

## Group taxation

Businesses are taxed as separate entities, and the tax law does not recognise group taxation.

### Transfer pricing regime
Transaction between related parties must be valued at arm's length. The tax law proposes to issue executive regulations that will define the transfer pricing policies.

### Inter-company payments
All inter-company payments are scrutinised in detail to ensure that the profits are not transferred to avoid payment of tax.

### Thin capitalisation
The tax law proposes to issue executive regulations that will define the thin capitalisation rules. Although there are no defined policies on thin capitalisation, the tax authorities review the terms of loans and interest payments in most cases.

### Controlled foreign company (CFC) regime
There is no CFC regime in Oman.

## Tax credits and incentives

### Foreign tax credit
Foreign taxes paid to a country with whom Oman has a double tax treaty (DTT) are eligible for a credit to the maximum of the Oman tax that would have been payable on such income. The tax payer is required to submit an application to the Secretariat General for Taxation to claim such credit.

### Exempt activities
Income from the principal activities listed below is exempt from tax, if an exemption is applied for and obtained.

- Industry and mining.
- Export of products manufactured or processed locally.
- Operation of hotels or tourist villages.
- Agriculture and animal husbandry and the processing of agricultural produce.
- Fishing and fish processing and aquaculture.
- University education, college or institutes of higher studies, private schools, nurseries, training colleges, and institutes.

The exemption is valid for a period of five years from the date of commencement of production or the practice of activities and may be made subject to such conditions as the Minister of Commerce and industry may specify. The exemption is renewable for a period not exceeding five years, subject to approval by the Financial Affairs and Energy Resources Council.



### Exempt incomes
The following income is exempt from income tax in Oman:

- Dividends received from an Omani company.
- Profits or gains on disposal of securities listed on Muscat Security Market.
- Omani marine companies, whether wholly owned by Omanis or with foreign and Omani ownership and registered in Oman, are exempt from tax. Foreign marine companies conducting activities in Oman through an authorised agent are exempted from tax with effect from the date of commencement of activity, provided that reciprocal treatment is afforded by the country of the foreign company.
- Income realised by foreign airlines carrying on business through establishments in Oman is exempt from tax. This exemption is limited to the extent of the income from operating airplanes for international transport, provided reciprocal treatment is accorded in the airline’s home country.
- Income realised by investment funds established in Oman under the Capital Market Authority Law or established overseas for dealing in shares and securities listed on Muscat Security Market is exempt.

- Foreign companies engaged in oil and gas exploration activities, while taxable under the law, normally have their tax obligations discharged by the government under the terms of the Exploration and Production Sharing Agreement.
- Foreign companies working for the government in projects deemed to be of national importance may be able to negotiate a tax protection clause whereby any tax paid by them is reimbursed by the government.

## *Withholding taxes*

As of 1 January 2010, certain changes to the categories that attract WHT were made.

Foreign companies that do not have a PE in Oman for tax purposes and that derive income from Oman in the nature of the following are subject to WHT at 10% of gross income from such sources:

- Royalty.
- Consideration for research and development (R&D).
- Consideration for use of or right to use computer software.
- Management fees.

Such WHT is required to be withheld by the Omani-based company and paid to the tax department within 14 days of the end of the month in which tax is deducted or payments are due or made to the foreign company.

There is no WHT on dividends and interest payments.

The term royalty has been defined under the law to include consideration for the use of intellectual property, including computer software, cinematography films, tapes, discs, or any other media, patents, trademarks, drawings, etc. The term further includes consideration for using industrial, commercial, or scientific equipment and consideration for information concerning industrial, commercial, or scientific experience or consideration for granting rights to exploit mining or other natural resources.

### *Double tax treaties (DTTs)*

The maximum withholding tax rates provided by the Oman DTTs are shown in the table below. The protocol to the DTT with the United Kingdom and the DTT with Croatia will enter into force in 2012. There are also agreements with various countries which are not yet in force.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Algeria | 5 (3)/10 | 5 | 10 |
| Belarus | 5 | 5 | 10 |
| Brunei | - | - | - |
| Canada | 5 (1)/15 | 10 | 10 |
| China | 5 | 10 | 10 |
| Croatia | 0 | 5 | 10 |
| France | 0 | 0 | 0 |
| India | 10 (1)/12.5 | 10 | 15 |
| Iran | 10 | 10 | 10 |
| Italy | 5 (3)/10 | 5 | 10 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Korea | 5 (1)/10 | 5 | 8 |
| Lebanon | 5 (4)/10 | 10 | 10 |
| Mauritius | 0 | 0 | 0 |
| Moldova | 5 | 5 | 10 |
| Morocco | 5 (1)/10 | 10 | 10 |
| Pakistan | 10 (1)/12.5 | 10 | 12.5 |
| Seychelles | 5 | 5 | 10 |
| Singapore | 5 | 7 | 8 |
| South Africa | 0 | 0 | 8 |
| Sudan | - | - | - |
| Syria | - | - | - |
| Thailand | 10 | 10 (5)/15 | 15 |
| Tunisia | 0 | 10 | 5 |
| Turkey | 10 (3)/15 | 10 | 10 |
| United Kingdom | 5 (1)/10 | 0 | 0 |
| United Kingdom (protocol) | 0/15 (2) | 0 | 8 |
| Uzbekistan | 7 | 7 | 10 |
| Vietnam | 5 (6)/10 (7)/15 | 10 | 10 |
| Yemen | 5 | 10 | 10 |

Notes

1. 10% minimum shareholding required.
2. Distributions by Real Estate Investment Company/Fund.
3. 15% minimum shareholding required.
4. 20% minimum shareholding required.
5. Interest received by financial institutions (including insurance companies) or loans/debt claims guaranteed by the government of the source state.
6. 60% minimum shareholding required.
7. 25% to 60% minimum shareholding required.



## *Tax administration*

### *Returns*

The tax year is the calendar year. Assessments can be made on the basis of a year-end other than 31 December, provided permission is granted in advance by the Omani tax authorities and the company then adheres to the year-end on a consistent basis.

A provisional declaration of tax must be submitted in the prescribed form within three months from the end of the accounting period to which it relates. The final annual return of income should be submitted in the prescribed format within six months from the end of the accounting period to which it relates. Reasonable time extensions can be sought and are normally provided for filing the provisional and annual returns of income, but these do not defer payment of tax, which will be subject to additional tax at 1% per month from the due date to the actual date of payment.

In the case of companies having a paid-up capital in excess of OMR 20,000, the annual return of income should be accompanied by audited accounts signed by an auditor registered in Oman. The law requires accounts to be drawn up in accordance with the International Financial Reporting Standards (IFRS) consistently applied. It specifically provides for accrual accounting unless prior permission of the Secretary General of

Taxation (the Secretary General) has been obtained. The accounts must be submitted in local currency unless prior approval of the Secretary General has been obtained for submitting them in foreign currency.

Delay or failure in submitting the provisional or annual returns may attract a penalty of not less than OMR 100 and not more than OMR 1,000.

Failure to file the provisional or annual returns of income may result in an estimated profit assessment by the Secretary General.

Failure to submit audited accounts as required under the Law is deemed to result in an incomplete annual return of income and may attract an estimated profit assessment.

The law confers wide powers on the Secretary General for requesting information. Experience has shown that, notwithstanding the presentation of audited accounts, the tax department requests very detailed information and supporting documentation relating to revenue and expenses. Failure to provide such information or the provision of incorrect information can result in an additional assessment by the Secretary General and/or various penalties on the company and/or the officer responsible for providing the information.

### *Payment of tax*

Any tax estimated to be payable in respect of an accounting period should be paid with the provisional assessment and 'topped up' for any additional amount computed as payable following submission of the annual return of income. Failure to pay taxes by the due date attracts interest at the rate of 1% per month from the date on which such tax was due to the date of payment.

The difference between the amount paid and the amount assessed, subject to filing of an objection, should be paid within one month from the date of the assessment. The additional amount assessed attracts interest at the rate of 1% per month from the date on which such tax was due to the date of payment.

Under the Law, the Secretary General has the authority, with the approval of the Minister and the Tax Committee, to sequester and sell the assets of a taxable entity to recover the taxes due.

If decisive proof is presented to the Secretary General that any person has paid tax for any year exceeding the tax due and payable for such tax year as finally settled, such person has the right to recover the tax. However, if any tax has become payable by such person in respect of another tax year, the excess amount will be adjusted against the future tax liability. Any request for recovery must be presented within five years from the end of the tax year to which it relates.

Where the taxpayer fails to declare correct income in the tax return for any tax year, the Secretary General may impose a fine not exceeding 25% of the difference between the amount on the basis of the correct taxable income and the amount of tax as per the return submitted.

### *Statute of limitation*

The tax authorities have a period of up to five years from the end of the year in which a tax return is submitted to complete the assessment for that tax year. However where the entity has not submitted any tax return, the tax authorities have a period of ten years to complete the assessments.

### *Maintenance of records*
The Law requires accounting records and supporting documentation to be maintained for ten years after the end of the accounting period to which these records relate.

### *Objections and appeals*
A company has a right to object to any assessment issued by the Secretary General. The objection document should be prepared in writing (in English and in Arabic) and filed with the office of the Secretary General for Taxation within 45 days from the date of assessment. The Secretary General is required to give a judgment within five months, extendable up to another five months at the Secretary General's discretion, from the date of receiving the objection. The tax demanded may be kept in abeyance on request. No additional tax is payable until the Secretary General issues the judgment.

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# Pakistan

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## Significant developments

The following significant developments in corporate taxation have recently occurred in Pakistan:

- The exemption of gain on the sale of listed securities has been withdrawn.
- Records are now required to be maintained for six years instead of five years.
- The rate of corporate tax for small companies has increased to 25% from 20%.
- Banks are now required to collect tax on certain other cash transactions, in addition to those already identified.

## Taxes on corporate income

A resident company is taxed on its worldwide income. The federal corporate tax rates on taxable income are as follows:

| Company type | Tax rate (%) |
|---|---|
| Banking company | 35 |
| Public company other than a banking company | 35 |
| Any other company | 35 |
| Small company *(see the Tax credits and incentives section for more information)* | 25 |

The term 'public company' implies a company listed on any stock exchange in Pakistan or one in which not less than 50% of the shares are held by the federal government or a public trust.

In the case of a modaraba (*see the Income determination section for a definition*), income, except relating to trading activities, is exempt from tax, provided that 90% of its profit is distributed to the certificate holders as cash dividends.

The final tax regime (FTR) for resident taxpayers, a presumptive tax scheme where taxes are withheld at the source on the sale of goods and execution of contracts or collected at the time of import (for other than industrial raw materials), is considered a final tax liability in respect of income arising from the sale, contract, or import.

In the case of exports, tax collected at the time of realisation of foreign-exchange proceeds is treated as final tax for that income.

The FTR is also applicable to non-resident taxpayers, at their option. However, it is only applicable in cases of receipts on account of the execution of a contract for construction, assembly, or installation, including a contract for the supply of management activities in relation to such project as well as certain contracts for services and contract for advertisement services rendered by TV satellite channels.

## *Corporate residence*

A company is resident in Pakistan if it is incorporated or formed by or under the law of Pakistan or if the control and management of its affairs is situated wholly in Pakistan in that year.

The term 'company' includes a trust, a cooperative society, a finance society, or any other society established or constituted by or under any law; a corporate body incorporated outside Pakistan; and any foreign association, incorporated or unincorporated, which the Central Revenue authorities may declare to be a company.

## *Other taxes*

### *Value-added tax (VAT)*

VAT (locally termed as 'sales tax') is ordinarily levied at 17% on the value of goods, unless specifically exempt, after allowing related input credits. Telecommunication services are levied VAT at the rate of 19.5%.

Significant zero-rated goods are as follows:

- Supplies and repair and maintenance of certain ships and aircrafts.
- Supplies to diplomatic missions and diplomats.
- Supplies against international tenders.
- Supplies of raw materials, components, and goods for export processing zones.
- Supplies of locally manufactured plant and machinery to export processing zones and supplies of certain specified machinery to exploration and production sector.
- Supplies to exporters.

Significant exemptions are as follows:

- Live animals and poultry.
- Live plants.
- Vegetables, pulses, fruits, certain spices, sugar cane, edible oils, etc.
- Milk preparations.
- Newsprints, newspapers, journals, periodicals, and books.
- Computer software.
- Certain special purpose vehicles.
- Aircrafts.
- Specified ships.
- Certain specified machinery.
- Agricultural produce not subjected to any process.

### *Excise duty*

Federal excise duty is levied on certain types of manufacturing, import of goods, and rendering of services.

### Customs and import duties
Custom and certain other duties are collected at import stage at varying rates classified under Harmonized System (HS) Code.

### Property taxes
Property owners are required to pay property tax levied and collected by provincial governments at varying rates.

### Stamp duty
In the case of sale or transfer of immovable property, stamp duty is payable (with varying rates on the basis of location of the property) on the value of the property.

## Branch income

The rates of tax for a branch of a company incorporated outside Pakistan are the same as those applicable on resident companies, other than public and banking companies. Tax at the rate of 10% is levied on the transfer of profits to the head office, with an exception for companies engaged in oil and gas exploration and production business.

Payments to a branch in Pakistan of a non-resident are subject to deduction of tax at the source, on the same basis as a resident in the case of sale of goods, rendering of professional services, and execution of contracts. In other circumstances, a reduced/0% withholding rate certificate can be obtained from the Commissioner of Income Tax.

Pakistan has signed agreements for avoidance of double taxation with over 60 countries.

## Income determination

### Inventory valuation
Inventories are to be stated at the lower of cost or market. The first in first out (FIFO) and average methods are accepted. Conformity of methods used for book and tax reporting is desirable, and the method used should be consistently applied.

### Capital gain
Capital gain on the sale of immovable property, on which depreciation is not allowed, is not taxable.

Gain on the disposal of shares of a resident company or a non-resident company, whose assets wholly or principally consist of immovable property situated in Pakistan or rights to explore/exploit natural resources in Pakistan, shall be Pakistan-source income.

Capital gains on the sale of shares of public companies or modaraba (profit sharing) certificates are exempt from tax if held for a period of more than 12 months. Capital gains on shares and modaraba, if held for less than 12 months, are taxable under two categories, (i) held for less than six months and (ii) held for more than six months but less than 12 months at 7.5% and 10% to be gradually enhanced to 17.5% and 10% by 2015.

Capital gain, other than on statutory depreciable assets, realised within one year of acquisition is fully taxed; after one year, 75% of such gains are taxed and 25% are exempt.

Capital gains on statutory depreciable assets (other than immovable property) are chargeable to tax as normal business income in the year of sale. They are measured as the difference between the sale proceeds and the tax written-down value of the relevant asset sold.

In the case of an asset disposal transaction that is on a non-arm's length basis, fair market value of the asset shall be taken to be the consideration received by the seller, as well as the cost for the buyer.

Where assets are transferred outside Pakistan, the original cost is treated as the sale price, which means that the entire depreciation is recaptured at the time of export, except if the assets are used in oil or gas exploration, in which case only the initial depreciation is recaptured.

No gain or loss shall be taken to arise on disposal of an asset by a resident company to another resident company, if certain conditions are met. The required conditions include, inter alia, that the transferor is 100% owned by the transferee or vice versa or both companies are 100% owned by a third company, and the transferee income is not exempt in the year of transfer. The scheme of arrangement is approved by the Securities and Exchange Commission of Pakistan or State Bank of Pakistan.

Any distribution to the shareholders of a company to the extent that it relates to undistributed profits is treated as a dividend.

Capital loss can be offset only against capital gains. Unabsorbed capital loss can be carried forward for adjustment against capital gains for six years.

### *Dividend income*
Dividend income is subject to tax withholding of 10% or a lower tax treaty rate.

The deduction at source shall be the full and final discharge of tax liability on dividend income.



### *Stock dividends*
Stock dividends declared by resident companies are exempt from tax.

### *Income from royalties and fees for technical services (FTS)*
Royalties received by non-residents are deemed to accrue or arise in Pakistan and are taxable if paid by a resident in Pakistan or borne by a permanent establishment (PE) of a non-resident in Pakistan.

Income from 'fees for technical services' (FTS) is deemed to accrue or arise in Pakistan if paid by a resident in Pakistan or borne by a PE of a non-resident in Pakistan. FTS means any consideration for the rendering of any managerial, technical, or consultancy services (including the provision of the services of technical or other personnel), but does not include consideration for any construction, assembly, or like project undertaken by the recipient or consideration that would be income of the recipient chargeable under the head salary.

### *Other significant items*
Liabilities allowed as a tax deduction in a tax year and remaining unpaid for three subsequent years are deemed to be income in the first tax year following the said three years. Such items are then allowed as a deduction in the year the liability is discharged.

Agricultural income is exempt from income tax.

### *Foreign income*

A resident company is taxed on its worldwide income and on its foreign income as earned. Double taxation of foreign income is avoided by means of foreign tax credits; this relief is allowed to the resident company on the doubly taxed income at the lower of the Pakistan or foreign tax rate. Undistributed income of a non-resident subsidiary is not subject to tax.

Foreign loss can only be offset against foreign income and can be carried forward for six years.

### *Modaraba*

Modaraba (profit sharing) is a financing vehicle which enables a management company to control and manage the business of a modaraba company with a minimum of 10% equity participation. The management company is entitled to remuneration based on an agreed percentage (but not exceeding 10%) of annual profits of the modaraba business. A modaraba can be for a specific purpose or many purposes and for a limited or unlimited period. The income of a modaraba not relating to trading activity is free from tax if 90% of its profits are distributed as cash dividend.

## *Deductions*

### *Depreciation*

Normal depreciation is allowed at the following prescribed rates by applying the reducing-balance method.

| Assets | Rate (%) |
|---|---|
| Buildings | 10 |
| Furniture | 15 |
| Machinery and equipment, including motor vehicles and ships | 15 |
| Computer hardware, including monitors and printers | 30 |
| Aircraft and aero engines | 30 |
| Below-ground installations in mineral oil concerns | 100 |
| Offshore platform | 20 |

All depreciable assets put into service for the first time in Pakistan during a tax year, other than road transport vehicles not plying for hire, furniture including fixtures, plant, and machinery used previously in Pakistan, or plant and machinery for which a deduction has been allowed under another section of this ordinance, for the entire cost of the asset, shall be entitled to an initial allowance at 50% of the cost of the asset.

Book depreciation need not conform to tax depreciation. Unabsorbed tax depreciation not set off against the income of the year is carried forward and added to depreciation of the assets of the same business in the following year. Tax depreciation can be carried forward without limit until fully absorbed.

### *Organisational and start-up expenses*

Expenditure incurred before the commencement of a business wholly and exclusively to derive income chargeable to tax can be deducted over a period of five years.

### Intangibles

The cost incurred on acquisition of a patent, invention, design or model, secret formula or process, copyright, software, quota, license, intellectual property or other like property or right and any expenditure that provides an advantage or benefit for a period of more than one year is allowed as deduction on a straight-line basis over the useful life of the asset, but not exceeding a period of ten years.

### Taxes

Taxes on income are not deductible. Sales tax and excise tax are tax deductible where these are to be absorbed by the business; otherwise, these are passed on to the consumer.

### Other significant items

The deductibility of a head office expenditure of a non-resident taxpayer is limited to the same proportion of total head office expenditure as the Pakistan turnover has with the total world turnover. However, such domestic rules are overridden if the branch is a tax resident of a country having an agreement for avoidance of double taxation (treaty) and that treaty provides a different basis.

Expenditure on scientific research incurred in Pakistan wholly and exclusively for the purpose of deriving income chargeable to tax is an allowable expenditure.

Exchange gains and loss on foreign currency loans specifically obtained for acquiring an asset are adjusted against the depreciable cost of the asset.

Any lease rental incurred by a person in the tax year to a scheduled bank, financial institution, approved modaraba, or approved leasing company shall be a deductible expense. However, financial charges paid for the above-mentioned leases are added back into the taxable income of the company.

### Net operating losses

Operating loss may be carried forward and set off against the profits of the succeeding six years of the same business in which the loss was incurred. Unabsorbed depreciation can be carried forward indefinitely.

Carried forward loss of an entity in the case of group relief cannot be utilised if the ownership of the holding company is reduced to less than 55% and 75% if one of the companies is a listed company or none of the companies is a listed company, respectively.

Business loss can be carried forward up to a period of six years in the case of the amalgamation of two companies, with the condition that the same business is continued for a minimum period of five years.

Carryback of loss is not permitted.

## Group taxation

A locally incorporated holding company and subsidiary of a 100% owned group may be taxed as one group by giving an irrevocable option for taxation as one fiscal unit. The relief is not available for losses prior to formation of the group. The group is available if the companies are designated as entitled to avail group relief by the Securities and Exchange Commission of Pakistan.

Any company that is the subsidiary of a holding company may surrender its loss for the year to its holding company or its subsidiary, or between another subsidiary of the holding company, provided that the holding company holds directly 55% or more capital of the subsidiary, if one of the companies is a listed company. However, if none of the companies is a listed company, the holding requirement is 75% or more. The loss can be surrendered for a maximum of three years, and the required holding is for at least five years.

### Transfer pricing
The tax authorities have the power in respect of a transaction between associates to distribute, apportion, or allocate income, deductions, or tax credits between such associates to reflect the income that would have been realized in an arm's-length transaction.

### Thin capitalisation
Where a foreign-controlled resident company (other than a financial institution or a banking company) or a branch of a foreign company operating in Pakistan has a foreign debt to foreign equity ratio in excess of three to one at any time during a year, a deduction shall be disallowed for the profit on debt (interest) paid by the company in that year on that part of the debt which exceeds the three to one ratio.

## Tax credits and incentives

Any relief from Pakistani income tax which is provided in any other law and not provided for in the Income Tax Ordinance or a treaty is not valid.

### Tax exemptions
Profits and gains derived from an electric power generation project set up in Pakistan are exempt from tax.

Profits and gains derived by a company from the export of computer software, information technology (IT) services, or IT enabled services are exempt from tax through 30 June 2016.

### Small companies
Activities of small companies are encouraged with a reduced income tax rate of 25%.

A small company has been defined to mean a company which:

- is registered on or after 1 July 2005 under the Companies Ordinance, 1984
- has a paid up capital plus undistributed reserves not exceeding 25 million Pakistani rupees (PKR) (USD 0.298 million)
- has an annual turnover not exceeding PKR 250 million (USD 2.976 million), and
- is not formed by splitting up or the reconstitution of business already in existence.

### Foreign tax credit
Where a resident taxpayer derives foreign source income on which foreign income tax is paid within two years from the year in which it is derived, the taxpayer is allowed tax credit equal to the lower of (i) the foreign income tax paid or (ii) the Pakistan tax payable in respect of that income. However, foreign tax paid is not refundable.

## *Withholding taxes*

Withholding tax (WHT) on payments of royalty and FTS, when royalty or FTS is not attributable to a PE in Pakistan, is 15% or a lower treaty rate, of royalty or gross fees. The tax withheld would be deemed to be the final tax liability of the non-resident. In the case of a non-resident where royalty or FTS is attributable to a PE in Pakistan, the amount of royalty/FTS shall be chargeable to tax as normal income, and withholding on payments can be avoided subject to approval of the commissioner. If a reduced rate is available in a tax treaty, such rate would be applicable.

Resident corporations making certain types of payments must withhold tax as follows:

| **Recipient (1, 2, 3)** | **Dividends (%)** | **Interest (%)** | **Royalties (%)** |
|---|---|---|---|
| Resident individuals | 10 | 10 | N/A |
| Resident corporations | 10 | 10 | 0 |
| | | | |
| Non-resident individuals: | | | |
| Non-treaty | 10 (10) | 10 | 15 |
| Treaty | 10 (10) | (4) | (4) |
| Non-resident corporations: | | | |
| Non-treaty | 10 | (5) | 15 |
| Treaty: | (6) | (7) | |
| Austria | 10 | (8) | 20 |
| Azerbaijan | 10 | 10 | 10 |
| Bahrain | 10 | 10 | 10 |
| Bangladesh | 10 | 15 | 15 |
| Belarus | 10/15 | 10 | 15 |
| Belgium | 10 | 15 | 15/20 |
| Bosnia and Herzegovina | 10 | 20 | 15 |
| Canada | 10 | 25 | 15/20 |
| China | 10 | 10 | 12.5 |
| Denmark | 10 | 15 | 12 |
| Egypt | 15/30 | 15 | 15 |
| Finland | 12/15/20 | 10/15 | 10 |
| France | 10 | 30 | (9) |
| Germany | 10 | 10/20 | 10 |
| Hungary | 10 | 15 | 15 |
| Indonesia | 10 | 15 | 15 |
| Iran | 5 | 10 | 10 |
| Ireland, Rep. Of | 10 | (8) | (9) |
| Italy | (8) | 30 | 30 |
| Japan | 3.75 | 0/30 | (9) |
| Jordan | 10 | 10 | 10 |
| Kazakhstan | 10 | 12.5 | 15 |
| Korea, Rep. Of | 10 | 12.5 | 10 |
| Kuwait | 10 | 0/10 | 10 |
| Lebanon | 10 | 10 | 7.5 |
| Libya | (8) | (8) | (8) |

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| Recipient (1, 2, 3) | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Malaysia | 10 | 15 | 15 |
| Malta | 10 | 10 | 10 |
| Mauritius | 10 | 10 | 12.5 |
| Morocco | 10 | 10 | 10 |
| Netherlands | 10 | 10/15/20 | 5/15 |
| Nigeria | 10 | 15 | 15 |
| Norway | 10 | 10 | 12 |
| Oman | 10/12.5 | 10 | 12.5 |
| Philippines | 10 | 15 | 25 |
| Poland | 10 | (8) | 15/20 |
| Portugal | 10/15 | 10 | 10 |
| Qatar | 10 | 10 | 10 |
| Romania | 10 | 10 | 12.5 |
| Saudi Arabia | 5/10 | 10 | 10 |
| Singapore | 10 | 12.5 | 10 |
| South Africa | 10/15 | 10 | 10 |
| Sri Lanka | 10 | 10 | 20 |
| Sweden | 10 | 15 | 10 |
| Switzerland | 10 | 30 | (9) |
| Syria | 10 | 10 | 10/15/18 |
| Tajikistan | 5/10 | 10 | 10 |
| Thailand | 10 | 10/25 | 10/20 |
| Turkmenistan | 10 | 10 | 10 |
| Turkey | 10 | 10 | 10 |
| Tunisia | 10 | 13 | 10 |
| United Kingdom | 10 | 15 | 12.5 |
| United States | 8.75 | (8) | (9) |
| United Arab Emirates | 10 | 10 | 12 |
| Uzbekistan | 10 | 10 | 15 |
| Vietnam | 15 | 15 | 15 |
| Yemen | 10 | 10 | 10 |

Notes

1. This table is a summary only and does not reproduce all the provisions that may be relevant in determining the application of WHT in each tax treaty.
2. Resident and non-resident imply tax status.
3. Individuals and companies are required to render annual returns of income and pay tax at the applicable rates. Credit is given for WHT deducted.
4. WHT rates for interest and royalties given to non-resident corporations (treaty countries) also apply to non-resident individuals.
5. The WHT rate for companies would be 30%.
6. The following remarks for dividends should be noted:
   - The intercorporate rate of tax on dividends received by a foreign corporation is 10%; corresponding treaty WHT rates in excess of 10% have been specified.
   - The rates given in the table for treaty countries relate to recipient corporations. The maximum rate, as stated above, in respect of intercorporate dividends is 10%. The lower rates are expressly provided in respect of dividends paid to a parent/associated corporation that has a certain minimum holding in a Pakistan industrial undertaking. The level of holding are noted:
     - Japan: 33.33%
     - United States: 50%
7. Certain treaties provide for tax exemption of interest paid to the government or the central bank of the contracting state and on foreign loans specifically approved by the federal government.
8. No concession is provided under the treaty.

9. A fair and reasonable consideration for royalties is exempt from tax, provided the recipient does not have a PE in Pakistan.
10. Intercorporate dividend where companies are entitled to group relief is exempt.

## Tax administration

### Returns and assessment

All companies are required to file an income tax return each year by 31 December for the preceding financial year (1 July through 30 June) by accounting for business income on an accrual basis. Tax authorities are empowered to approve a special year-end. If the special year ends on 31 December, then the tax return is required to be filed by 30 September following the year-end.

An across-the-board self-assessment scheme is in place whereby assessment is taken to be finalised upon filing of the return. The Commissioner, however, has powers to amend the assessment if it is believed that the ordinance has been incorrectly applied or there is definite information that the assessment made is incorrect. These powers are to be exercised within a prescribed time frame. In the case of transactions between associates, the Commissioner can substitute the transaction value with the fair market consideration. The Commissioner is also empowered to determine tax liability according to the substance of the transaction, disregarding formal arrangements between the parties.

### Payment of tax

Companies are required to pay advance tax on the basis of tax liability of the immediately preceding tax year in respect of their income (excluding capital gains and presumptive income). The advance tax is to be paid after adjusting the taxes withheld at source (other than the tax withheld relating to final tax regime).

Advance tax is required to be paid in four quarterly instalments on or before 15 September, 15 December, 15 March, and 15 June in each financial year. Credit for tax paid in a tax year shall be allowed against tax liability of that year.

The total tax liability is to be discharged at the time of filing the return of income.

Advance taxes and taxes withheld are adjustable against the tax payable with the return of income.

## Other issues

Special rules are applicable for computation of income from exploration and production of petroleum, mineral deposits, insurance business, and banking business.

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# Panama

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## Significant developments

Significant developments on taxation issues, mostly initiated after the second quarter of 2009, have taken place under the Administration of Panama's President Martinelli.

As of May 2011, Panama has in force two double taxation treaties to avoid double taxation: with Mexico and Barbados. A treaty to exchange information with the United States has also entered into force this year. There are several other tax treaties to avoid double taxation approved by the National Deputies Assembly, which may come into force in the near future. These tax treaties have been signed with Italy, Luxembourg, The Netherlands, Portugal, Qatar, Singapore, South Korea, and Spain.

As of April 2011, loans to shareholders are deemed dividend distributions subject to a 10% withholding tax (WHT).

## Taxes on corporate income

Panamanian income tax is levied based on the territoriality principle.

As of 1 January 2011, corporations are subject to income tax at a fixed rate of 25%. Certain businesses and the related parties that render services to them will be subject to a 30% tax rate until 31 December 2011. Beginning on 1 January 2012, this tax rate will be reduced to 27.5%; and on 1 January 2014, it will be reduced even further to 25%.

The higher tax rate (i.e. the 30% rate) applies to either the generation or distribution of energy, telecommunication services in general, insurance, reinsurance, financial institutions regulated by Law No. 42 of 2001, cement industries, the operation and management of gambling games, mining in general, and entities dedicated to banking activities in Panama.

For companies in which the state owns more than 40% of the stock, the tax rate will remain at 30%.

The tax base (i.e. amount to which the tax rate will apply) for companies whose taxable income is greater than 1,500,000 US dollars (USD) is the greater of:

- net taxable income calculated on the normal basis
- 4.67% of the gross taxable income (excluding exempted and non-taxable income and foreign-source income) – this is called the alternate calculation of income tax (Calculo Alternativo del Impuesto sobre la Renta or CAIR).

If the entity's tax year results in a loss due to the alternative calculation, the taxpayer may request to the Tax Administration (the General Directorate of Revenues, i.e. Dirección General de Ingresos or DGI) not to be subject to the CAIR.

The taxpayer may also request not to apply the CAIR if its effective income tax rate is higher than the applicable income tax rate (25% since January 2011). Here is an example of such an instance:

| | | |
|---|---|---|
| **Net taxable income** | | |
| a | Total revenues | 2,000.00 |
| b | Deductible costs and expenses | 1,950.00 |
| c | Net taxable income | 50.00 |
| **CAIR** | | |
| d | Presumptive net taxable income (4.67*a) | 93.40 |
| e | Income tax (25%*d) | 23.35 |
| **CAIR effective tax rate** | | |
| f | Presumptive income tax (e) | 23.35 |
| g | Net taxable income (c) | 50.00 |
| h | Effective tax rate (f/g) | 46.70% |

The DGI has a six-month period within which to reach a decision on such requests, otherwise the petition will be considered as granted.

## *Corporate residence*

A company is considered as a tax resident when it has been incorporated in Panama, regardless of where the main office is located or whether central management is exercised in Panama or abroad. Entities incorporated abroad may also be registered with the Tax Administration in order to avoid WHT.

Since the Panamanian income tax is levied based on the territoriality principle, Panamanian-source income is subject to taxation whether it is received by a resident or non-resident entity. Residency is only relevant to determine if the entity is subject to WHT or not.

### *Permanent establishment (PE)*

Panama does not have formal PE rules. Under tax treaties signed, Organisation for Economic Co-operation and Development (OECD) rules will be applicable once treaties are in force.

## *Other taxes*

### *Franchise tax*

Franchise income tax must be paid by all corporations on an annual basis (USD 300 per year). The deadline for payment depends on the date of incorporation of the company. If the company was incorporated on any date during the first six months of the year, the due date for payment will be on 15 July of each year. If it was incorporated in the last six months, the due date will be 15 January of each year.

Non-profit organisations, cooperatives, and civil partnerships are not subject to franchise tax.

### *Movable goods and services transfer tax (ITBMS)*
The movable goods and services transfer tax (ITBMS) is the Panamanian value-added tax (VAT).

The general tax rate is currently 7%.

Alcoholic beverages are taxed at 10%, and tobacco and tobacco-derived products are taxed at 15%.

ITBMS is calculated on the value-added through a method of tax credits (i.e. ITBMS paid on transactions to produce taxable transactions) and tax debits (i.e. ITBMS collected on transactions).

Exports are not taxed, and the ITBMS paid to generate the exports may be refunded. The sale of goods such as medicines, foods, and certain products for babies are not taxed and may allow the supplier to recover the ITBMS as an exporter if certain criteria is met.

Medical services and transportation among other services are not taxed but do not produce ITBMS credit for the supplier.

### *Excise tax (selective consumption tax)*
The selective consumption tax is applied to goods (e.g. jewellery, expensive automobiles, guns, tobacco, alcoholic beverages) and services (e.g. mobile, cable TV, satellite TV) that are considered as non-essential. The tax base is the cost, insurance, and freight (CIF) price plus import duties for imported items and sales price for all other activities. The tax is levied at only one stage: on the importation of the taxed products; the sale of taxed goods produced in Panama; and for services, when the service is invoiced, the service is completely rendered, or upon receipt of advance payments, whichever first occurs.

Different tax rates apply depending on the type of service or good, with a minimum of 5% on sodas and 100% on tobacco products.

### *Customs duties*
All goods introduced into the Panamanian territory from another country are subject to customs duties. The duty rates are provided by the Panamanian Customs and Tariffs Office.

Customs duties may only be assessed by authorised customs brokers.

### *Local municipal tax*
Local municipal tax is charged based on the gross income generated by the business through the corresponding accounting period; it also depends on the type of activity being conducted by the corporation. In most cases, it cannot exceed USD 1,000 per month for each activity performed.

### *Operations notice tax*
The notice of operations is an annual tax on equity at a rate of 2%, with a minimum tax amount of USD 100 and a maximum tax amount of USD 60,000. In the case of free

zones or special trade areas, the tax will be calculated at a rate of 1% up to a maximum tax amount of USD 50,000.

The tax base is the outcome from total assets less total liabilities (excluding liabilities with related parties abroad).

### *Stamp duty*
Stamp duty is charged at a rate of USD 0.10 per USD 100 (or fraction thereof) of value on non-ITBMS taxed transactions.

## *Branch income*

For tax purposes, branches are considered separate entities from the head office and must therefore keep accounts separately and will have separate tax liability.

Branches located within the Panamanian territory must pay dividend tax through definitive WHT of 10% of net taxable income generated by the Panamanian branch, less all income taxes paid by the same corporation in Panama. This amount will be paid jointly on filing the corresponding income tax return.

## *Income determination*

Under the territoriality principle, the following will not be considered as taxable income: all income produced outside Panama, all income generated from operations or services performed outside the Panamanian territory, distribution of dividends from income not generated within the Panamanian territory.

### *Inventory valuation*
Inventory should be valued at the start of any business and subsequently at least once every accounting period. All assets must be put together, depending on their nature, and indicate different aspects such as: the unit of measurement, the name of the asset, the price of the unit, and the total value of units. Reference to the accounting records should also be included.



Inventories are generally stated at cost and can be valued using the compound average cost method, first in first out (FIFO) method, retailer method, or specific identification method. Since all entities must keep legal records, any adjustment resulting from using different methods of inventory valuation for tax purposes and financial purposes should be recorded and must be reported to the proper authorities. Once a taxpayer adopts a method, they must maintain it for at least five years.

### *Capital gains*
The transfer of real estate property and securities is subject to WHT on the gross transactions amount, but the taxpayer may make a special income tax assessment to pay the capital gain and may request a rebate of the difference between the WHT and the capital gain.

In the case of the transfer of real estate property, a 2% real estate transfer tax plus a 3% income tax advance payment must be remitted (done over the gross transaction amount or the cadastral value, whichever is greater). The 3% may be deemed definitive; contrariwise, the tax will be assessed at 10% of the gain and the 3% of the advance payment will be credited. Any amount in excess may be subject to rebate.

The rates as described in the table below will be applicable to the transfer of real estate if:

- the transferor's core business is the sale of real estate with new constructions
- it is the first transfer of the real estate after the new construction is built
- the construction permit was issued after 1 January 2011, and
- the land value was appraised within the last two years prior to the transfer.

| New housing construction | Rate (%) |
|---|---|
| Up to USD 35,000 | 0.50 |
| From USD 35,000 up to USD 80,000 | 1.50 |
| Greater than USD 80,000 | 2.50 |
| New commercial construction | 4.50 |

When transferring new housing real estate with new constructions, the real estate transfer tax (2%) does not apply.

If the first criterion is met but any of the other criteria needed to apply for the special tax rate table are not met, then the income tax will have to be assessed under the ordinary regime.

The transfer of securities is subject to a 5% WHT, and the tax rate on capital gain is 10%. The law establishes the application of a 5% WHT that will be applied by the buyer. The seller may accept the WHT as definitive or perform the calculation of the gain, apply the rate of 10%, and deduce the applied WHT. In case the WHT is superior, the taxpayer can choose to claim the return of payments made in excess.

Example:

| | |
|---|---|
| Sales price (a) | 1,000 |
| Cost (b) | 900 |
| Benefit (c) | 100 |
| WHT at 5% of (a) | 50 |
| Tax at 10% of (c) | 10 |
| Payment in excess | 40 |

The sale of fixed assets is subject to 10% on the capital gain, and there is no WHT.

### *Dividend income*

Panamanian legislation establishes that distribution of dividends is subject to definitive WHT, applied at the moment of distribution. Generally, dividends are subject to income tax at a rate of 10% without taking into consideration the form of payment, types of stock, assets, or money.

Dividend tax applies at a 5% rate on dividends paid from foreign source income, from income derived from exports, as well as exempt income from banking account interests and interests and earnings derived from securities issued by the government.

Free zone users are taxed at a 5% rate as well for local source income.

Loans to shareholders are deemed a dividend distribution, subject to a 10% withholding even in the cases where the 5% tax rate applies.

Notwithstanding the aforementioned, if the entity's shares are issued to bearer, they will be subject to dividend tax at a rate of 20%.

Dividend tax is levied if the entity meets one of the following criteria: (i) requires an operation permit to operate in Panama, (ii) requires an operation key to operate at the Colon Free Zone; (iii) is established in a Fuel Free Zone; (iv) is established in a free zone or special zone; (v) produces Panamanian-source taxable income. Dividend tax also does not apply to dividends paid on income received as a dividend if the entity is not required to withhold dividend tax or if the entity withheld the tax.

A complementary tax applies each tax year that the entity distributes less than 40% of the net profits after income tax. The complementary tax is an advance payment of the dividend tax, calculated on the difference of the distributed dividends and 40% of the net profits after income tax and applies the corresponding tax rate. If complementary tax is paid, then the entity may offset the paid complementary tax with the dividend tax when the corresponding dividend is decreed.

### *Inter-company dividends*

The distribution of dividends derived from income received as dividends from other entities is not subject to income tax or dividend tax as long as the entity that paid the dividend in the first instance was exempt from withholding any dividend tax, or if it was required to, made the corresponding withholding.

### *Foreign income*

Panamanian resident companies are taxed on their income generated within the Panamanian territory. Any other income generated abroad will be exempt from income tax payment but may be subject to dividend tax.

## *Deductions*



Taxable income is determined by deducting from the Panamanian source income all costs, expenses, and non-taxable income applicable and permitted by law. The deductibility of costs and expenses depend on the relation of such costs and expenses with the generation or preservation of income source. Special restrictions apply to the following:

- Bad debts.
- Depreciation.
- Donations.

Costs and expenses related to non-taxable income are not considered as deductible. Thus, the taxpayer must split the expenses and costs related to taxable transactions from those related to non-taxable transactions. As of 1 July 2010, the expenses and costs allocated to taxed transactions may not exceed the amount from multiplying the portion of taxable income from the total income by the total costs and expenses. The following deductions are not subject to the deductions cap: deductions on bad debts, donations to the State and non-profit organisations and education institutions (limited to 1% of the taxable income).

### *Depreciation and depletion*
The straight-line and sum-of-the-years-digits methods of depreciation are allowed.

| Assets | Straight-line (%) |
|---|---|
| Buildings | $3^{1/3}$ as maximum |
| Machinery and equipment | 33 as maximum |
| Furniture and fixtures | 33 as maximum |
| Vehicles | 33 as maximum |

In the case of mines, depletion will be deductible during its useful life or depending on the state contract methodology

### *Net operating losses*
Losses incurred by common taxpayers may be carried forward and deducted from the taxable profits for the following five years, at a rate of 20% each year, but limited to 50% of taxable income. Loss carrybacks are not allowed, and losses are not allowed for estimated income tax purposes.

### *Payments to foreign affiliates*
A payment to a foreign entity (including affiliates) in a foreign country will be subject to WHT anytime it represents a cost or expense for the payer. The tax base will be 50% of the remittance, and the income tax rate applicable is 25% as of 1 January 2011.

## *Group taxation*

In Panama there are no group taxation rules.

### *Transfer pricing*
Transfer pricing rules are applicable only if a tax treaty to avoid double taxation is in use.

### *Thin capitalisation*
There are currently no thin capitalisation rules in Panama.

## *Tax credits and incentives*

### *Free zones*
Entities established in free zones may enjoy exemption from import duties on goods, income tax, sales tax, export tax, and selective consumption tax derived from royalties on exportation and re-exportation activities. Aside from trading activities, the following businesses may also apply for the regime: higher education centres, scientific research centres, specialized centres for health services, high technology businesses, ensembling businesses, semi processed or finished products processing businesses, services businesses, environmental service businesses, general services, logistics services businesses, and manufacturing businesses.

### *Tourism, industry, and agriculture allowances*
The Incentive Law for Tourism Development grants several tax benefits, such as exemption from import duties on certain tourism services, related goods, and from property tax for companies dedicated to tourism, but only for those corporations with a

signed tourism agreement with the government. Income tax exemptions may apply in special cases.

In general, income from individuals or corporations that engage in agricultural production activities will be exempted from income tax if annual gross income is lower than USD 250,000.

Forestry plantations are totally exempted from income tax payment until 2018 if the lot planted has been duly registered at the Forestry Registry of the Environmental National Authority and resolution with approval from this authority has been issued.

### *Special laws*

The Panamanian government has enacted special laws regarding tax exemptions for certain activities performed in Panama such as call centres (Law No. 54 of 2001) and tax exemptions for certain appointed areas such as the Panama Pacific Economic Zone (Law No. 41 of 2004) and Law No. 41 of 2007, which creates a special regime for the establishment and operation of Regional Headquarters in Panama.

By means of Law No. 8 of 2010, Real Estate Investment Societies may deduct the profits distributed to their shareholders, provided that these Real Estate Investment Societies

- raise long term funds in a securities market
- are registered in the National Securities Commission
- distribute no less than 90% of their free cash flow
- register in the General Direction of Revenues, and
- withhold 20% of the profits distributed as an income tax advance payment on behalf of the shareholder, which may be deemed the definitive tax to be paid by the shareholder.

## *Withholding taxes*

Royalties and commissions on services paid to foreign entities are taxed through the application of the corresponding tax rate (25% as of 1 January 2011) over 50% of remittance under the concept of WHT (effective tax rate is 12.5%). The taxpayer may decide not to withhold taxes and consequently not deduct the expense.

Payment of interest is also subject to income tax on 50% of the interest paid to a beneficiary abroad on loans invested in Panama, but the payer must proceed with the WHT even if one does not deduct the interest.

If the beneficiary is registered as a taxpayer in Panama before the Tax Administration, no WHT may be required.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Foreign corporations | 5/10/20 | 12.5 | 12.5 |

In case of treaties, special rules are applicable in order to avoid double taxation.

## Tax administration

### Returns

The accounting period is the period for which the company makes its accounts. Returns shall be made upon completion of the accounting period and may not exceed 12 months. For most companies it is usually from 1 January to 31 December.

The due date for filing is three months after the end of the fiscal year, with the possibility for an extension of up to two additional months.

### Payment of tax

Income tax payment shall be made depending on the income tax return and shall be made no longer than three months after closing of the corresponding accounting period.

Taxpayers must make income tax advance payments based on 1% of monthly gross income. The taxpayer will have to file monthly income tax returns assessing the advance payment within the next 15 days following the end of the month. VAT on purchases may be offset against this advance payment if the taxpayer is a seller in the local market of pharmaceutical products or food and meets certain criteria.

### Statutes of limitation

The statute of limitation depends on the type of tax. The Tax Administration may audit the income tax returns filed within the last three years from the last day of the year on which the tax return was filed. The statute of limitation for the ITBMS is five years.

# Papua New Guinea

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## Significant developments

Unlike the 2010 National Budget, there were a number of amendments to existing tax law announced when the 2011 National Budget was handed down on 16 November 2010. The majority of those changes are effective as of 1 January 2011. In summary, the key taxation developments announced in the 2011 National Budget included the following:

- There has been no change to the general corporate income tax rates of 30% for residents and 48% for non-residents.
- As of 1 January 2011, a new Division 2AB will create personal liability for unpaid salary or wages tax for the directors of a company. This is intended as a further lever to ensure a higher standard of group tax compliance. Where a notice demanding payment has been served and where the required amount of group tax is not paid, each director of that company is jointly and severally liable to the extent of the shortfall.
- One of the more substantive technical amendments to the Income Tax Act 1959 is the introduction of two new provisions which operate to provide specific deductions for environmental protection and clean-up costs.
- The method by which a taxpayer may elect to pool exploration expenditure under Section 155N of the Income Tax Act was clarified, and it is now clear that a written election must be made and lodged with the Commissioner General prior to the due date for lodgement of the income tax return for the year of income in which the exploration expenditure was incurred (or within any such further period as the Commissioner General may allow).
- The Goods and Services Tax (GST) Act was amended to confirm that supplies could be made to holders of a "mining lease", as well as to holders of either a special mining lease or an exploration licence, on a GST zero-rated basis.

It has been reported that Papua New Guinea (PNG) is in the process of entering into a double taxation treaty (DTT) with Indonesia, although the terms of the DTT are currently unknown.

## Taxes on corporate income

PNG resident companies are liable for income tax on their worldwide income. Companies that are not resident in Papua New Guinea are only required to remit tax on income sourced in Papua New Guinea. A non-resident's PNG sourced passive income, including dividends, interest, and royalties, is generally only subject to withholding tax. It is ordinarily the case that the payer of the dividend, interest, or royalty must withhold the relevant amount of the tax and remit this to PNG's Internal Revenue Commission (IRC).

Papua New Guinea levies income tax on companies on a flat rate basis. The operations of a company, rather than the company's taxable income level, will dictate the rate applied to the company's taxable income.

Generally, trading profits and other income (except income which is specifically exempt) of resident companies in Papua New Guinea are assessed tax at a rate of 30%, whereas non-resident companies operating in Papua New Guinea are assessed tax at a rate of 48%. There are, however, different tax rates for income derived from mining, petroleum, and gas operations.

Specifically, trading profits and other income from operations in Papua New Guinea are liable for PNG income tax at the following rates:

| | |
|---|---|
| Income other than income from mining, petroleum, or gas operations – resident company | 30% |
| Income other than income from mining, petroleum, or gas operations – non-resident company | 48% |
| Income from petroleum operations – existing projects | 50% |
| Income from petroleum operations – new projects | 45% |
| Income from petroleum operations – incentive rate projects | 30% |
| Income from mining operations – resident company | 30% |
| Income from mining operations – non-resident company | 40% |
| Income from gas operations | 30% |

## ***Corporate residence***

A company is deemed a resident for income tax purposes if it is incorporated in Papua New Guinea. A company incorporated outside Papua New Guinea that trades in Papua New Guinea and has its voting power controlled by resident shareholders or has its central management and control in Papua New Guinea is also considered a resident. What constitutes central management and control is a question of degree and fact, and it exists where the directors meet to do the business of the company. This may be divided between two places, in which case the company will be resident in both places.

### ***Incorporation test***

A company incorporated in Papua New Guinea is automatically regarded as a PNG tax resident. However, the operation of the law of another country and a relevant tax treaty may result in a company also being treated as resident in another country.

### ***Management and control test***

A company is a PNG tax resident if it is managed and controlled in Papua New Guinea, regardless of where it is incorporated. Generally, a company is managed and controlled in Papua New Guinea if key decisions affecting the company are made at directors' meetings held in Papua New Guinea.

An entity may be a tax resident of both Papua New Guinea and another country by application of domestic legislation. A DTT entered into between Papua New Guinea and another country may contain a tiebreaker test to determine the country of residence for the purposes of the DTT.

## Other taxes

### Goods and services tax (GST)

The GST rate is 10% and applies to most goods and services supplied in Papua New Guinea. Exported goods and services attract a zero rate of GST. Goods and services, other than motor cars, supplied to mining, petroleum, or gas companies are also zero-rated. Some goods and services are exempt, including medical, educational, and financial services. Land is excluded from GST, but buildings and other improvements are subject to the tax.

### Land tax

Land tax is imposed by provincial governments on the unimproved value of the land, and the power to levy land tax is vested exclusively with the provincial governments. In Papua New Guinea, land tax is difficult to implement and faces major geographical and social problems.

### Customs duties / Import tariffs

The majority of manufacturing inputs (including plant and machinery) attract no custom duties, and other custom duty rates are being progressively reduced. The remaining rates for custom duties vary depending on the nature of the good being imported and are assessed on the total value of the goods imported, including cost, insurance, and freight. Customs bonds may be issued for the temporary importation of goods that are to be re-exported within 12 months.

### Excise taxes

Although customs duties are now minimal in many cases, some goods – most notably motor vehicles – now attract excise tax. Private motor vehicles generally attract excise at the rate of 60%, whereas work vehicles attract excise tax of 10%. Excise taxes can also apply to some domestically produced goods, including refined fuel products, alcohol, and tobacco.



### Stamp duties

Stamp duty applies at varying rates on documents and certain transactions. Of particular note is duty charged on the conveyance of property, which rises to a maximum of 5% where the value of the property being transferred exceeds 100,000 Papua New Guinea kinas (PGK). The duty is payable by the purchaser, and a 5% duty on the unencumbered value of land may also be payable where there is a transfer of shares in certain landholding companies.

Other dutiable transactions include share transfers (including some share buy-backs) which are subject to a rate of 1%. The Collector of Stamp Duties has the power to amend assessments and refund overpayments of stamp duty.

Stamp duty is payable on documents executed outside Papua New Guinea which relate to property or matters done or to be done in Papua New Guinea.

### Export duty

Export duty on timber logs (not sawn timber or plantation logs) is calculated with reference to the FOB value per cubic meter of exported logs and rates that increase as the value of the exported logs increase.

### *Contributions to employee superannuation funds*

Contributions to employee superannuation funds are compulsory for entities with 15 or more permanent employees. The employer's compulsory contribution is 8.4% of each employee's gross basic salary. The employee's minimum contribution is 6.0%.

Membership is generally compulsory for citizens. Non-citizens are currently exempt; however, this is under continuing review.

Contributions must be paid to an authorised superannuation fund. Contributions paid to an authorised fund are tax-deductible to the extent that they do not exceed 15% of the relevant employee's gross taxable salary. Contributions to non-resident funds are not tax-deductible.

### *Training levy*

All businesses whose annual payroll exceeds PGK 200,000 are subject to a 2% training levy, calculated on the sum of the taxable salaries, including benefits, of all personnel. Qualifying expenses incurred in training PNG citizen employees are creditable up to the actual amount of the levy. The training levy, if payable, is not tax-deductible.

### *Departure tax*

A departure tax is collected by airlines issuing tickets for persons departing Papua New Guinea.

### *Gaming machine tax*

Papua New Guinea imposes a 74% tax on gross revenue from gaming machines.

### *Spice export levy*

Levies are imposed from time to time on the export of specified spices (e.g. vanilla).

### *Resource project production levies*

Production royalties of 2% are payable to the national government on the net smelter return from mining operations. These royalties are tax-deductible. A royalty, at the rate of 2% of the wellhead value, is also payable from the production of petroleum and gas operations. Holders of new petroleum development licences are entitled to treat royalties as income tax paid. However, new petroleum projects will also pay a tax-deductible development levy calculated at the same rate of 2% of the wellhead value.

Mining projects are also required to pay a production levy to the Mineral Resources Authority calculated at a rate between 0.25% and 0.5% of the assessable income from production.

## *Branch income*

Income derived by a non-resident contractor for services in Papua New Guinea is usually subject to a withholding tax at the rate of 12% of gross income. This amount is calculated on deemed taxable income of 25% of the gross contract income, which is taxed at the foreign contractor tax rate of 48% (subject to tax treaties). The provisions extend to payments for the following:

- The installation, maintenance, and use in Papua New Guinea of substantial equipment or machinery.
- Construction projects.

- For the lease or charter of any industrial, commercial, or scientific equipment or any machinery or vehicle.
- Consultancy or management services.

Where the non-resident contractor rules do not apply, the non-resident company will be subject to income tax at the foreign contractor tax rate of 48% on its PNG sourced taxable income.

PNG branch remittances are not liable for dividends withholding tax (DWT) or any branch profits or similar tax.

## *Income determination*

Taxable income is defined as the sum of assessable income minus the allowable deductions. In practice, profits are calculated for tax purposes by reference to the profits reported in the financial accounts. Accounts must be prepared in accordance with PNG accounting principles, which follow the International Financial Reporting Standards.

### *Inventory valuation*

There is no form of stock relief or trading stock valuation adjustment to recognise the effects of inflation in Papua New Guinea. There is a once-only option to adopt the lowest of the cost amount, the market selling value, or the replacement value. Where the option is not exercised, the value of the stock is deemed to be the cost price. However, in special circumstances, the Commissioner General of Internal Revenue may accept a lower valuation.

### *Capital gains*

There is no general capital gains tax in Papua New Guinea. However, profits arising on the sale of property acquired for the purpose of resale at a profit, or from the carrying out of a profit-making scheme, are taxable as ordinary income.

### *Dividends*

Unless otherwise exempt from income tax, dividends are included in the assessable income of a shareholder.

Dividends received by a resident company from other companies, whether resident or non-resident, while being assessable to tax, are generally subject to a full tax rebate and are effectively received tax-free. However, where a company has losses on other activities or losses carried over from earlier years, those losses are applied against dividend income before the calculation of the dividend rebate.

### *Foreign income*

PNG resident companies are liable for income tax on their income from all sources (i.e. including foreign sourced income). A foreign tax credit may be available to offset foreign tax paid against PNG tax payable. The foreign tax credit is limited to the lesser of the foreign tax paid or the average PNG tax payable on that foreign income.

### *Stock dividends*

In most cases, the payment of a dividend by way of the issue of shares is subject to the same taxation treatment as the payment of a dividend by way of cash or the distribution of other property. However, dividends paid by the issues of shares wholly and exclusively out of profits arising from the sale or revaluation of assets not acquired for the purpose of resale at a profit are exempt from income tax and DWT.

### *Interest income*
Unless exempt under specific provisions, interest paid or credited by a financial institution, the Central Bank, or a company to a person resident in Papua New Guinea, is includable in income, and the person making the payment of or crediting interest in the account is liable to withhold and pay tax upon the amount.

### *Partnership income*
A partner's share of the assessable income of the partnership less all allowable deductions to the partnership is includable in the partner's assessable income for the year of income. Likewise, the partner's individual interest in a partnership loss incurred in the year of income is an allowable deduction. Further, if income is exempt income to the partnership, this income will be exempt income to the individual partner relative to their individual interest.

### *Unrealised exchange gains / losses*
Generally, foreign exchange gains realised and derived from debts made on or after 11 November 1986 or denominated in a currency other than the Papua New Guinea kina are included in assessable income.

## *Deductions*

General deduction provisions provide that all losses and expenditures, to the extent incurred in gaining or producing the assessable income or are necessarily incurred in carrying on a business for the purpose of gaining or producing that income, are allowable deductions. However, the general deduction provisions do not allow a deduction to the extent a loss or expenditure is an outgoing of capital, or of a capital, private, or domestic nature, or incurred in relation to the gaining or production of exempt income.

### *Depreciation and depletion*
Depreciation is allowed for equipment and other assets at prescribed rates. A taxpayer must use the diminishing value method unless an election is made to use the prime cost method. The applicable diminishing value rates are 150% of the prime cost rates.

#### Plant, machinery, and equipment
Plant, machinery, and equipment (including buildings) are depreciable at rates according to their estimated lives. A taxpayer other than a taxpayer who derives income from mining, petroleum, or gas operations may elect to claim special accelerated depreciation rates for certain capital items. For example, flexible depreciation rates (up to 100%) may be claimed on new industrial plant with a life exceeding five years that is used for manufacturing purposes. Other new plant and articles used in manufacturing, construction, transport, storage, communication, and agricultural production are eligible for an accelerated deduction equal to 20% of cost in the year of purchase. New plant and articles used for tourism are eligible for an accelerated deduction equal to 55% of cost in the year of purchase.

#### Motor vehicles
Motor vehicles are generally depreciable at 20% of prime cost. There is no upper limit in value for depreciation purposes.

#### Buildings
Buildings forming an integral part of plant, machinery, and equipment are depreciable at a prime cost rate of up to 7.5% depending on the construction materials. Buildings

housing plants eligible for the one-year write-off deduction *(see comments on new industrial plant under Plant, machinery, and equipment above)* can be written off in the year of construction. Other income producing buildings may qualify for the accelerated deduction of 20% in the year of purchase.

**Agricultural and fishing plants**
Most items of new agricultural and commercial fishing plants qualify for 100% depreciation as do boats and ships, including ancillary equipment, used solely as dive boats or for scuba diving by accredited tour operators. Other new items having a life exceeding five years used by a person carrying on agricultural operations are eligible for accelerated depreciation in the initial year of use.

### *Net operating losses - domestic*
Trading losses may be offset against all income received in the same accounting period or carried forward and offset against future trading profits. The limitation period on the carryforward of losses is generally 20 years. Losses may not be carried back against prior years' profits. Primary production losses and resource project losses may be carried forward without a time limitation, although again they may not be carried back *(see the Tax credits and incentives section for more information)*.

Note that the carryforward of losses is subject to a 50% or more continuity of shareholding and control test, or a continuity of business test where there is a breach of the ownership test.

### *Net operating losses – foreign*
Losses incurred by a resident taxpayer from a source outside Papua New Guinea (other than in relation to export market development) are not deductible against assessable income derived within Papua New Guinea. In practice, overseas losses can be carried forward and offset against overseas income for up to 20 years.

### *Payments to foreign affiliates*
The deduction available to a taxpayer for management fees paid to an associated person is limited to the greater of:

- 2% of assessable income derived from PNG sources by the taxpayer.
- 2% of the total allowable deductions, excluding management fees incurred by the taxpayer in Papua New Guinea.

The limitation applies to both resident and non-resident taxpayers. Special rules apply to mining, petroleum, and gas companies. These limits may not apply where the recipient of the management fee is resident in a country with which Papua New Guinea has a DTT or where it can be demonstrated that the management fee arrangements do not have the purposes or effect of avoiding or altering the income tax payable in Papua New Guinea.

Papua New Guinea also has transfer pricing provisions that require transactions with foreign affiliates to be conducted on an arm's-length basis.

### *Taxes*
A deduction is not allowable in respect of payments of income tax or training levy. Other taxes may be deductible subject to meeting the general principles for deductibility.

### *Double deductions*
An additional amount equal to the actual amount of expenditure incurred is deductible in respect of certain expenditures (e.g. export market development costs, some staff training costs, and certain donations). In other words, a "double deduction" is available with respect to these items.

### *Bad debt*
Bad debts are deductible if they have previously been included in assessable income and written off by year end or if the bad debt was in respect of money lent in the ordinary course of the taxpayer's business of money lending.

### *Pension expenses*
Contributions paid to an authorised superannuation fund are tax-deductible to the extent that they do not exceed 15% of the relevant employee's gross taxable salary. Contributions to non-resident funds are not tax-deductible. *See the Other taxes section for more information.*

## *Group taxation*

Companies are assessed for income tax separately regardless of whether they are part of a group of associated or related companies. Losses of one company within a group cannot be offset for tax purposes against the profits of another company within that group.

The Companies Act allows two or more companies to amalgamate and continue as one, and provisions are in place to allow this to occur without any adverse income tax consequences.

## *Tax credits and incentives*

### *Foreign tax credit*
A foreign tax credit may be available to offset foreign tax paid against PNG tax payable. The foreign tax credit is limited to either the foreign tax paid or the average PNG tax payable on that foreign income, whichever is less.

### *Manufacturers' wage subsidy*
Certain companies manufacturing new products are eligible for a subsidy based on a percentage of the relevant minimum wage of full-time citizen employees. The subsidy is taxable and available over a five-year period with a reduction in the relevant percentage each year.

### *Research & development (R&D) deduction*
A 150% deduction is available for expenditures on R&D. The deduction is available to all sectors of the economy. Broadly, R&D expenditures are defined as systematic, investigative, and experimental activities that involve innovation or a high degree of technical risk carried out for the purpose of acquiring new knowledge, or creating new or improved materials, products, devices, processes, or services.

### *Primary production deduction*
Outright deductions are allowed for certain capital expenditures including clearing, preparing, or conserving land for agriculture, eradicating pests, providing labourers' accommodation, and for the conservation and conveyance of water.

In addition, a 100% deduction is available for a new plant used directly for the purposes of agricultural production, and an initial 20% accelerated depreciation deduction is allowed for a new plant with a life exceeding five years.

Losses incurred in carrying on a primary production business can be carried forward indefinitely; they are not restricted to the 20-year limit that generally applies to company tax losses.

### *Investment in primary production*
Agricultural companies may transfer to their shareholders the benefit of the outright tax deduction available for many types of capital expenditures. The total deduction available to shareholders may not exceed the amounts paid on their shares.

### *Incentive rate for new primary production projects*
As part of promoting investment in primary production, a 20% tax rate is prescribed in respect of 'incentive rate primary production income' derived by a company (as opposed to the normal 30% tax rate for a resident company or 48% for a non-resident company). The 20% rate of income tax applies during the period commencing on the date that construction, clearing, or planting was started and ending at the end of the tenth full tax year after the date of commencement.

The 'incentive rate primary production income' is income from primary production derived by a company from a new primary production development project that is:

- a project with a capital cost not less than PGK 1 million
- located in an area in which primary production of the crop or the livestock proposed was not previously carried out, or not previously carried out on a large scale
- not an extension or development of an existing primary production project, and
- a project that commenced construction, clearing, or planting during the period 1 January 2004 to 31 December 2011.

### *Solar heating deduction*
Expenditures on the acquisition and installation of a solar heating plant for use in deriving income are allowable as an outright deduction.

### *Agricultural production extension services deduction*
A 150% deduction is available for expenditures on services provided free of charge to smallholder growers, including the provision of advice, training, and technical assistance in relation to primary production to assist growers with production, processing, packaging, and marketing issues.

### *Rural development incentive*
Qualifying new businesses located in certain specified remote areas of the country are exempt from income tax on their income for ten years after the commencing year. Any loss from this exempt activity is deductible against taxable income from another activity.

### *Incentive rate for large scale tourist accommodation facilities*
A 20% tax rate applies to income derived by a taxpayer from the operation of a large scale tourist accommodation facility or a substantially improved large scale tourist accommodation facility. The rate applies for 14 years after the end of the year of income in which the taxpayer first derives income from the facility. There are four main requirements which must all be satisfied:

- The taxpayer must derive all its income from the operation of the tourist accommodation facility.
- Construction of the facility or improvements thereto must be commenced between 1 January 2007 and 31 December 2011.
- The amount expended on the construction or improvement must exceed USD 7,000,000.
- There must be 100 rooms or more for the purpose of temporary accommodation of people.

### *Double deduction for staff training costs*

Certain staff training costs, including the cost of full-time training officers and tourism training, are eligible for a double deduction. The total tax saving is limited to 75% of the expenditure incurred.

### *Double deduction for export market development costs*

Expenditures incurred in the promotion for sale outside Papua New Guinea of goods manufactured in Papua New Guinea or tourism promotion is eligible for double deduction. The total tax saving cannot exceed 75% of the expenditures incurred.

### *Export incentives*

The net export income from the export sale of certain types of goods is exempt for the first four years of income, with a partial exemption in the following three years.

### *Deductions for environmental protection and clean-up costs*

Beginning 1 January 2011, new provisions came into effect which operate to provide specific deductions for environmental protection and clean-up costs.

Section 72D operates to provide a deduction for expenses incurred for the purpose of 'environmental protection activities'. This is an exhaustively defined term and refers to the prevention or clean-up of:

- pollution that has been caused (or is likely to be caused) by a taxpayer, or
- pollution that is present on a site that a taxpayer has or will be entitled to use.

This provision includes a number of specific exclusions, which are more in the nature of integrity measures than substantive limitations. Specifically excluded is expenditure of a capital nature that relates to the construction of a building and expenditures that relate to the acquisition of land. Where a taxpayer has deducted an amount under Section 72D, the subsequent recoupment of all or part of that expenditure will be assessable income. In addition, where a site is subsequently sold, the sale consideration will be deemed to be a recoupment of deductible environment protection costs to the extent that a deduction has or could be claimed.

Section 72E operates to permit an allowable deduction for the costs associated with preparing an environmental impact study. These costs will be deductible over the anticipated life of the project, or ten years. Like Section 72D, this deduction will only be available where costs are incurred for the sole or dominant purpose of preparing an environmental impact study. Amounts that represent a recoupment of prior expenditure will be assessable.

The depreciation provisions ensure that plant or equipment used in the course of environmental protection activities or conducting an environmental impact study is depreciable.

### *Tax credit for infrastructure development by agricultural, mining, petroleum, and gas companies*

A tax credit is available to agricultural, mining, petroleum, gas, and certain tourism companies that incur expenditures on a prescribed infrastructure development. In the case of taxpayers engaged in mining, petroleum, and gas operations, the credit is limited to 0.75% of the assessable income or the amount of tax payable for the year (in respect of that mining, petroleum, or gas project), whichever is less. Excess expenditures over the 0.75% or tax payable may be included in the following year's rebate claim.

Unutilised credits or excess expenditures can generally only be carried forward for two years. In the case of taxpayers engaged in agricultural production, the credit is limited to 1.5% of the assessable income or the amount of tax payable for the year, whichever is less.

A prescribed infrastructure development includes a school, aid post, hospital road, and other capital assets that have been approved as such by the Department of National Planning and the IRC. It cannot be an expenditure required under the Mining Act or the Oil and Gas Act.

### *Incentives for petroleum, mining, and gas operations*

Special incentives and rules apply to mining, petroleum, and gas exploration, extraction, and production activities. The main aspects are as follows:

#### Project basis of assessment

A project basis of assessment (ring-fencing) is adopted for all resource projects. This means losses from other operations, regardless of whether or not they are resource related cannot generally be offset against resource project income from a particular ring-fenced project. However, there are some concessions to the ring-fencing principle in respect of exploration expenditures and expenditures in respect of discontinued projects.

In general, all costs incurred in the exploration and development phases of the project are accumulated and amortised over the life of the project. Once production starts, an immediate deduction is allowed for 'normal' operating and administration expenses. Capital expenditures incurred after the start of production are capitalised and amortised over the life of the project.

#### Rate of tax

The rates of tax in respect of income from a resource project are:

| | Non-resident companies | Resident companies |
|---|---|---|
| Mining | 30% | 40% |
| Petroleum – existing projects | 50% | 50% |
| Petroleum – new projects | 45% | 45% |
| Petroleum – incentive rate | 30% | 40% |
| Gas | 30% | 30% |

#### Interest deductions

Interest is not deductible prior to the commencement of a resource project. Following the issue of a resource development licence, a person carrying on a resource project or exploration in relation to a resource project may claim a deduction against resource income for interest on money borrowed for carrying on the relevant operations or exploration. This is subject to a number of conditions including maintaining a debt-to-equity ratio of 3:1.

### Capital allowances

Allowable exploration expenditures (AEE) are amortised over the life of the resource project. The deduction is calculated by dividing the unamortised balance by either the remaining life of the project or four, whichever is less. The amount of the deduction is limited to the amount of income remaining after deducting all other deductions, other than deductions for allowable capital expenditure. In other words, the deduction cannot create a tax loss.

Allowable capital expenditures (ACE) are amortised over the life of the resource project. The ACE is split into two categories: capital expenditures with an estimated effective life of more than ten years (long-life ACE) and capital expenditures with an estimated effective life of less than ten years (short-life ACE).

The annual deduction for long-life ACE is claimed on a straight-line basis over ten years.

Where the remaining life of the project is less than ten years, the rate at which the deduction is allowed is calculated by referring to the remaining life of the project. For short-life ACE, the annual deduction is calculated by dividing the unamortised balance by either the remaining life of the project or four, whichever is less. For new mining projects, the deductions for both long-life ACE and short-life ACE are calculated by dividing the unamortised balance by either the remaining life of the project or four, whichever is less.

The amount of the deduction for ACE is limited to the amount of income remaining after deducting all other deductions. In other words, the deduction cannot create a tax loss.

### Off licence exploration expenditure

A major easing of the ring-fencing principle applies to taxpayers, which are involved in a producing project, where the taxpayer or a related party incurs exploration expenditures outside the area of the productive project. In this situation, the taxpayer can elect (whether or not it is currently involved in a producing project) to add such exploration expenditures to an exploration pool that can be amortised against income from the producing project.

The amount allowable as a deduction from this exploration pool in respect of resource operations carried on by the taxpayer or a related corporation is the lesser of:

- 25% of the total undeducted balance of expenditures in the exploration pool or
- such amount as reduces the income tax (other than additional profits tax) which would, but for this deduction, be payable by the taxpayer and its related corporations in respect of those resource operations for that year of income, by 10% (or 25% for mining projects).

### Management fees

Once a resource project derives assessable income, the deduction for management fees is restricted to 2% of operating expenses other than management fees. During the exploration phase of a project, the amount of management fees which can be treated as allowable exploration expenditure is limited to 2% of the exploration expenditure other than management fees. Furthermore, during the development phase the amount of management fees which can be treated as allowable capital expenditure is limited to 2% of the allowable capital expenditure other than management fees.

**Transfer of expenditures**

When interests are transferred from one taxpayer to another, the vendor and purchaser can agree to transfer deduction entitlements for the unamortised balances of allowable exploration expenditure and allowable capital expenditure to the purchaser.

**Liquefied natural gas (LNG) project**

A number of provisions with specific application to the PNG LNG project have been included in the Income Tax Act, Stamp Duties Act, Goods and Services Tax Act, Customs Act, and Excise Act.

Other provisions were added or amended at the same time as the PNG LNG project-specific provisions, the most notable being the re-introduction of additional profits tax for all designated gas projects.

## *Withholding taxes*

### *Interest, dividend, royalties, and technical/management fees*

The following withholding tax (WHT) rates apply to interest, royalties, technical fees, and dividends under PNG domestic law and tax treaties. PNG domestic legislation provides an exemption from WHT for interest and dividends in certain circumstances. The higher rates quoted are the maximum rates allowable under the treaties.

| Recipient | Interest (%) | Dividends (%) (1) | Royalties (%) | Technical fees (%) |
|---|---|---|---|---|
| Domestic law (non-treaty) | | | | |
| Non-resident corporations and individuals | 15 | 17 | 10/30 | 17 |
| Treaty | | | | |
| Australia | 10 | 17 | 10 | 0 |
| Canada | 10 | 17 | 10 | 0 |
| China | 10 | 15 | 10 | 0 |
| Fiji | 10 | 17 | 15 | 15 |
| Germany (2) | 10 | 15 | 10 | 10 |
| Korea, Republic of | 10 | 15 | 10 | 0 |
| Malaysia | 15 | 15 | 10 | 10 |
| Singapore | 10 | 15 | 10 | 0 |
| United Kingdom | 10 | 17 | 10 | 10 |

Notes

1. The rate of WHT on dividends paid by mining companies is 10%. Dividends paid to a resident or a non-resident out of income from petroleum or gas operations are exempt from income tax and are not subject to WHT.
2. The treaty with Germany has not yet been ratified by Germany.

### *Business income withholding tax*

Income derived by local contractors in certain industries is covered by the business income withholding tax regime. The industries affected include:

- Building and construction

- Motor vehicle repairs
- Advertising
- Joinery and cabinet making
- Entertainment
- Architecture
- Consultancy
- Engineering
- Equipment hire
- Surveying
- Security
- Road transport
- Cleaning and maintenance

Businesses affected are required to have a certificate of compliance and to produce it when entering into contracts with their customers. Payers are required to file an annual income reporting statement where either they make an eligible payment of PGK 500 or more in relation to one contract or eligible payments for several contracts exceeding PGK 3,000 in the year of income in relation to a single payee. Payers are required to deduct a 10% WHT if payees do not produce a certificate of compliance.

### *Non-resident insurer withholding tax*
Premiums paid to non-resident insurers in respect of insurance contracts on property situated in Papua New Guinea or insured events which can only occur in Papua New Guinea are subject to tax in Papua New Guinea. The tax is calculated on a deemed taxable income equal to 10% of the gross premium, which is taxed at the non-resident tax rates of 48% (companies) or 30% (unincorporated associations). Tax treaties may limit the rate of tax applied.

### *Overseas shippers*
Income derived by overseas shippers or charterers carrying passengers, livestock, mail, or goods out of Papua New Guinea is taxable in Papua New Guinea. The tax is calculated on a deemed taxable income equal to 5% of the gross income which is taxable at the non-resident rate of 48% in the case of companies. The IRC may exempt the overseas shipper from tax if the shipper's home country exempts PNG shippers from a similar tax.

## *Tax administration*

### *Returns*
Papua New Guinea operates on a full assessment basis, and companies are required to lodge an annual income tax return showing the calculation of taxable income for the year. In addition, the return must provide detailed disclosures in relation to income derived and expenses incurred during the year of income.

The tax year is generally the period 1 January to 31 December; however, application may be made for a substituted tax year end. These will normally be granted where the substituted tax year end coincides with the accounting year end of an overseas holding company. A company's tax year does not need to be the same as its accounting period.

A company must file a tax return by 28 February in the year following the year of income to which the return relates. However, an automatic extension to 30 June applies where the company lodges its return through a registered tax agent.

### *Payment of tax*

Corporate income tax is collected under a provisional tax system. Under this system, tax is paid in respect of a company's current year profits (i.e. payments made in the year of income are in respect of income derived in the same year as the payment is due).

Provisional tax is assessed by the IRC based on the last return lodged. In the event that no tax was payable on the previous year's return, the Commissioner General has the right to estimate the amount of tax based on any other information available.

Provisional tax is payable in three equal instalments by 30 April, 31 July, and 31 October.

Applications may be made to reduce provisional tax assessed if the tax due for the year in question is expected to be lower than the provisional tax assessed. Where estimated provisional tax is less than 75% of the income tax ultimately assessed, additional tax may be levied. Additional tax at a rate of 20% will be assessed, based on the difference between the estimate lodged and the provisional tax originally determined, or the actual tax payable, whichever is less. The Commissioner General has the discretion to require payment of additional tax.

Mining, petroleum, and gas companies are subject to advance payments tax, a system that broadly mirrors the provisional tax system in place for non-resource companies. The main difference for resource companies is they have the option to lodge an estimate of their taxable income for the year prior to 30 April, 31 July, and 31 October each year, which the IRC uses to assess each advance payments tax instalment.

Following the lodgement of the income tax return, the IRC will serve a notice of assessment on the company. The balance of tax payable for a year of income, after the application of provisional tax (or advance payments tax in the case of a resource company) and other tax credits or rebates, is due to be paid within 30 days of the date of service of the notice of assessment.

# Paraguay

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## Significant developments

There have been no significant corporate tax developments in Paraguay during the past year.

## Taxes on corporate income

Income is taxed in Paraguay according to the resource principle (i.e. the territorial system of taxation).

There are three tax systems in Paraguay, depending on the type of taxpayer, as follows:

- For income from commercial, industrial, and service activities, the general income tax rate of 10% applies.
- For income from agricultural and cattle activities, the rate ranges from 2.5% to 10% (determined by annual income).
- For those taxpayers with annual income of less than 100 million Paraguayan guaraní (PYG), a single tax at a rate of 10% applies.

## Corporate residence

Corporate legal residence is determined as the place where direction or central management takes place, unless the corporation's charter states otherwise.

## Other taxes

### Value-added tax (VAT)

VAT applies to all corporations and to individuals or associations of individuals rendering personal services.

The general VAT rate is 10%, but a special VAT rate of 5% applies for selling real state, basic groceries, farming products, pharmaceutical products, and loans interest.

### Real estate tax

Real estate tax is levied annually at 1% of the fiscal value of the property, which is generally less than actual value. A tax rate of 0.5% applies if the area of rural property is smaller than five hectares and is used for agricultural or cattle ranching. In certain areas, an additional tax is levied on the fiscal value of vacant and semi-vacant land when the area of the built-up portion falls within certain determined percentage limits. Large tracts of land in rural areas are subject to an additional tax determined on a percentage basis and to a proportional tax of 0.5% to 1% on the fiscal value of tracts with areas ranging from 10,000 to 60,000 or more hectares.

The 1992 Paraguayan Constitution established that municipalities and departments are entitled to the tax revenues directly related to real estate. Collection of these taxes is the responsibility of municipal governments.

### Tax on acts and documents

There is no longer a tax on acts and documents in Paraguay since fiscal year 2007.

## Branch income

Branches are taxed at the same rate as domestic corporations. Profits transferred or credited to the head office are subject to a 15% withholding tax (WHT) when remitted to the head office abroad.

Additionally, the payment of dividends (by the head office's instructions) is subject to a 5% WHT to be paid at the time of the remittance and charged to the local entity.

## Income determination

### Inventory valuation

Taxpayers may adopt any method of inventory valuation, provided it is technically acceptable, according to Tax Administration criteria (e.g. first in first out (FIFO), average cost). The valuation must be applied consistently and may be changed only with the prior approval of the treasury minister.

Damaged, deteriorated, and obsolete inventories may be written down to fixed values by the taxpayer. The tax administration can reject valuations that are not realistic.

### Capital gains

Gains on all assets, tangible and intangible, are taxable as part of profits and subject to income tax at a rate of 10%.

### Dividend income

Dividends are not taxable income except when the recipient (or shareholder) is a non-resident, in which case a 15% WHT applies. An additional 5% tax is charged to local entities when the income or dividend is distributed to a local or foreign (non-resident) shareholder.

### Stock dividends

Stock dividends are not taxable income, except when dividends represent more than 30% of the taxable income of an investor. In the case when dividends represent more than 30% of an investor's taxable income, a tax rate of 15% and an additional tax rate of 5% apply *(see Dividend income above)*.

### Foreign income

Foreign-source income is not taxable. Interest, commissions, and capital gains are considered Paraguayan source when the investor is resident in Paraguay.

## Deductions

General provisions for expenses or other potential losses are not deductible.

Other specific non-deductible items include:

- Interest on capital, loans, or any other investment by an owner, partner, or shareholder in a business.
- Personal expenses of an owner, partner, or shareholder.
- Money drawn on account of future earnings.
- Amortisation of goodwill.
- Direct expenses incurred in earning non-taxable income.
- Earnings from any fiscal period that are retained in the business as capital increases or reserve accounts.

### Depreciation and depletion

The maximum allowable depreciation rates range from 2.5% for urban buildings to 25% for computer equipment. Depreciation is calculated by the straight-line method based on the useful life of assets, as determined by the Treasurer. The Treasurer may also authorise the use of other depreciation or depletion methods that are deemed to be technically justified and generally accepted.

Fixed assets must be revalued annually based on the increase of the price index. Capital gains derived from the revaluation of fixed assets are not taxable income.

### Extraordinary losses/bad debts

The deduction of extraordinary losses and bad debts require the meeting of certain conditions (e.g. communication to Tax Authority, evaluation of the actual loss in monetary terms, audit review).

### Charitable contributions

The deduction of a donation is subject to a formal registration of the beneficiary entity as a public benefactor before the Treasury Ministry.

### Executive remuneration

The deduction of executive remuneration is limited to a percentage defined according to the enterprise's profits.

### Taxes

*In general, all taxes mentioned in the Other taxes section are deductible.* Income tax and any fiscal surcharges or fines are not deductible.

### Net operating losses

Net operating losses are not permitted to be carried forward and applied against future years. However, Congress is considering amending the law to permit carrying forward of losses for three years.

Losses may not be carried back in Paraguay. However, a taxpayer may modify one's tax returns at a later date.

### Payments to foreign affiliates

There are no limits on the deductibility of payments to foreign affiliates, including management fees, research and development (R&D), and general and administrative expenses, provided that the taxpayer maintains corresponding legal documentation that includes the country of origin and applies appropriate WHT. *See the Withholding taxes section for the applicable WHT rates.*

## Group taxation

Group taxation is not permitted in Paraguay.

### Transfer pricing

Paraguay does not have transfer pricing rules.

## Tax credits and incentives

### Investment incentives

The framework of economic investment was established in the Law No. 60/90, which offers some special tax exemption benefits to foreign and local investors.

The benefits of the Law No. 60/90 may be available for the following investments:

- Cash, financing, provision of credit, or other financial instruments, under the conditions established by the administration of the President of Paraguay and the corresponding ministries.
- Capital goods, raw materials, and inputs for local industry for the fabrication of capital goods.
- Transfers of licensing rights with respect to trademarks, industrial processes and models, and other technologies.
- Technically specialised services.
- Capital leases.
- Other forms that the administration of the President of Paraguay and the corresponding ministries determined by law.

The investment incentives included in Law 60/90 that remain enacted after tax law modification (Law No. 2421/04) are the exemptions from certain fiscal, municipal, and customs duties taxes.

When the amount of financing for an investment is greater than USD 5 million, it will be exempt from WHTs on interest, commissions, and capital that have to be paid to financial or banking entities abroad. This benefit is for five years.

If the investment is at least USD 5 million and the project is approved for a term of at least ten years, the dividends and profits derived from the project are tax exempt. In this case, the taxes on those dividends and profits are not creditable in the country of origin.

### Other incentives

Exports are exempt from certain customs duties and from VAT.

A Capital Market Law (No. 1284/98) established incentives for companies listed on the Asunción Stock Exchange.

In addition, Law 536/95 established incentives for forestry activities.

## Withholding taxes

### WHT on payments made by a domestic corporation

| Recipient | Dividends (%) (1) Portfolio | Dividends (%) (1) Substantial holdings | Interest (%) (2, 3) | Royalties (%) (3, 4) | Fees (%) (3, 5, 6) |
|---|---|---|---|---|---|
| Non-resident corporations | 15 | 15 | 30 | 30 | 30 |
| Non-resident individuals | 10 | 10 | 30 | 10 | 10 |
| Tax treaty with Chile | | | | | |
| Non-resident corporations | 10 | 10 | 10/15 (7) | | |
| Non-resident individuals | 10 | 10 | | | |

Notes

1. Since 2006, local entities are required to pay an additional 5% WHT when the income or dividend is distributed.
2. The WHT on interest is based on 100% of the amount paid when remitted to the head office abroad. In other cases, when the payment is not directly made to the head office or shareholders that have control of the local subsidiary, the WHT is based on 50% of the amount paid. The tax rate is 30%.
3. VAT is withheld on interest, royalties, and other services provided for non-resident corporations or individuals at a rate of 9.09%, except on fees for financing, which are withheld at a rate of 4.76%.
4. The WHT on royalties is based on 100% of the amount paid when remitted to the head office abroad. In other cases, when the payment is not directly made to the head office or shareholders that have control of the local subsidiary, the WHT is based on 50% of the amount paid. The tax rate is 30%.
5. The WHT on fees is based on 100% of the amount paid when remitted to the head office abroad. In other cases, it is based on 50% of the amount paid. The tax rate is 30%.
6. Fees for personal services rendered by non-resident corporations are subject to withholding income tax at a rate of 50% on the amount paid. The tax rate is 30% (effective tax rate of 15%). Fees for personal services rendered by non-resident individuals are subject to withholding of the personal income tax at a rate of 50% on the amount paid. The tax rate is 20% (effective tax rate of 10%). Congress is considering suspending this tax.
7. In case of a loan to Chile, the WHT on the interest is 15% if the loan is from a bank or insurance company. On the other hand, if the loan is from an associated company or head office, the tax rate is 10%. Regarding VAT WHT, *see Note 3.*

## Tax administration

### Returns

Income tax returns are submitted on a fiscal-year basis as a self-assessment and must be filed by the fourth month following the end of the fiscal year.

### Payment of tax

Income tax is due on varying days in the fourth month following the end of the fiscal year, depending on the taxpayer ID number, according to a calendar established by the treasury ministry. Four equal advance payments are made throughout the year, calculated based on 100% of the tax due in the previous year. Payments must be made in May, July, September, and November of each year after the due date for filing the income tax return, according to the calendar established by the tax authorities.

# Peru

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## Significant developments

Several changes to corporate taxation legislation in Peru were incorporated during 2011, including the following:

- The financial transactions tax (FTT) rate for fiscal year (FY) 2011 has been established at 0.005% as of 1 April 2011.
- As of 1 April 2011, the value-added tax (VAT) rate is 18%.
- The tax exemption on income from bank deposits in local banks remains in force until 31 December 2011.
- A recent proposal to modify Peruvian income tax law in order to include as a taxable event the indirect disposal of shares of Peruvian entities was approved in the Congress. Even though approved, the bill has not been published yet (and thus is not in force yet). Specifically, the proposal establishes that an indirect disposition will take place when there is a sale of shares from a non-domiciled company which owns directly, or through another company, shares of a domiciled entity, and (i) in any of the 12 months prior the sale, the market value of the shares of the domiciled entity owned by the non-domiciled company (directly or through other company) is equivalent to 50% or more of the market value of all the shares of the non-domiciled company or (ii) the non-domiciled company is resident in a black listed territory (tax haven), unless it can prove that it is not included in the situation describe in (i).
- There is a special depreciation regime applicable for years 2010 and 2011 for buildings and constructions that allows for depreciation at a 20% rate, provided certain requirements are met.



## Taxes on corporate income

Companies incorporated in Peru are considered resident in Peru for tax purposes and thus subject to an income tax rate of 30% on worldwide net income.

For purpose of determining taxable income, such entities are allowed to deduct expenses to the extent that they are necessary to generate or maintain the source of taxable income. Requirements, limitations and/or caps may apply to the deduction of certain expenses (thin capitalisation rules), bad debt provisions, salaries, travel expenses, gifts, etc.

The Peruvian income tax law allows crediting for various payments against income tax, including income taxes paid in advance, amounts paid for certain other taxes, and income taxes paid in foreign tax jurisdictions, provided that the foreign country's tax rate is not higher than the Peruvian corporate tax rate.

Dividends and any other types of profit distributions are taxed at a 4.1% rate, upon distribution, whether the distributions are made to resident companies or non-resident companies (either individuals or legal entities). The entity distributing dividends or profits is liable for withholding tax (WHT) at a rate of 4.1%. Nevertheless, enterprises are subject to an additional tax rate of 4.1% on every amount or payment in kind that, as result of a tax audit, is construed as taxable income to the extent that it is an indirect distribution of such income that is not susceptible to further tax control, including income that has not been declared.

## *Corporate residence*

For income tax purposes, the following entities, among others, are considered as resident entities in Peru:

- Corporations duly incorporated in Peru.
- Branches, agencies, and permanent establishments (PE) in Peru of non-resident individuals or entities (the Regulations of the Peruvian income tax law provide the cases in which a PE is deemed to be established in Peru).
- Partnerships and limited liability companies.

## *Other taxes*

### *Value-added tax (VAT)*

As of 1 April 2011, the general rate of VAT is 18% (19% prior to 1 April 2011) and is applicable to the following operations:

- Sale of goods within the country.
- Rendering or first use of services within the country.
- Construction contracts.
- The first sale of real estate made by construction firms.
- Import of goods.

For all transactions, the vendor is subject to VAT, except in the case of importation of goods or services rendered abroad, but economically used within Peru, for which VAT is self-assessed by the importers and users, respectively.

The VAT law follows a debit/credit system, and input VAT may be offset by output VAT. Should excess input VAT be obtained in a particular month, it shall offset output VAT obtained during the following months, until it is exhausted. Cash refunds of excess input VAT may be made only if it is not possible to offset the excess input VAT related to the exportation of goods and services, as explained below, but not to domestic transactions.

The export of movable goods (including the sale of goods in the international zone of ports and airports) is not subject to VAT, nor is the exportation of certain services. Thus, VAT paid upon the acquisition of goods, performance of services, construction agreements, and the importation of goods related to exported goods or services creates a positive VAT export balance.

The positive balance may offset output VAT, income tax, or any other outstanding tax debt in favour of the central government. If the positive balance is not completely offset, as the amount of the aforementioned tax obligations is insufficient, the taxpayer may apply for a refund (which may be made in cash or by cheque).

### *Excise tax*
The sale of specific goods, including fuel, cigarettes, beer, liquor, and vehicles, is subject to excise tax.

Excise tax rates depend on the type of goods or services.

### *Financial transactions tax (FTT)*
As of 1 April 2011, FTT is applied at a rate of 0.005% (0.05% prior to 1 April 2011) on all debits and/or credits on bank accounts held by the taxpayers.

The following operations, among others, are exempted from the FTT:

- Operations made between accounts of the same holder.
- Credits to bank accounts for payment of salaries.
- Credits and debits to bank accounts of diplomatic representations and international organisations recognised in Peru.

Payments of FTT are deductible as expenses for income tax purposes.

### *Temporary net assets tax (TNAT)*
Companies subject to income tax are obliged to pay TNAT, except companies that are in preoperative stages or that commenced business on 1 January of the fiscal year in which TNAT must be paid.

The taxable basis is the value of the assets set forth in the taxpayer's balance sheet as of 31 December of the year prior to that of the tax payment, adjusted for deductions and amortisations accepted by the Peruvian law.

The amount of TNAT is determined by applying the following rates on the taxable basis:

- Up to 1 million Peruvian nuevos soles (PEN): 0%.
- Excess of PEN 1 million: 0.4%.

The amount paid for TNAT may be credited against the taxpayer's income tax.



## *Branch income*

Branches, agencies, and PEs of non-resident companies or entities incorporated in Peru are subject to income tax at a 30% rate on their Peruvian-source income.

For tax purposes, branches or subsidiaries are subject to the same obligations applicable to all companies in Peru, including income tax, VAT, FTT, filing of the corresponding income tax and VAT returns, issuance of invoices, etc.

Nevertheless, the following important differences between subsidiaries and branches resident in Peru must be taken into account:

- Branches are subject to income tax only for their Peruvian-source income, while subsidiaries are subject to income tax on their global-source income (both Peruvian and foreign income).

- For branches, the 4.1% rate for distribution of dividends is applied from the date the annual income tax return is submitted. Subsidiaries are subject to the 4.1% rate on the earlier of the date in which the corresponding shareholders agreement took place or the date when the beneficiary has the right to use the dividends distributed by the subsidiary.

## Income determination

### Inventory valuation
The first in first out (FIFO), average, specific-identification, retail, and normal or base-stock methods are allowed for inventory valuation. The last in first out (LIFO) method is not permitted.

### Capital gains
Capital gains are taxed as ordinary income.

### Dividend income
Cash dividends distributed to resident corporations are not subject to any taxes.

### Foreign income
A Peruvian corporation is taxed on foreign-source income. Foreign-source income is recognized upon accrual. No tax deferral is allowed on this type of income. Double taxation may be avoided by means of foreign tax credits.

## Deductions

### Acceptable payment methods
Obligations that are fulfilled through cash payments exceeding PEN 3,500 must be made via bank account deposits, wire transfers, payment orders, credit cards, non-negotiable cheques, or other means of payment provided by entities of the Peruvian financial system. Failure to use one of these payment methods when such an obligation exists will result in the disallowance of deductions for any expenses or costs for income tax purposes and the disallowance of a credit for the corresponding VAT.

### Expenses derived from transactions entered into with entities resident in tax havens
Certain expenses are not tax-deductible, including expenses incurred with respect to transactions with (i) entities resident in tax havens on the list attached to the Peruvian Income Tax Law regulations, (ii) PEs located in tax havens, or (iii) entities that generate revenues or income through tax havens.

Nonetheless, expenses incurred from the following transactions are excluded from the above-mentioned limitations:

- Interest on loans.
- Insurance premiums.
- Leases of aircraft or ships.
- Maritime freight.
- Fees for passing through the Panama Canal.

### Depreciation
Assets may be depreciated for tax purposes, via the straight-line method, at the following rates:

| Assets | Rate (%) |
|---|---|
| Buildings | 5 |
| Cattle (both labour and reproduction) and fishing nets | 25 |
| Vehicles (except trains) and any kind of ovens | 20 |
| Machines and equipment used for mining, oil and construction activities, excluding furniture, household, and office goods | 20 |
| Equipment for data processing | 25 |
| Machines and equipment acquired as of 1 January 1991 | 10 |
| Other fixed assets | 10 |

There is a special depreciation regime applicable for years 2010 and 2011 for buildings and constructions that, provided certain requirements are met, allows for depreciation at a 20% rate.

### Organisational and start-up expenses
Organisation expenses, pre-operating expenses (including initial operations and further expansion of operations), and interest accrued during the pre-operating period may be expensed in the first period of operation or amortised using the straight-line method over a maximum of ten years. However, once a company has elected to recover start-up costs via the straight-line method, it may revoke such election only upon receiving approval of the tax authorities.

### Profit sharing
Entities with more than 20 employees, provided they obtain taxable income during the fiscal year, must distribute a percentage (5%, 8%, or 10% depending on the industry) of their profits (the basis is the tax profit of the fiscal year) among their employees. The amount of distribution for each employee depends on the effective working days during the year and annual remuneration.



### Employee's retributions and health insurance premiums
Employee's retributions paid during a fiscal year may be deducted in such year, provided the payments are made by the employer before the term to file its annual income tax return expires. Likewise, health insurance premiums for employees, their spouses, and children are deductible.

### Vehicle expenses deductions
Vehicle expenses may be deducted, provided the vehicles are essential to a company's business activities and are continually used for such purpose. There is a limitation on the tax deductibility of car expenses, depending on the amount of income generated by the company. The number of company cars assigned to directors, managers, and representatives of a company may not exceed five under any circumstances.

Vehicles subject to these limitations are those classified in categories as A2, A3, and A4, pursuant to the provisions of the Ministry of Transport.

### Taxes
Other taxes assessable on properties and activities generating taxable income are deductible for income tax purposes.

### Net operating losses
Tax losses may be offset according to either of the following systems:

- Against net income generated within the following four fiscal years after the year in which the loss was generated. Any losses that are not offset within such period may not be carried forward to any later years.
- Against 50% of the net income generated in the following fiscal years after the year in which the loss was generated. Under this system, there is no time limitation for carrying forward the losses.

After choosing one of the aforementioned systems, the taxpayers may not change the system until any accumulated tax losses from prior fiscal years are exhausted. Losses may not be carried back to years prior to the year in which the loss was generated.

### Payments to foreign affiliates
Payment of royalties to non-resident affiliates is permitted and deductible from gross income.

## Group taxation

Group taxation is not permitted in Peru.

## Tax credits and incentives

### Early recovery of VAT
Companies in a preoperative stage with large projects in process may apply for early recovery of VAT prior to commencing operations. An investment agreement with the government (the Ministry of its sector) is required.

### Stability agreement
Investors may enter into stability agreements with the government, either under the general regime or specific regimes (i.e. mining and petroleum).

Under the general regime, investors may enter into Juridical Stability Agreements that guarantee the following advantages for a ten-year period:

- Stability of the income tax regime in force at the time the agreement is entered into with respect to dividends and profit distribution.
- Stability of the Peruvian government monetary policy, according to which there is a complete absence of exchange controls, foreign currency can be freely acquired or sold at whatever exchange rate the market offers, and funds can be remitted abroad without any previous authorisation.
- Right of non-discrimination between foreign and local investors.

Under the mining regime, local mining companies may enter into stability agreements of guarantees and investment promotion measures that guarantee the following for ten or 15 years:

- Stability of the overall tax regime.
- Stability of the overall administrative regime.
- Free disposition of funds (foreign currency) arising from export operations.
- No exchange rate discrimination.

- Free trade of products.
- Stability of special regimes for tax refunds, temporary importation, etc.

Oil companies may enter into stability agreements that guarantee the following for the term of the contract:

- Stability of the overall tax regime.
- Free disposition of funds (foreign currency) arising from export operations.
- Free convertibility of its funds.
- Free trade of products.

### *Investment promotion in the Amazon*
Certain tax benefits with regard to VAT and income tax have been established for taxpayers located in the area designated by the law as the 'Amazon' and that are engaged in the following activities:

- Agriculture and livestock enterprises.
- Aquaculture.
- Fishing.
- Tourism.
- Manufacturing activities linked to the processing, transformation, and commercialisation of primary products originating in the activities listed above and in forest transformation, provided these products are produced in the area.

### *Special zones – Centres of Export, Transformation, Industry, Commercialisation, and Services (CETICOS)*
CETICOS are geographical areas duly delimited with custom primary zone status and special treatment, destined to generate development poles through industrial, maquila, assembling, or storage activities. CETICOS are located in Paita, Ilo, and Matarani cities.

Agribusiness and agro-exporting activities may be performed within a CETICOS. Agribusiness activity is primarily the transformation of agro-farming products produced in the country. Such transformation must be carried out at CETICOS.



Companies engaged in industrial, maquila, or assembling activities, established or set up in the CETICOS, until 31 December 2012, are exempt from income tax, VAT, excise tax, municipal promotion tax, as well as from any other taxes, fees, contributions levied by the Central Administration, and even taxes that require express exempt regulation.

## *Withholding taxes*

Domestic corporations are required to withhold income tax with respect to income paid to non-resident entities at the following rates:

| Type of payment | WHT (%) |
|---|---|
| Interest on non-related party loans, provided certain requirements are fulfilled | 4.99 |
| Interest on related party loans | 30 |
| Interest paid by Peruvian financial entities or banks to foreign beneficiaries for credit lines used in Peru | 4.99 |
| Royalties | 30 |
| Digital services | 30 |

| Type of payment | WHT (%) |
|---|---|
| Technical assistance, provided that certain requirements are met (otherwise 30%) | 15 |
| Lease of vessels or aircraft | 10 |
| Dividends or profit distributions | 4.1 |
| Other income | 30 |

Note that resident taxpayers may not deduct the WHT of a third party, except in the case of loans provided by non-resident creditors, to the extent that the debtor has contractually assumed the obligation of bearing the WHT.

Capital gains derived from the sale of stocks through the stock exchange paid to a non-resident company have an income tax rate of 5% and are not subject to any withholding. In these cases, the income tax must be paid directly by the non-domiciled company.

Capital gains derived from the sale of stocks paid to resident individuals are subject to a 5% income tax rate, even though they are not sold through the stock exchange.

In the case of the services mentioned below that entail the execution of activities both in Peru and abroad, non-resident entities are only subject to tax on a percentage of gross income at the following rates:

| Type of payment | WHT (%) |
|---|---|
| Insurance | 7 |
| Lease of vessels | 80 |
| Lease of aircraft | 60 |
| Air transport | 1 |
| Maritime transport | 2 |
| Telecom services | 5 |
| International news services | 10 |
| Distribution of movies, records, and similar products | 20 |
| Rights for broadcasting live foreign TV shows within Peru | 20 |

### *Tax treaties*

Peru has entered into treaties with Canada, Chile, and Brazil regarding double taxation on income tax (the last three entered into in accordance with the Organisation for Economic Co-operation and Development (OECD) Model). Recently, Peru has entered into a double-taxation treaty (DTT) with Spain and Mexico (also entered into pursuant to the OECD Model), but the treaties have not yet entered into force, as the Peruvian Congress ratification required for such purpose is still pending. In addition, Peru is a member of the Andean Community of Nations (ACN), which also includes Bolivia, Colombia, and Ecuador.

Pursuant to the provisions of the tax treaties entered into in accordance with the OECD Model, income is taxable in the country of the service provider's residence, unless a PE is configured, in which case both countries are entitled to levy tax on income and the country of residence allows a credit for taxes paid in the other country.

On the other hand, according to the treaties with the ACN, income is taxable in the country in which its source is located, unless a PE is configured, in which case income tax is levied in the country where the PE is located. Thus, in transactions with entities resident from one of the member countries of the ACN, in certain cases income is taxable in Peru if the source of such income is located within Peru. For such purpose, the term 'source' is defined as the place where the activity, right, or goods that generates or will generate income is located.

## *Tax administration*

### *Returns*

According to law, the fiscal year must coincide with the calendar year. The filing deadline for the income tax return is generally the first week of April. The system is one of self-assessment, but the tax return filed with the tax authorities is subject to review.

### *Payment of taxes*

Income tax is paid in advanced instalments calculated based on monthly revenue, either by applying a 2% rate or by a factor equivalent to the effective tax rate on net revenue of the prior year. Income tax is paid in 13 instalments (12 monthly payments and the annual income tax return). As noted, the first 12 payments must be made on a monthly basis and the last payment is due at the time that the annual tax return is filed. Late payment of interim or final instalments is subject to moratorium interest. Excess payments are subject to indexation up to the date of reimbursement or application to future taxes.

### *Tax authority*

The tax authority in Peru is called 'Superintendencia Nacional de Administración Tributaria' (SUNAT). SUNAT is responsible for administering all of the aforementioned taxes (income tax, VAT, etc.). Companies resident in Peru must be registered with the tax administration (Taxpayer's Registry).

The Tax Court (Tribunal Fiscal) is a specialised court of law that is given an administrative level from the Economics and Finances Ministry, but is otherwise autonomous regarding its specific functions. Its mission is to rule over tax contingencies that may arise between the Tax Administration and the taxpayers, by interpreting and applying the corresponding tax legislation, issuing mandatory observance jurisprudence, establishing homogenous criteria, and providing legislation that continues to support the progress of the tax system.

# Philippines

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## Significant developments

### Exchange of information on tax matters

The Exchange of Information on Tax Matters Act of 2009 (Republic Act (RA) No. 10021) became effective in 2010. The law was passed in order for the Philippine government to be compliant with the internationally-agreed tax standards required for the exchange of tax information with its tax-treaty partners. Among its salient features are the following:

- Among others, the Commissioner of Internal Revenue has the authority to inquire into bank deposit accounts and related information held by financial institutions if a specific taxpayer or taxpayers is/are subject of a request for the supply of tax information from a foreign tax authority pursuant to an international convention or agreement on tax matters to which the Philippines is a signatory or party of. The information obtained from the banks and other financial institutions may be used by the Bureau of Internal Revenue (BIR) for tax assessment, verification, audit, and enforcement purposes.
- A taxpayer subject of a request for the supply of tax information held by financial institutions from a foreign tax authority shall be duly notified in writing by the Commissioner of the request.
- Income tax returns of a specific taxpayer subject of a request for exchange of information by a foreign tax authority shall be open to inspection upon the order of the President of the Philippines, under rules and regulations as may be prescribed by the Secretary of Finance, upon recommendation of the Commissioner.
- The Commissioner has the authority to supply information which is at his disposal to a Foreign Tax Authority.
- The information received pursuant to the request for the supply of tax information from a foreign tax authority shall be kept confidential.

### Tax on life insurance policies

RA No. 10001 made several amendments to the taxation of life insurance policies in 2010. The rate of percentage tax on life insurance policies was reduced from 5% to 2% of the total premiums collected. Moreover, documentary stamp taxes (DST) rates on life insurance policies were also revised, as follows:

- Exempted if the amount of insurance does not exceed 100,000 Philippine pesos (PHP).
- PHP 10 for amounts exceeding PHP 100,000 but not exceeding PHP 300,000.
- PHP 25 for amounts exceeding PHP 300,000 but not exceeding PHP 500,000.
- PHP 50 for amounts exceeding PHP 500,000 but not exceeding PHP 750,000.
- PHP 75 for amounts exceeding PHP 750,000 but not exceeding PHP 1 million.
- PHP 100 for amounts exceeding PHP 1 million.

### *Value-added tax (VAT) exemption of certain expenses by senior citizens*
Congress passed 'The Expanded Senior Citizens Act of 2010' (RA No. 9994) which gives additional benefits and privileges to the elderly. Among the benefits is a 20% discount and exemption from the VAT on the sale of goods and services (medicines, medical and dental fees, transport fares, services in hotels and restaurants, admission fees in theatres and other places of leisure). The BIR has released a revenue regulation to clarify how the VAT exemption will be put in effect by affected establishments.

### *Excise tax on alcohol and tobacco products*
Pursuant to the provision of RA No. 9334, the excise tax on the following alcohol and tobacco products are increased effective 1 January 2011:

- Excise tax rates on alcohol products are increased by 8%.
- Excise tax on tobacco is increased from PHP 1.12 per kilogram to PHP 1.19 per kilogram.
- Excise tax on cigarettes packed by hand is increased from PHP 2.47 per pack to PHP 2.72 per pack.
- Excise tax on cigarettes packed by machines is increased from PHP 2.47 to PHP 27.16 per pack depending on net retail price to PHP 2.72 to PHP 28.30 per pack depending on net retail price.

## *Taxes on corporate income*

A domestic corporation is subject to tax on its worldwide income. On the other hand, a foreign corporation is subject to tax only on income from Philippine sources *(see the sub-sections on Resident foreign corporations and Non-resident foreign corporations below)*.

### *Domestic corporations*
The following corporate income tax (CIT) rates apply to domestic corporations:

| Income | CIT rate (%) |
|---|---|
| In general, on net income from all sources | 30 |
| Minimum corporate income tax (MCIT) on gross income, beginning in the fourth taxable year following the year in which business operations commence. MCIT is imposed where the CIT at 35% is less than 2% MCIT on gross income. | 2 |
| **Proprietary educational institutions and non-profit hospitals:** | |
| On net taxable income if gross income from unrelated trade, business, and other activities does not exceed 50% of the total gross income from all sources | 10 |
| On total net taxable income if gross income from unrelated activities exceeds 50% of income | 30 |
| Non-stock, non-profit educational institutions (all assets and revenues used actually, directly, and exclusively for educational purposes) | Exempt |

Certain passive income from domestic sources is subject to final tax rather than ordinary income tax *(see the Income determination section)*.

### *Improperly accumulated earnings tax*
An improperly accumulated earnings tax of 10% is imposed on improperly accumulated income. The tax applies to every corporation formed or used for the purpose of avoiding income tax with respect to its shareholders, or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided

or distributed. Exceptions are made for publicly held corporations, banks and non-bank financial intermediaries, and insurance companies.

### *Resident foreign corporations*
Resident foreign corporations are taxed in the same manner as domestic corporations (except on capital gains on the sale of buildings not used in business, which are taxable as ordinary income), but only on Philippine-source income. International carriers are subject to an income tax of 2.5% on their gross Philippine billings. Where there is a tax treaty, the preferential rate provided in it applies.

Income of offshore banking units (OBUs) and foreign currency deposit units (FCDUs) of depository banks from foreign currency transactions with non-residents, other OBUs, or FCDUs and local commercial banks (including branches of foreign banks) authorised by the Bangko Sentral ng Pilipinas (central bank) to transact business with OBUs and FCDUs are exempt from all taxes except net income specified by the Secretary of Finance upon recommendation of the Monetary Board. Interest income from foreign currency loans granted to residents other than OBUs or local commercial banks shall be subject to a 10% final income tax.

### *Non-resident foreign corporations*
In general, non-resident foreign corporations are taxed on gross income received from sources within the Philippines at 30%, except for reinsurance premiums, which are exempt, and on interest on foreign loans, which is taxed at 20%. Dividends from domestic corporations are subject to a final withholding tax (WHT) at the rate of 15% if the country in which the corporation is domiciled does not impose income tax on such dividends or allows a tax deemed paid credit of 15%. If the recipient is a resident of a country with which the Philippines has a tax treaty, the treaty rate applies, if lower. Otherwise, the normal corporate rates apply.

Rentals and charter fees payable to non-resident owners of vessels chartered by Philippine nationals on leases or charters approved by the Maritime Industry Authority are subject to a final tax of 4.5%. Rentals, charter fees, and other fees payable to non-resident lessors of aircraft, machinery, and other equipment are subject to a final tax of 7.5%.

Regional or area headquarters of multinational corporations that do not earn or derive income from the Philippines, and that act as supervisory, communications, and coordinating centres for their affiliates, subsidiaries, or branches in the Asia-Pacific region and other foreign markets are not subject to CIT.

## *Corporate residence*

A domestic corporation is a corporation that is created or organized under Philippine laws. A foreign corporation that is duly licensed to engage in trade or business within the Philippines is referred to as a 'resident foreign corporation'.

### *Permanent establishment (PE)*
The business profits in most Philippine treaties permits Philippines to tax only those profits attributable to a PE. While Philippine treaties adopt the United Nations (UN) Model Convention, Organisation for Economic Co-operation and Development (OECD) commentaries have often been cited by tax authorities to support their interpretation of treaty provisions. The main implication is that most Philippine treaties contain a rule

deeming a PE to arise when services are performed in the Philippines for a specified period of time.

## Other taxes

### Value-added tax (VAT)

VAT applies to practically all sales of services and imports, as well as to sales, barter, exchange, or lease of goods or properties (tangible or intangible). The tax is equivalent to a uniform rate of 12%, based on the gross selling price of goods or properties sold, or gross receipts from the sale of services. On importation of goods, the basis of the tax is the value used by the Bureau of Customs in determining tariff and customs duties plus customs duties, excise taxes, if any, and other charges. Where the valuation used by the Bureau of Customs is by volume or quantity, the VAT basis is the landed cost plus excise taxes, if any.

Certain transactions are zero-rated or exempt from VAT. Export sales by VAT-registered persons are zero-rated.

Certain sales of services exempt from VAT, including services provided by financial intermediaries, are subject to percentage taxes based on gross sales, receipts, or income. A 3% percentage tax also applies to persons who are not VAT-registered because their annual sales or receipts do not exceed PHP 1.5 million.

### Fringe benefits tax

A final tax of 32%, payable by the employer, is imposed on the grossed-up monetary value of fringe benefits (e.g. housing, expense accounts, vehicles of any kind, household personnel, interest on loans at lower than market rates (the current benchmark rate is 12%), membership dues for social and athletic clubs, foreign travel expenses, holiday and vacation expenses, educational assistance, insurance) furnished or granted to managerial or supervisory personnel by the employer. An exception is for fringe benefits required by the nature of or necessary to the trade, business, or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer.



The following fringe benefits are not subject to the tax:

- Those authorised and exempted from tax under special laws.
- Contributions of the employer for the benefit of the employee to retirement, insurance, and hospitalisation benefit plans.
- Those granted to rank-and-file employees (however, the employees may be subject to WHT on compensation).
- Those of relatively small value or de minimis benefits.

The fringe benefits tax is payable on the calendar quarter basis and is an additional deductible expense for the employer. Fringe benefits already subjected to fringe benefits tax will no longer be included in the employee’s taxable income.

The grossed-up monetary value of the fringe benefit is generally computed by dividing the actual monetary value of the benefit by 68%.

### Excise taxes

Excise tax is payable at varying rates on alcohol products, tobacco products, petroleum products, mineral products, and automobiles. Excise tax is also payable on all goods commonly or commercially known as jewelry, whether real or imitation; perfumes and toilet waters; and yachts and other vessels intended for pleasure or sport at 20% of the wholesale price or value of the importation used by the Bureau of Customs in determining tariff and custom duties.

### *Documentary stamp tax (DST)*

DST is payable at varying rates on various documents and transactions. The following table contains selected examples:

| Taxable document/transaction (tax base) | Rate |
|---|---|
| Original issue of shares | PHP 1.00 for every PHP 200 or fractional part of par value |
| Sale, barter or exchange of shares of stock listed and traded through the local stock exchange | Exempt |
| Other sales agreement, agreement to sell, memoranda of sales, delivery or transfer of shares or certificates of stock | PHP 0.75 for every PHP 200 or fractional part of par value |
| Certificate of profits, interest in property or accumulations | PHP 0.50 for every PHP 200 or fractional part of face value |
| Non-exempt debt instruments | PHP 1.00 for every PHP 200 or fractional value of the issue price. |
| Bank check, draft, certificate of deposit not bearing interest, other instruments | PHP 1.50 for each instrument |
| Life insurance policy | PHP 10 to PHP 100 depending upon the amount of insurance |
| Lease/hiring agreement | PHP 3.00 for the first PHP 2,000 or fractional part of amount stipulated in contract, and PHP 1.00 for every PHP 1,000 or fractional part in excess of PHP 2,000 for each year of contract term |
| Mortgage, pledge, deed of trust | PHP 20.00 for the first PHP 5,000 of amount secured, and P 10.00 for every PHP 5,000 or fractional part in excess of PHP 5,000 |
| Deed of sale, conveyance of real property | PHP 15.00 for each PHP 1,000 of consideration/value or fractional part thereof |

### *Local government taxes*

Local government units impose local (business) taxes and permit fees, which are generally based on the prior year's gross sales or gross receipts, and real property taxes, which are levied on the basis of a fixed proportion of the value of the real property (taxable value). Real property located in a province may be subject to real property tax of not more than 1% of its taxable value, while real property in a city (or municipality in Metro Manila) may be subject to real property tax of not more 2% of its taxable value.

## *Branch income*

The income tax rate on branch profits is the same as on corporate profits. In general, profits remitted abroad by a branch office are subject to a 15% tax rate, based on the total profits applied or earmarked for remittance, without any deduction for the tax component thereof. A lower rate may apply under certain tax treaties. Profits from qualified activities remitted by a branch registered with the Philippine Economic Zone Authority (PEZA) are exempt.

Regional operating headquarters (ROHQ) pay a tax of 10% of their taxable income. A ROHQ is a branch established in the Philippines by a multinational company that is engaged in any of the following services: general administration and planning, business planning and coordination, sourcing and procurement of raw materials and components, corporate finance advisory services, marketing control and sales promotion, training and personnel management, logistic services, research and development services and product development, technical support and maintenance, data processing and communication, or business development.

## *Income determination*

### *Inventory valuation*

Inventories are generally stated at cost or at the lower of cost or market. Last in first out (LIFO) is not allowed for tax purposes. Generally, the inventory valuation method for tax purposes must conform to that used for book purposes.

### *Capital gains*

Capital gains arise from the sale or exchange of ‘capital assets’. Capital assets are property held by the taxpayer (whether or not connected with its trade) other than the following:

- Inventories or property held primarily for sale to customers in the ordinary course of business.
- Real property or depreciable property used in trade or business.
- Property of a kind that would be included in the inventory of the taxpayer if on hand at the close of the taxable year.

Capital losses are deductible only to the extent of capital gains.

There are no holding period requirements for capital assets of corporations.

A 6% final tax is imposed on the higher of the gross selling price or fair market value upon the sale, exchange, or disposition of land or buildings not actually used in the business of a corporation. The tax is withheld by the buyer at the time of sale.

Net capital gains derived from the sale, exchange, transfer, or similar transactions of shares of stock not traded through a local stock exchange are taxed at 5% of gains not over PHP 100,000, and 10% of gains in excess of PHP 100,000. Sales of shares of stock listed and traded on a local stock exchange, other than the sale by a dealer in securities, are subject to a stock transaction tax of 0.5%, based on the gross selling price.

Capital gains from the sale of bonds, debentures, or other certificates of indebtedness with a maturity of more than five years are exempt from tax.

A tax is levied on every sale, barter, exchange, or other disposition through an initial public offering (IPO) of shares of stock in closely held corporations. A ‘close corporation’ is any corporation of which at least 50% in value of the total outstanding capital stock, or at least 50% of the total combined voting power of all classes of stock entitled to vote, is owned directly or indirectly by, or for, not more than 20 individuals. The tax rates provided hereunder are based on the proportion of the gross selling price, or gross value in money, of the shares of stock sold, bartered, exchanged, or otherwise disposed of to the total outstanding shares of stock after listing on the local stock exchange.

| Proportion of sale to total shares | Tax rate (%) |
|---|---|
| 25% or less | 4 |
| Over 25% but not over 33.33% | 2 |
| Over 33.33% | 1 |

### *Dividend income*
Dividends received by a domestic or resident foreign corporation from another domestic corporation are not subject to tax. These dividends are excluded from the taxable income of the recipient.

Dividends received by a non-resident foreign corporation from a domestic corporation are subject to a final WHT at the rate of 15% if the country in which the corporation is domiciled either does not impose income tax on such dividends or allows tax deemed paid credit of 15%. If the recipient is a resident of a country with which the Philippines has a tax treaty, the treaty rate applies if lower. Otherwise, the normal CIT rate of 30% applies.

### *Stock dividends*
A Philippine corporation can distribute stock dividends tax-free, proportionately to all shareholders.

### *Interest income*
Interest on bank savings, time deposits, and money market placements received by domestic or resident foreign corporations from a domestic corporation are subject to a final tax of 20%.

Interest income of domestic or resident foreign corporations from FCDU deposits is subject to a final tax of 7.5%. Such income is excluded from gross income reportable in CIT returns.

Interest income of OBUs and FCDUs from foreign currency loans granted to residents other than OBUs or local commercial banks shall be subject to 10% tax.

### *Royalty income*
Royalties received by domestic or resident foreign corporations from a domestic corporation are subject to a final tax of 20%.

### *Other significant items*
Other items exempt from CIT include the following:

- Proceeds of life insurance policies.
- Return of policy premium.
- Gifts, bequests, and devises.
- Interest on certain government securities.
- Income exempt under a treaty.
- Gains from sale, exchange, or retirement of bonds.
- Gains from redemption of shares of stock in mutual fund companies.

### *Foreign income*
A Philippine (domestic) corporation is taxed on its worldwide income. A domestic corporation is taxed on income from foreign sources when earned or received, depending on the accounting method used by the taxpayer.

Income earned through foreign subsidiary is taxed only when paid to a Philippine resident shareholder as dividend. Meanwhile, income earned through a foreign branch is taxed as it accrues. The losses incurred by the foreign branch are deductible against other income earned by the Philippine corporation.

Double taxation is generally relieved through a credit for foreign taxes. However, a taxpayer can take a deduction for foreign taxes instead, if that leads to a more favourable outcome.

## *Deductions*

Note that corporate taxpayers are given the option to avail themselves of the optional standard deduction computed at 40% of gross income. The optional standard deduction is in lieu of the itemised operating expenses.

### *Depreciation and depletion*
Depreciation is generally computed on a straight-line basis, although any reasonable method may be elected if the aggregate amount of depreciation, plus salvage value at the end of the useful life of the property, will equal the cost of the property. Gain on the sale of depreciated property is taxable as ordinary income. Generally, book depreciation should conform to tax depreciation, unless the latter includes incentives.

Properties used in petroleum operations may be depreciated over a period of ten years using the straight-line or declining-balance method, at the option of the service contractor. Properties used in mining operations with expected life of more than ten years may be depreciated over any number of years between five years and their expected life.



A cost depletion allowance is available as follows:

- For oil and gas wells, depletion is based on actual reduction in flow and production ascertained, not by flush flow, but by the settled production or regular flow.
- For mines, depletion is allowable up to an amount not to exceed the market value, as used for purposes of imposing the mining *ad valorem* taxes, of the products mined and sold during the year.

### *Interest expenses*
The allowable deduction for interest expense is reduced by an amount equal to 33% of interest income that is subject to final tax.

### *Charitable contributions*
The deduction for charitable contributions ordinarily may not exceed 5% of taxable income. However, contributions to certain institutions are 100% deductible, subject to certain conditions.

### Entertainment expenses

Entertainment, amusement, and recreation expenses should not exceed 0.5% of net sales for taxpayers engaged in sale of goods or properties, or 1% of net revenue for taxpayers engaged in sale of services, including professionals and lessors of properties.

### Special deductions

Special deductions are allowed for certain businesses (e.g. insurance, mining, petroleum, and real estate investment trust).

### Taxes

Corporate taxpayers can claim a deduction for all taxes paid or accrued within the taxable year in connection with their trade or business, except for the following:

- Philippine CIT.
- Income taxes imposed by authority of any foreign country, unless the taxpayer elects to take a deduction in lieu of a foreign tax credit.
- Estate and donor's taxes.
- Taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

In the case of a foreign corporation, deductions for taxes are allowed only if they are connected with income from sources within the Philippines.

### Net operating losses

A net operating loss for any taxable year immediately preceding the current taxable year, which had not been previously offset as a deduction from gross income, may be carried over as a deduction from gross income for the next three consecutive taxable years immediately following the year of this loss (except losses during the period when the taxpayer was tax-exempt), provided there has been no substantial change in the ownership of the business or enterprise.

For mines, other than oil and gas wells, a net operating loss calculated without the benefit of incentives provided for under Executive Order (EO) No. 226, or the Omnibus Investments Code of 1987, as amended, incurred in any of the first ten years of operation may be carried over as a deduction from taxable income for the next five years immediately following the year of such loss.

Loss carrybacks are not allowed.

### Payments to foreign affiliates

A Philippine corporation can claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates, provided such amounts are equal to what it would pay an unrelated entity, and the appropriate WHTs are withheld and remitted.

The registration of licensing and management agreements, now known as technology transfer arrangements (TTAs), has been liberalised. Only TTAs not conforming to certain provisions of the Intellectual Property Code require approval by, and registration with, the Documentation, Information, and Technology Transfer Bureau of the Intellectual Property Office (formerly Bureau of Patents, Trademarks, and Technology Transfer) to render the contracts enforceable.

### Head office expense allocations
A resident foreign corporation is allowed to claim allocated head office expenses as a deduction, subject to compliance with certain requirements.

## Group taxation

Group taxation is not permitted in the Philippines.

### Transfer pricing
There are no specific consolidated transfer pricing rules in the Philippines, but the OECD transfer pricing guidelines are being used until the tax authorities issue transfer pricing regulations.

### Thin capitalisation
There are no thin capitalisation rules in the Philippines.

### Controlled foreign company (CFC) regime
There are no CFC rules in the Philippines.

## Tax credits and incentives

### Export incentives
Tax incentives available to export enterprises registered with the Board of Investments (BOI) are as follows:

- Income tax holiday (ITH) giving full exemption from CIT for six years for pioneer firms and those locating in less-developed areas and four years for non-pioneer firms from the date of commercial operation, or target date of operation, whichever is earlier. Expanding export-oriented firms are given three years. If prescribed conditions are met, an income tax holiday may be extended by up to three years. In no case, however, can an income tax holiday exceed eight years. Subject to certain exceptions, new and expansion projects located in the National Capital Region (NCR) or Metro Manila are no longer entitled to the income tax holiday.
- Tax and duty exemption on imported spare parts and supplies for export producers with a customs bonded manufacturing warehouse exporting at least 70% of annual production, if foreign-owned or 50%, if Filipino-owned.
- Full deduction of the cost of major infrastructure undertaken by enterprises in less-developed areas.
- Additional deduction of 50% of the incremental labour expense if the prescribed ratio of capital assets to annual labour is met and 100% of the incremental labour if located in less-developed areas within five years from date of registration (this incentive cannot be availed of simultaneously with the income tax holiday).
- Ten-year exemption from taxes and duties on importation of breeding stock and genetic materials.
- Tax credit on domestic breeding stocks and genetic materials (ten years).
- Exemption from wharfage, any export tax, duty, impost, or fees.
- Tax credits equivalent to taxes and duties paid on purchases of raw materials, supplies, and semi-manufactured products forming part of the products for export.

### Other incentives
Export and free-trade enterprises, information technology (IT) enterprises, and special economic zone developers/operators (including IT buildings located in Metro Manila

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and IT parks) registered with PEZA are entitled to an income tax holiday of six years for pioneer firms and four years for non-pioneer firms. Foreign articles brought into the zones will be exempt from import duties and taxes. Local purchases of goods from VAT-registered suppliers outside the economic zones are zero-rated. After the lapse of the income tax holiday incentives, enterprises registered and operating within special economic zones/export processing zones (EPZ) will pay only 5% final tax on gross income earned, in lieu of paying all local and national taxes.

A regional or area headquarters established in the country as a supervisory, communications, and coordination centre for a corporation's subsidiaries, affiliates, and branches in the Asia-Pacific region, and whose headquarters do not derive income from the Philippines, are not subject to any CIT nor VAT and are entitled to certain non-tax incentives.

ROHQ that are allowed to derive income in the Philippines by performing qualifying business services to its affiliates, subsidiaries, or branches in the Philippines, in the Asia-Pacific Region, and other foreign markets may avail itself of the following incentives:

- Income tax at the preferential rate of 10% of its taxable income.
- Exemption from all kinds of local taxes, fees, or charges imposed by a local government unit, except real property tax on land improvements and equipment.
- Tax and duty-free importation of equipment and materials for training and conferences which are needed and used solely for its functions as ROHQ and which are not locally available, subject to the prior approval of the BOI.
- Importation of new motor vehicles, subject to the payment of corresponding duties and taxes.
- Exemption from travel tax, specific immigration fees, and requirements, subject to certain conditions.

The following are the incentives granted to exporters under the Export Development Act (Republic Act No. 7844):

- Exemption from Presidential Decree No. 1853 (requiring 100% of Letter of Credit), provided that the importation shall be used for the production of goods and services of export.
- Tax credit for incremental export performance. The tax credit for increase in current export revenues shall be computed as a percentage to be applied on the incremental export revenue converted to pesos at the current rate. The percentages or rates are as follows:
  - For the first 5% increase in annual export revenues over the previous year: 2.5%.
  - For the next 5% increase: 5.0%.
  - For the next 5% increase: 7.5%.
  - In excess: 10.0%.

  Note that this incentive is not available for exporters enjoying ITH or VAT exemption or whose local VAT is below 10%.

In addition to the above incentive, all existing incentives being enjoyed by the enterprise if registered with the BOI, PEZA, Subic Bay Metropolitan Authority (SBMA), Clark Development Corporation (CDC), or other ecozone regulating agencies.

### *Foreign tax credit*
Domestic corporations are allowed to claim a credit for any income taxes paid to a foreign country, provided that the taxes are not claimed as deductions. Foreign corporations are not allowed foreign tax credits.

Credits for foreign taxes are determined on a country by country basis. The amount of foreign tax credit in respect to the tax paid in a country shall not exceed the same proportion of the tax against which the tax credit is taken, which the taxpayer's income from the country bears to its entire taxable income. There is, however, a further limitation based on the total amount of foreign-sourced income that the taxpayer earns. The total amount of foreign tax credits shall not exceed the same proportion of the tax against which the tax credit is taken, which the taxpayer's foreign-sourced income bears to its entire taxable income.

## *Withholding taxes*

Corporations and individuals engaged in business and paying certain types of income to non-residents are required to withhold the appropriate tax, which generally is 30% in the case of payments to non-resident foreign corporations or 25% for non-resident aliens not engaged in trade or business. *For WHT on resident corporations, see the discussions in the Income determination section.*

### *Tax treaty rates*
For countries with which the Philippines has concluded tax treaties, the taxes to be withheld are as follows:

As of April 2011:

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) |
|---|---|---|---|
| Australia | 15/25 (3, 4) | 10/15 (5) | 15/25 (6) |
| Austria | 10/25 (37) | 10/15 (5, 8) | 10/15 (6, 9) |
| Bahrain | 10/15 (7) | 10 | 10/15 (10) |
| Bangladesh | 10/15 (11) | 15 | 15 |
| Belgium | 10/15 (7) | 10 | 15 |
| Brazil | 15 /30 | 10/15 (5) | 15/25 (12) |
| Canada | 15/25 (3, 7) | 10/15 (5) | 25 (9) |
| China, P.R | 10/15 (7) | 10 | 10/15 (13) |
| Czech Republic | 10/15 (7) | 10 | 10/15 (14) |
| Denmark | 10/15 (11) | 10 | 15 |
| Finland | 15/30 (3, 7) | 10/15 (5) | 15/25 (15) |
| France | 10/15 (3, 7) | 10/15 (5) | 15 |
| Germany | 10/15 (11) | 10/15 (5, 16, 17) | 10/15 (13) |
| Hungary | 15/20 (3, 11) | 15 | 15 (9) |
| India | 15/20 (3, 7) | 10/15 (5, 17) | 15/30 (6) |
| Indonesia | 15/20 (3, 11) | 10/15 (5) | 15/25 (6) |
| Israel | 10/15 (7) | 10 | 15 (9) |
| Italy | 15 | 10/15 (5) | 15/25 (6, 18) |
| Japan | 10/15 (3, 7) | 10 | 10/15 (20) |
| Korea, Rep. of | 10/25 (3, 11) | 10/15 (5) | 10/15 (6) |

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| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) |
|---|---|---|---|
| Malaysia | 15/25 | 15 | 15/25 (6, 18) |
| Netherlands | 10/15 (7) | 10/15 (5, 16, 17) | 10/15 (6) |
| New Zealand | 15/25 | 10 | 15/25 (6) |
| Norway | 15/25 (3, 7) | 15 | 7.5/10/25 (9, 21) |
| Pakistan | 15/25 (3, 11) | 10/15 (5) | 15/25 (6) |
| Poland | 10/15 (11) | 10 | 15 |
| Romania | 10/15 (11) | 10/15 (5, 16, 17) | 10/15/25 (22) |
| Russia | 15 | 15 | 15 |
| Singapore | 15/25 (3, 23) | 10/15 (5) | 15/25 (6, 18) |
| Spain | 10/15 (7) | 10/15 (5, 16) | 10/15/20 (24) |
| Sweden | 10/15 (11) | 10 | 15 |
| Switzerland | 10/15 (7) | 10 | 15 |
| Thailand | 15/30 | 10/15 (5) | 15/25 (6, 18) |
| United Arab Emirates | 10/15 (7) | 10 | 10 |
| United Kingdom | 15/25 (3, 7) | 10/15 (5) | 15/25 (6, 20) |
| United States | 20/25 (3, 7) | 10/15 (5) | 15/25 (6, 9) |
| Vietnam | 10/15 (11) | 15 | 15 |

Notes

1. The lower rate generally applies if the beneficial owner of the dividends is a company with a substantial ownership in the dividend paying company.
2. Interest derived by a foreign government or its agencies is typically exempt from Philippine tax. Many treaties also contain special rules for both Philippine and home country taxation of interest paid on instruments secured by a government agency of one of the countries. Such provisions have been excluded from the analysis.
3. A 15% rate applies under domestic law if the home country exempts the dividend from tax or permits a 15% or greater credit for corporate taxes paid by the company paying the dividend.
4. Entitlement to the lower rate depends on how the dividend will be taxed in Australia.
5. The 10% rate applies to interest paid in respect of the public issues of bonds, debentures, or similar obligations.
6. The lower rate applies to royalties paid by an enterprise registered with the Philippine BOI and engaged in preferred areas of activity.
7. The threshold for substantial ownership is 10%.
8. The 10% rate also applies to interest paid by a company registered with the BOI and engaged in preferred pioneer areas of investment in the Philippines.
9. The treaty also contains a most-favoured-nation rule, limiting the Philippine tax on royalties to the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid in similar circumstances to a resident of a third state.
10. The 15% rate applies to royalties arising from the use of, or the right to use, any copyright of literary, artistic, or scientific work including cinematograph films or tapes for television or broadcasting.
11. The threshold for substantial ownership is 25%.
12. The 25% rate applies to royalties arising from the use or the right to use trademarks and cinematographic films, films or tapes for television or radio broadcasting. The 15% applies to any other royalties.
13. The 10% rate applies to the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience. Strictly, application of the rate is generally at the discretion of the Philippine Competent Authorities, but the Bureau of Internal Revenue (BIR) has never raised this as an issue.
14. The 10% rate applies to royalties arising from the use of, or the right to use, any copyright of literary, artistic, or scientific work (other than copyright of cinematograph films), any patent, trademark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.
15. The 15% rate applies to royalties paid by an enterprise registered and engaged in preferred areas of activities, and to royalties in respect of cinematographic films or tapes for television or broadcasting, and for the use of, or the right to use, any copyright. The 25% rate applies to other royalties.
16. The 10% rate also applies to interest paid in connection with the sale on credit of any industrial, commercial, or scientific equipment.
17. The 10% rate also applies to interest paid on any loans granted by a bank.

18. The 15% rate also applies to royalties in respect of cinematographic films or tapes for television or broadcasting.
19. The 10% rate applies to interest paid on government securities, or bonds or debentures. The 15% rate applies to any other interest income.
20. The 15% rate applies to royalties paid for the use of, or the right to use, cinematographic films and films or tapes for radio or television broadcasting.
21. The 7.5% rate applies to the lease of containers. The 10% rate applies to royalties paid by an enterprise registered with the BOI. The 25% rate applies to other royalties.
22. The 10% rate applies to royalties paid by an enterprise registered with the BOI and engaged in preferred pioneer areas of activity. The 15% rate applies to rentals from cinematographic films and tapes for television or broadcasting. The 25% rate applies to all other royalties.
23. The threshold for substantial ownership is 15%.
24. The 10% rate applies to royalties paid by an enterprise registered with the BOI and engaged in preferred pioneer areas of activity. The 20% rate applies to rentals from cinematographic films and tapes for television or broadcasting. The 15% rate applies to all other royalties.

## *Tax administration*

### *Returns*

Corporations should file their returns and compute their income on the basis of an accounting period of 12 months. This accounting period may be either a calendar year or a fiscal year. With prior approval of the Commissioner of Internal Revenue, corporations may change their accounting period from calendar year to fiscal year, or vice versa.

Corporate taxpayers file self-assessing returns. Electronic filing and payment of taxes are available under the Electronic Filing and Payment System (EFPS) of the BIR.

A domestic or resident foreign corporation is required to file income tax return on a quarterly basis. Within 60 days from the close of the first three quarters in its taxable year, the corporation must file in duplicate a return summarizing its gross income and deductions for the year to date. A final annual income tax return must be filed on or before the 15th day of the fourth month following the close of the tax year.

### *Payment of tax*

Every corporation files cumulative quarterly income tax returns for the first three quarters and pays the tax due thereon within 60 days after each quarter. A final adjustment return covering the total net taxable income of the preceding taxable year must be filed on the 15th day of the fourth month following the close of the taxable year. The balance of the tax due after deducting the quarterly payments must be paid, while the excess may be claimed as refund or tax credit. Excess estimated quarterly income taxes paid may be carried over and credited against estimated quarterly income tax liabilities for succeeding taxable years. Once the option to carry over has been made, such option is irrevocable for that taxable period, and no cash refund or tax credit certificate (TCC) is allowed.

# Poland

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## Significant developments

### Amendments to the corporate income tax (CIT) regulations

The most important amendments to the CIT regulations, which came into force as of 1 January 2011, affect the taxation of the following:

- Redemption of shares. Under the amended regulation, sale of shares (stocks) for the purpose of redemption are no longer subject to taxation as dividend income, but general taxation rules apply.
- EU/EEA seated investment and pension funds by ending the tax discriminatory treatment. Since 1 January 2011, investment and pension funds seated in EU/EEA may benefit from exemption on income derived from Poland if certain conditions are met.

### New value-added tax (VAT) rates

As of 1 January 2011, the standard VAT rate increased from 22% to 23%, the 7% reduced rate increased to 8%, and a separate 5% reduced rate was added. *See Value-added tax in the Other taxes section for more information.*

As of 1 January 2012, the standard VAT rate will apply to supplies of children's clothing and footwear. Prior to 1 January 2012, the 8% reduced VAT rate is applicable for those goods.

### New excise duty rates and rules

As of 1 September 2010, some excise duty rates increased and various new rules came into force. *See Excise duties in the Other taxes section for more information.*

## Taxes on corporate income

CIT is the only tax levied on corporate income. The CIT rate is 19%.

Polish residents are subject to tax on their worldwide income. Non-residents are taxed only on their Polish-sourced income. The tax authorities' right to tax a non-resident is further limited if the non-resident's home country concluded a double-tax treaty (DTT) with Poland. In this case, the Polish tax authorities are entitled to tax only the portion of the non-resident's income that is derived through a permanent establishment (PE) located in Poland. The exceptions relate to specific types of income such as royalties, interest, dividends, and capital gains that are taxed based on special treaty rules.

Further to these rules, the CIT applies to companies with foreign participation. Such companies may be set up as either limited liability companies or joint-stock companies. There is no limitation on the percentage of foreign participation. Both types are subject to the general CIT rules, including the 19% tax rate. The same rate applies to branches of foreign companies *(see the Branch income section for more information)*.

## Corporate residence

A company is considered to be a resident in Poland if its registered office or management is located in Poland.

From the group of taxpayers, certain entities are explicitly excluded in the CIT Law (e.g. Treasury, National Bank of Poland). As of 1 January 2011, EU/EEA based investment funds are also exempted on the grounds of such provision (before this date, only Polish investment funds enjoyed the exemption).

### Permanent establishment (PE) in Polish CIT Law

According to Polish CIT Law, a PE should be understood as:

- a permanent place of business through which a non-Polish tax resident conducts its business activities, in whole or in part, within the territory of Poland, in particular a branch, agency, office, factory, workshop, or place of extraction of natural resources
- a construction site, construction, assembly, or installation works carried on within the territory of Poland by non-Polish tax resident, or
- a person who, on behalf and for the benefit of non-Polish tax resident, operates in Poland, if such person holds and exercises a power of attorney to enter into agreements on one's behalf.

We note that Polish CIT Law:

- does not encompass any provisions concerning the period required for construction works to create a PE
- does not include provisions indicating that an independent agent does not create a PE, and
- does not include provisions indicating that actions of an auxiliary or preparatory character do not lead to creation of a PE in Poland.



### Permanente establishment (PE) from a DTT perspective

In general, the provisions of DTTs concluded by Poland are based on the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital (OECD Model), except for provisions related to taxation of royalties, which are based on the United Nations (UN) Model Double Taxation Convention.

As a principle, treaties based on the OECD Model provide for the following concepts, which determine whether activities of a foreign entrepreneur constitute a PE (usually in Article 5):

- Fixed place of business concept.
- Dependant agent concept.
- Construction PE concept.

Note that some DTTs concluded by Poland also encompass other PE concepts (e.g. service PE concept or offshore PE concept).

## Other taxes

### Value added tax (VAT)

Polish VAT applies to the following activities:

- Supplies of goods and services within the territory of Poland.
- Exports of goods outside the territory of the European Union.
- Imports of goods from countries that do not belong to the European Union.
- Intra-community acquisitions of goods (imports from countries belonging to the European Union).
- Intra-community supplies of goods (exports to the countries belonging to the European Union).

#### VAT rates

As of 1 January 2011, the VAT rates are 23% (standard rate), 8%, 5%, 0%, and exemption.

The standard 23% VAT rate generally applies to the supply of all goods and services, except for those that are covered by special VAT provisions that provide other rates or treatments. Prior to 1 January 2011, the standard VAT rate was 22%.

Supplies covered by a reduced rate of 8% include, among others, supplies of pharmaceutical products and passenger transport services and also supply of goods for the Social Housing Programme (no greater than 150 square metres). Prior to 1 January 2011, this reduced rate was 7%.

Supplies covered by a reduced rate of 5% include books and journals, unprocessed food, and basic food. This reduced rate was not available prior to 1 January 2011.

Zero-rated activities include, among others, exports of goods to countries outside the European Union.

VAT-exempt supplies include, among others, certain financial, insurance, and educational services.

As of 1 January 2012, the standard VAT rate will apply to supplies of children's clothing and footwear. Prior to 1 January 2012, the 8% reduced VAT rate is applicable for those goods.

#### Basic calculation rules

In general, the VAT due equals the VAT on outputs decreased by the VAT on inputs (in other words, input VAT is deducted from output VAT). Input VAT may be deducted from output VAT when a business (with a VAT payer status) receives an invoice for goods or services purchased. Input VAT may not be deducted unless a purchased supply is linked to the VAT-able activities. Furthermore, the deductibility of input VAT is restricted by the VAT law with respect to the purchase of certain goods and services. In addition, subject to numerous conditions, output VAT may be reduced when receivables, resulting from VAT-able sales, become uncollectible.

#### VAT refunds

The Polish VAT law allows direct refunds when input VAT (available for deduction) exceeds output VAT.

A Polish business may also be entitled to the VAT refund owed by another country under certain circumstances. Likewise, a foreign business not registered for VAT purposes in Poland may be, in most cases, entitled to the refund of Polish VAT. If the respective countries belong to the European Union, the procedure is substantially simplified due to the EU Directive which provides favourable rules for businesses based in EU countries that are seeking VAT refunds in other EU countries (i.e. electronic VAT refunds are possible).

### Reporting rules

Generally, the VAT reporting period is one month. VAT returns should be submitted by the 25th day of the month following the VAT reporting period. All taxpayers may opt for a quarterly, instead of monthly, reporting period. Note that businesses involved in intra-community acquisitions or supplies of goods are obliged to submit additional VAT returns with respect to these particular transactions.

### International services

The treatment of international services largely depends on the place of supply, since it is determinative of whether particular services are subject to the Polish VAT. The Polish VAT applies only to those services that are supplied within Poland.

Generally, the place of supply depends on the recipient of services. If the recipient is a business entity, the place of supply is determined to be the recipient's country; if the recipient is a private person, the place of supply is determined to be the service provider's country. Thus, according to general rules, if a Polish entity supplies services to a foreign business entity, the place of supply is outside Poland (these services are not subject to Polish VAT); if a foreign company supplies services to a Polish business entity, the place of supply (taxation) is in Poland. However, these general rules are subject to several exceptions.

If services are supplied by a taxpayer without seat or fixed place of business in Poland and the place of supply (taxation) is Poland, the purchaser who is the Polish VAT taxpayer has to apply the reverse-charge mechanism. Since 1 April 2011, the reverse charge is mandatory (i.e. the foreign supplier cannot voluntarily register and settle the Polish VAT).



As of 1 April 2011, an obligatory reverse-charge mechanism also applies to a domestic supply of goods performed by a taxpayer not having seat or fixed place of business in Poland to a purchaser who is a taxpayer and has seat or fixed place of business in Poland or is a legal entity (and is not taxpayer) and has a seat in Poland.

## *Excise duties*

Excise duties are levied on the production, sale, import, and intra-community acquisition of 'excise goods', which are listed in the excise duty law and include (among others) alcohol, cigarettes, energy products (e.g. petrol, oils, gas), passenger cars, and electricity.

Depending on the excise goods in question, one of four methods of calculating excise tax may be applicable:

- A percentage of the taxable base.
- An amount per unit.
- A percentage of the maximum retail price.
- An amount per unit and a percentage of the maximum retail price.

The excise rate for car petrol is 1,565 Polish złoty (PLN) per 1,000 litres.

Passenger cars are subject to the following excise rates:

- 3.1% for cars with engine cubic capacity that does not exceed 2,000 cc.
- 18.6% for cars with engine cubic capacity that exceeds 2,000 cc.

Notwithstanding the above, Polish excise duty law provides for a wide system of excise duty exemptions as well as 0% taxation. Under specified circumstances, such preferential treatment may apply to specified goods that are otherwise taxed based on general rules. This concerns, for example, specific energy products used for other purposes than as a fuel or for heating.

On 1 September 2010, changes in excise came into force and set new rules related to the following areas:

- Taxation of illegal consumption of electricity.
- Changes in taxation of passenger vehicles.
- Movement of excise goods under suspension regime (EMCS).
- Importation of excise goods from non-EU countries and sending them forward with use of duty suspension arrangements.
- Changes in scope and conditions of certain excise duty exemptions.

### *Property tax*
Property tax rates are fixed by municipalities within limits set in the Law on Local Taxes and Fees. In 2011, land used for business purposes is subject to a rate limit of PLN 0.80 per square metre. Buildings used for business purposes are subject to a rate limit of PLN 21.05 per square metre.

### *Capital tax*
A share capital increase is subject to a 0.5% capital tax, payable by a company that receives a capital contribution. This tax applies equally to limited liability companies as well as joint-stock companies. A merger, division, or transformation of a company into another company is no longer subject to capital tax, even if the transaction results in a share capital increase for any party. A similar exemption applies to a capital increase resulting from an in-kind contribution, including a whole business or a branch thereof.

### *Custom duty*
As a member of the European Union, Poland belongs to a customs union, thus only goods imported from non-EU countries or exported from Poland to the non-EU countries are subject to customs duties and formalities. Moreover, all the Community customs regulations are directly applicable in Poland. The most important act is the Community Customs Code and its implementing provisions, as well as the Community Customs Tariff.

These regulations are supplemented with certain Polish national rules, especially in respect to procedures and specific areas which are not defined in the Community customs law (e.g. strict regulations concerning the export of works of art and animals, limits on the amount of cash that may be brought from Poland to non-EU countries).

## Branch income

Foreign businesses are allowed, under certain conditions, to establish their branch offices (exclusively within the scope of their 'foreign' business activity) and representative offices (exclusively with regard to promotion and advertising) in Poland.

A branch office almost always has PE status in Poland. Once a branch is established, the foreign company pays CIT at the standard rate of 19%, based on the income attributable to the operations of the Polish branch. For this purpose, as well as for accounting purposes, a branch is obliged to keep accounting books that include all the data necessary to establish the taxable base. In this respect, general income determination rules relevant to Polish companies apply to branches as well. In the few cases in which a branch can demonstrate, based on a DTT, that its business presence in Poland does not amount to a PE, its profits are not subject to Polish CIT.

## Income determination

The tax base is the overall income, which is the difference between aggregated taxable revenue and aggregated tax-deductible costs. A tax-deductible cost is defined as a 'cost incurred in order to generate revenue' as well as the cost incurred to 'protect a source of revenue'.

Subject to numerous exemptions, the tax base includes all sources of income. Consequently, there is no special treatment for income such as capital gains or interest.

In practice, taxable income is calculated by adjusting the profit reported for accounting purposes. The relevant adjustments are necessary due to differences between tax and accounting treatment of numerous revenue and cost items. As a result, the taxable base is usually higher than the accounting profit.

### Inventory valuation

Generally, the value of inventory shortages may be included as a tax-deductible cost. Other write-offs in the value of inventory are not recognised for tax purposes until the inventory in question is sold.



When inventory is lost or sold, a tax deduction is allowed for the costs incurred when the inventory was purchased. The methods acceptable for inventory valuation for tax (and accounting) purposes are standard cost, average (weighted) cost, first in first out (FIFO), and last in first out (LIFO).

### Capital gains

There is no separate capital gains tax. Capital gains or losses are aggregated with an entity's other taxable income or losses. Capital losses are tax-deductible.

### Domestic dividend income

Dividends received from Polish residents (domestic dividends) are excluded from overall income. Instead, such dividends are subject to a 19% WHT, which is withheld and remitted to the tax office by the payer of dividends. Based on a participation exemption, however, domestic dividends are not subject to the 19% WHT if the Polish beneficiary holds at least a 10% share in the paying company for at least two years.

As of 1 January 2011, the revenue arising from voluntary redemption of shares is no longer treated as a dividend for tax purposes and does not enjoy the benefits of the participation exemption (i.e. the method of redemption, whether voluntary or automatic, will matter).

### *Dividend income from abroad*

Generally, dividends collected by a Polish corporate tax resident, if paid by a non-resident, are treated as regular income and taxed at the standard CIT rate. CIT on such dividends paid in other countries may be credited proportionately against Polish CIT. The CIT law also provides for an 'underlying tax credit', which is related to the CIT paid by a foreign subsidiary under a foreign tax jurisdiction, subject to a number of conditions. Specifically, a DTT between Poland and the subsidiary's country of residence should be in place and the Polish recipient of the dividend should hold at least 75% of the shares in the foreign subsidiary.

Additionally, dividends received from entities seated in the European Union (including Poland), EEA member states, or Switzerland can benefit from CIT exemption, if the Polish company owns respectively at least 10% (in respect to companies seated in the EU/EEA member states) or 25% (in respect to companies seated in Switzerland) in the share capital of the payer for two consecutive years (and certain other conditions are met).

Dividends received from non-EU/non-EEA member states may benefit from underlying tax credit. If a Polish company or a PE of a company from a EU/EEA member state located in Poland receives a dividend from a company seated in a non-EU/non-EEA country, it may deduct the tax paid by the payer on profits out of which the dividend was paid. The deduction is only possible provided that the Polish company/company from EU/EEA, which PE is located in Poland, holds (for two consecutive works) at least 75% of shares of the dividend payer. The tax may be deducted in an appropriate proportion. Furthermore, the deduction is possible provided that there is a DTT. Based on the provisions of the relevant DTT or other agreement concluded by Poland, the Polish tax authority may exchange tax information with its counterparty.

### *Foreign income*

Resident corporations are taxed on their worldwide income unless there is an applicable DTT in place between Poland and the relevant country that provides that the foreign income shall be exempt from taxation in Poland *(see Foreign tax credit in the Tax credits and incentives section)*.

## *Deductions*

Generally, a tax-deductible cost is defined as a cost incurred in order to generate taxable revenue or to 'protect a source of income'. The last element of the definition of a tax-deductible cost was added a few years ago to reduce uncertainties surrounding the deductibility of business expenses that do not directly generate revenue.

The CIT law provides a list of items that are not deductible for tax purposes, even if the items meet the general conditions described above. This list contains over 60 items including, among others, the following:

- Written-off, lapsed accounts receivable.
- Entertainment costs.
- Accrued but unpaid interest.
- Accounting and comparable provisions.
- Tax penalties and penalty interest.

- A portion of the insurance premium paid on a passenger car (i.e. the portion calculated on the excess of the car value over EUR 20,000).
- A portion of the depreciation write-offs made on a passenger car (i.e. the portion calculated on the excess of the car value over EUR 20,000).

Furthermore, expenses incurred in connection with the acquisition of fixed and intangible assets (e.g. licenses, trademarks, know-how) are not deductible directly. Instead, the acquired assets are subject to depreciation. If such assets are sold, a business is entitled to deduct the net value (cost of acquisition reduced by the overall value of the tax depreciation allowances made). Similar treatment relates to the acquisition of shares or land, except that these particular assets are not depreciable. Therefore, the full cost of an acquisition of shares or land may be deducted when such assets are sold.

### *Depreciation*
Depreciation is treated as a tax-deductible cost. Generally, depreciation allowances are calculated based on the straight-line method and the maximum rates provided in the CIT law. If this is the case, a taxpayer deducts equal annual write-offs, calculated by multiplying the maximum rate of depreciation by the asset's initial value until the total value of write-offs equals the initial value (typically, the initial value equals the purchase price).

For certain categories of machinery and vehicles (but not passenger cars), the reducing-balance depreciation method may be applied. Under this method, the tax depreciation may be accelerated during the initial period of the asset's use by multiplying the statutory maximum rate by two. The rate is then applied to the net value of fixed assets (i.e. initial value reduced by earlier annual write-offs). The reducing-balance method is applied until the annual depreciation write-off equals the hypothetical write-off that would be made under the straight-line method. From this point, the depreciation allowance is taken based on the straight-line method for its remaining useful life.

The main categories of assets and the related statutory annual tax depreciation rate are as follows:

| Assets | Rate (%) |
|---|---|
| Various buildings and constructions | 1.5 to 10 |
| Machinery and equipment (general) | 7 to 20 |
| Machinery for road building and construction | 18 to 20 |
| Machinery for paper industry | 14 |
| Office equipment | 14 |
| Computers | 30 |

Apart from the above, the Polish CIT law includes provisions for accelerated depreciation (within specified limits) for assets used in deteriorated conditions and for second-hand assets.

### *Taxes*
Income tax and, in most cases, VAT are not deductible. However, VAT is deductible for CIT purposes if it cannot be offset against the company's output VAT. Other taxes, if paid in the course of business activities, are generally deductible in full.

### Net operating losses
A tax loss reported in a tax year may be carried forward over the next five consecutive tax years; however, in any particular tax year, the taxpayer may not deduct more than 50% of the loss incurred in the year in which it was reported. For example, a taxpayer that incurred PLN 100 annual loss in 2010 may carry it forward to 2011-2015. However, the maximum loss deduction in any of these years may not exceed PLN 50 (assuming that there are no other losses available for deduction).

Currently, there is no possibility to carry back tax losses in Poland.

### Payments to foreign affiliates
Deductions may be claimed for royalties, management services, and interest charges paid to foreign affiliates. However, note that interest expenses are subject to the thin capitalisation restrictions *(see Thin capitalisation in the Group taxation section for more information)*. Furthermore, note that transactions with related companies should be made according to the market conditions. Where a company shifts income to another entity (especially a foreign entity), the tax authorities may adjust the taxable base upward *(see Transfer pricing in the Group taxation section for more information)*.

## Group taxation

The CIT law includes provisions on group taxation (i.e. in theory, a group of companies) if it meets certain conditions and can be treated as a single taxpayer. However, the required conditions are extremely demanding and very few taxpayers of this type exist.

### Transfer pricing
Transactions between related parties should be conducted in accordance with the arm's-length principle. The tax authorities may increase the taxable base if the pricing used between related parties differs from what would have been used between unrelated parties in a similar business transaction and the difference results in income being shifted from a Polish taxpayer to another entity (whether a Polish resident or not). Similar rules apply to transactions between Polish residents and the residents of tax haven countries. These transactions may be subject to the transfer pricing principles even if the parties thereto are not related. The CIT law also contains detailed requirements for transfer pricing documentation.

Taxpayers can reduce the transfer pricing risk by applying for an advance pricing arrangement (APA). An APA decision shall be issued by the Minister of Finance in response to a taxpayer's application. An APA will oblige a taxpayer to follow a specified methodology when calculating the transfer prices applicable to transactions between related entities. In exchange, the tax authorities may not challenge the agreed upon methodology.

### Thin capitalisation
A portion of the interest paid by a Polish company on a loan granted by a qualified lender (a qualified shareholder or a qualified sister company) will not be considered a tax-deductible cost if the value of the Polish company's overall debt from the shareholders and other affiliates mentioned in the tax law exceeds three times the value of the Polish company's share capital (3:1 debt-to-equity ratio). A qualified shareholder is defined as a holder of 25% or more of the voting power of a Polish company. A qualified sister company is a company of which a shareholder holds at least 25% of the value of the shares.

## Tax credits and incentives

### Special Economic Zones (SEZs)

Polish legislation provides investment incentives related to business activities carried out in 14 zones defined as SEZs. A business entity can benefit from tax incentives, provided that the entity obtains a permit from the Ministry of the Economy to conduct business activities there and meets other legal requirements. Note that a CIT exemption applies only to income earned on activity conducted with an SEZ.

In general, the amount of the tax incentive depends on project location. For large enterprises, it can be 30%, 40%, or 50% of eligible expenditures (i.e. investment expenditures or two-year labour costs). In other words, the CIT exemption allows the investor to avoid paying tax up to the limit calculated on the basis of eligible expenditures and state aid intensity. In case of investment valued PLN 20 million and intensity aid of 40%, the investor would be entitled not to pay tax due up to PLN 8 million. If the available limit of the tax exemption exceeds the annual tax due generated on SEZ activity, the excess may be utilised in the following tax years. Consequently, in the case of significant investments, it is possible for businesses that run activities in the SEZs to enjoy exemption from income tax for a considerable period. The deadline for utilising available tax exemption is the end of 2020.

Note that in the case of small enterprises, the limit of the tax exemption may be increased by 20%. In the case of medium-sized enterprises, the limit of the tax exemption may be increased by 10%.

### Foreign tax credit

Resident corporations are taxed on their worldwide income unless there is an applicable DTT in place between Poland and the relevant country that provides that the foreign income shall be exempt from taxation in Poland. In all other cases (in particular, when the income is not covered by any treaty), Poland uses the ordinary credit method to avoid double taxation. Therefore, a Polish resident is liable for income tax imposed on its worldwide income, but the tax is proportionately reduced by the income tax paid abroad.



## Withholding taxes

### Domestic provisions: General rules

The general domestic WHT rate for dividends is 19%. Dividends encompass also income from liquidation of a company and the income from the redemption of shares (with the exception of gain from voluntary redemption, which is treated as a capital gain subject to 19% CIT rate in Poland if the gain is realised by a taxpayer from non-treaty country or the treaty includes a so-called real estate clause).

The general WHT rate on interest and royalties paid to non-residents is 20% (10% regarding services of sea or air transportation). These WHT rates may be reduced by DTTs.

There is also a 20% WHT on payments made to non-residents for intangible services (such as consulting services). However, if a payment is made to a country that has a DTT with Poland, this tax may be avoided with the completion of certain minimal administrative formalities. Few treaties treat payments for technical services as royalties (e.g. India).

### Special treatment: EU directives

The CIT law provisions and certain EU directives provide special treatment for dividends, royalties, and interest paid to numerous European countries.

When joining the European Union, Poland was granted a transitional period to phase out the WHT on interest and royalty payments paid by Polish corporate residents to associated EU or EEA companies. As of 1 July 2009, the WHT rate on these payments is 5%. Starting on 1 July 2013, a full exemption will apply. In general, the transitional rules, as well as the full exemption after 1 July 2013, only apply to interest and royalty payments between associated companies (parent-subsidiary relationships or sister-sister relationships) in which capital involvements are significant.

Dividends paid to corporate residents of EU and EEA countries are exempt from WHT, subject to certain conditions specified in the CIT law. The basic requirement is that the foreign beneficiary holds at least 10% of the shares in the Polish company for a minimum of two years. This condition is also fulfilled if the required period passes after the day of payment of the dividend. If the period is interrupted afterwards, the company is obliged to pay the tax with standard rate with interest.

Note that as of 1 January 2011, several additional conditions which have to be met to apply the reduced rate/exemption from the WHT based on the Directive were introduced (e.g. the company receiving the dividend/interest/royalty cannot be exempt from tax on all its income, regardless of its source; the recipient has to have ownership title to the shares in the Polish company).

Additionally, the amendments state that in order to enjoy the exemption from WHT on dividends and decreased WHT rate on interest and royalties, based on the Directives' provisions, the relevant DTT or other agreement concluded by Poland should allow exchange of tax information between the tax authorities of Poland and the country of the payment recipient. Currently, a binding treaty between Poland and Switzerland does not encompass such a provision. Hence, the Directive does not apply to payments made to tax residents of Switzerland. Given the fact that Poland did not conclude a DTT with Liechtenstein, payments made to tax residents of Liechtenstein should not benefit from the Directive.

### Treaty rates

If EU special rules do not apply, the domestic WHT rates can be decreased by a DTT concluded between Poland and the payment recipient's country of residence if certain administrative conditions are met (i.e. the payer obtains a valid certificate of a fiscal residence of the payment recipient/beneficial owner).

The following table lists the WHT rates as provided in the treaties concluded by Poland. Notably, the following table shows only rates that result from general treaty provisions; the treaties themselves occasionally include special provisions (applicable in special circumstances or to special entities) that provide lower WHT rates than the ones listed.

Furthermore, if a treaty rate is higher than a domestic one, the latter should apply.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Non-Treaty | 19 | 20 | 20 |
| Treaty: | | | |
| Albania | 5 (1)/10 | 10 | 5 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Armenia | 10 | 5 | 10 |
| Australia | 15 | 10 | 10 |
| Azerbajian | 10 | 0 (2)/10 | 10 |
| Austria | 5 (3)/15 | 0 (4)/5 | 5 |
| Bangladesh | 10 (5)/15 | 0 (6)/10 | 10 |
| Belarus | 10 (7)/15 | 0 (79)/10 | 0 |
| Belgium | 5 (8)/15 | 0 (9)/5 | 5 |
| Bosnia & Herzegovina (Yugoslavian Treaty) | 5 (1)/15 | 10 | 10 |
| Bulgaria | 10 | 0 (10)/10 | 5 |
| Canada | 15 | 0 (11)/15 | 0 (12)/10 |
| Chile | 5 (13)/15 | 0 (74)/15 | 0 (75)/5 (14)/10 |
| China, P.R. | 10 | 0 (15)/10 | 10 (16)/10 of 70 (14) |
| Croatia | 5 (1)/15 | 0 (15)/10 | 10 |
| Cyprus | 10 | 0 (17)/10 | 5 |
| Czech Republic | 5 (18)/10 | 0 (10)/10 | 5 |
| Denmark | 0 (19)/5 (20)/15 | 0 (21)/5 | 5 |
| Egypt | 12 | 0 (22)/12 | 12 |
| Estonia | 5 (23)/15 | 0 (24)/10 | 10 |
| Finland | 5 (23)/15 | 5 | 5 |
| France | 5 (3)/15 | 0 | 0 (25)/10 |
| Georgia | 10 | 0 (26)/8 | 8 |
| Germany | 5 (3)/15 | 0 (27)/5 | 5 |
| Greece | 19 (76) | 10 | 10 |
| Hungary | 10 | 0 (10)/10 | 10 |
| Iceland | 5 (23)/15 | 0 (10)/10 (77) | 10 |
| India | 15 | 0 (28)/15 | 20 |
| Indonesia | 0 (13)/10 | 0 (10)/10 | 15 |
| Iran | 7 | 0 (29)/10 | 10 |
| Ireland, Republic of | 0 (30)/15 | 0 (31)/10 | 10 |
| Israel | 5 (32)/10 | 5 | 5 (14)/10 |
| Italy | 10 | 0 (33)/10 | 10 |
| Japan | 10 | 0 (34)/10 | 0 (35)/10 |
| Jordan | 10 | 0 (10)/10 | 10 |
| Kazakhstan | 10 (36)/15 | 0 (37)/10 | 10 |
| Korea, Republic of | 5 (3)/10 | 0 (38)/10 | 10 |
| Kyrgyzstan | 10 | 0 (39)/10 | 10 |
| Kuwait | 0 (40)/5 | 0 (41)/5 | 15 |
| Latvia | 5 (23)/15 | 0 (42)/10 | 10 |
| Lebanon | 5 | 0 (37)/5 | 5 |
| Lithuania | 5 (23)/15 | 0 (10)/10 | 10 |
| Luxembourg | 5 (23)/15 | 0 (43)/10 | 10 |
| Macedonia | 5 (23)/15 | 0 (10)/10 | 10 |
| Malaysia | 0 (44)/15 | 0 (45)/15 | 0 (46)/15 |
| Malta | 5 (18)/15 | 0 (10)/10 | 10 |
| Mexico | 5 (23)/15 | 0 (47)/5 (48)/15 | 10 |

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| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Moldova | 5 (23)/15 | 0 (37)/10 | 10 |
| Morocco | 7 (18)/15 | 10 | 10 |
| Mongolia | 10 | 0 (10)/10 | 5 |
| Montenegro (Yugoslavian Treaty) | 5 (23)/15 | 10 | 10 |
| Netherlands | 5 (3)/15 | 0 (78)/5 | 5 |
| New Zealand | 15 | 10 | 10 |
| Norway | 0 (49)/15 | 0 (4)/5 | 5 |
| Pakistan | 15 | 0 (50)/20 | 15 (51)/20 (52) |
| Philippines | 10 (23)/15 | 0 (53)/10 | 15 |
| Portugal | 10 (54)/15 | 0 (55)/10 | 10 |
| Romania | 5 (23)/15 | 0 (42)/10 | 10 |
| Russia | 10 | 0 (56)/10 | 10 |
| Serbia (Yugoslavian treaty) | 5 (23)/15 | 10 | 10 |
| Singapore | 0 (57)/10 | 0 (58)/10 | 10 |
| Slovak Republic | 5 (18)/10 | 0 (42)/10 | 5 |
| Slovenia | 5 (23)/15 | 0 (59)/10 | 10 |
| South Africa | 5 (23)/15 | 0 (10)/10 | 10 |
| Spain | 5 (1)/15 | 0 | 0 (35)/10 |
| Sri Lanka | 0 (60)/15 (80) | 0 (61)/10 | 0 (62)/10 |
| Sweden | 5 (23)/15 | 0 | 5 |
| Switzerland | 5 (23)/15 | 10 | 0 (63)/10 |
| Syria | 10 | 0 (64)/10 | 18 |
| Tajikistan | 5 (23)/15 | 0 (39)/10 | 10 |
| Thailand | 19 | 0 (58)/10 | 0 (65)/5 (66)/15 |
| Tunisia | 5 (1)/10 | 12 | 12 |
| Turkey | 10 (23)/15 | 0 (10)/10 | 10 |
| Ukraine | 5 (23)/15 | 0 (37)/10 | 10 |
| United Arab Emirates | 0 (67)/5 | 0 (10)/5 | 5 |
| United Kingdom | 0 (68)/10 | 0 (69)/5 | 5 |
| United States | 5 (70)/15 | 0 | 10 |
| Uzbekistan | 5 (71)/15 | 0 (72)/10 | 10 |
| Vietnam | 10 (23)/15 | 10 | 10 (73)/15 |
| Zimbabwe | 10 (23)/15 | 10 | 10 |

Notes

1. When the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends.
2. When interest is paid to the government, the central bank of the state, including local authorities or other government bodies.
3. When the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends.
4. When interest is paid to the government, a political subdivision, or a local authority in connection with:
   - a loan granted, insured, or guaranteed by a governmental institution for the purposes of promoting exports
   - a sale on credit of any industrial, commercial, or scientific equipment, or
   - any loan granted by a bank.
5. When the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends.
6. When the interest is paid:
   - to the Central Bank of Poland
   - to the Central Bank of Bangladesh
   - to the Government of the Republic of Poland or the Government of the Republic of Bangladesh, or

- in respect of a loan made or guaranteed or insured by the government of the other state, or any agency including a financial institution owned or controlled by the government.

7. When the beneficial owner is a company (other than a partnership) which holds directly at least 30% of the capital of the company paying the dividends.
8. When the beneficial owner is a company (other than a partnership):
   - which holds directly at least 25% of the capital of the company paying the dividends or
   - which holds directly at least 10% of the capital of the company paying the dividends, and the value of investments in the company is at least EUR 500,000 or is equal to the amount in the other currency.
9. When interest is paid:
   - on loan granted, guaranteed, or insured, or a credit granted, guaranteed, or insured, by a general system organized by the state, including political subdivisions or local authorities for purposes of promoting exports
   - on loan of whatever kind, except in the form of bearer securities, granted by a banking company, or
   - to other states, including political subdivisions and local authorities.
10. When interest is paid to the government, including local authorities, to the central bank or any financial institution controlled by that government, or on loans guaranteed by that government.
11. When interest is paid in respect of a loan made, guaranteed, or insured by the state or agreed public body.
12. Copyright royalties and other similar payments in respect of the production or reproduction of any literary, dramatic, musical, or artistic work (not including royalties in respect of motion picture films and works on film or videotape for use in connection with television).
13. When the beneficial owner is a company which controls directly 20% of the voting stock of the company paying the dividends.
14. For the use of, or the right to use any industrial, commercial, or scientific equipment.
15. When interest is paid:
   - to the government, a local authority, and the central bank or any financial institution wholly owned by that government or
   - to the other resident of the other state with respect to debt-claims indirectly financed by the government of the other state, a local authority, and the central bank or any financial institution wholly owned by the government.
16. For the use of, or the right to use, any copyright of literary, artistic, or scientific work, including cinematograph films, and films or tapes for radio or television broadcasting, or any patent, know-how, trademark, design or model, plan, secret formula, or process.
17. When interest is paid to the government, including political sub-divisions and local authorities, the central bank or any statutory body of the state with respect to loans or credits made or guaranteed by the government of the other state, including political sub-divisions and local authorities, the central Bank, or any statutory body of the other state.
18. When the beneficial owner is a company (other than a partnership) which holds directly at least 20% of the capital of the company paying the dividends.
19. When the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends, where such holding is being possessed for an uninterrupted period of no less than one year and the dividends are declared within that period
20. When the beneficial owner is a pension fund or other similar institution providing pension schemes in which individuals may participate in order to secure retirement benefits, when such pension fund or other similar institution is established, recognized for tax purposes and controlled in accordance with the laws of the other state.
21. When interest is paid:
   - on loan whatever kind granted, insured, or guaranteed by a financial institution owned or controlled by the state
   - in connection with the sale on credit of any industrial, commercial, or scientific equipment
   - in respect of a bond, debenture, or other similar obligations of the government of the state, or of a political subdivision or local authority, or
   - to the other state, or to a political subdivision or local authority.
22. When interest is paid to the government of the other state, including local authorities and the central bank.
23. When the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends.
24. When interest is paid to the government of the other state, including political subdivisions and local authorities, the central bank, or any financial institution owned by the government or on loans guaranteed by the government.
25. From copyright of literary, artistic, or scientific work.
26. When the beneficial owner is the government of the other state or central bank.
27. When the interest, subject to certain exceptions related to silent shareholders, is paid:
   - to the Government of Poland or Germany on a loan of whatever kind granted, insured, or guaranteed by a public institution for purposes of promoting exports
   - in connection with the sale on credit of any industrial, commercial, or scientific equipment
   - in connection with the sale on credit goods between companies, or
   - on any loan of whatever kind granted by a bank.
28. If the following conditions are met:
   - Interests paid to

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    - the government, a political sub-division, or a local authority of the other contracting state or
    - the central bank of other contracting state.
  - When the beneficial owner is a resident of the other contracting state and is derived in connection with a loan or credit extended or endorsed by
    - Bank Handlowy (in scope of financing export and import) – for Poland
    - the Export-Import Bank of India (in scope of financing export and import) – for India
    - any institution in the other contracting state in charge of public financing of external trade, or
    - any other person, provided that the loan or credit is approved by the government of the first mentioned contracting state.
29. When the beneficial owner is the government, ministry, other governmental institution, municipality, central bank or any other bank wholly owned by the government of the other contracting state.
30. When the beneficial owner is a resident of the other contracting state and holds directly at least 25% of the voting power of the company paying the dividends.
31. Interest paid in connection with:
    - the sale on credit of any industrial, commercial, or scientific equipment
    - the sale on credit of any merchandise by one enterprise to another, or
    - on any loan of whatever kind granted by the bank.
32. When the beneficial owner is a company which holds directly at least 15% of the capital of the company paying the dividends.
33. If the following conditions are met:
    - When the payer of interests is the government or contracting state or a local authority of thereof.
    - Interest is paid to the government of other contracting state or local authority thereof (incl. financing institutions) wholly owned by other contracting state or local authority thereof.
    - Interest is paid to any other entity, including financial institutions, in relation to loans made in application of an agreement concluded between governments of contracting states.
34. When beneficial owner is the government of other contracting state, including local authorities thereof, the central bank, any financial institutions controlled by that government or any resident of the other contracting state with respect to debt-claims, guaranteed or indirectly financed by institutions mentioned above.
35. For payments connected with copyrights, literary, artistic, and scientific activity, including payments connected with films for cinemas and films and tapes for TV.
36. When the beneficial owner is a company which holds directly or indirectly, at least 20% of the capital of the company paying the dividends.
37. When interest is paid to the government or local authorities.
38. When interest
    - arising in contracting state and received by the government of the other contracting state, including political subdivision or a local authority thereof or the central bank of that other contracting state
    - arising in contracting state is paid in respect of loans and credits made or guaranteed:
      - by the Bank Handlowy – for Poland
      - by the Export-Import Bank of Korea and Korea Development Bank – for Korea
    - is paid in connection with the sale on credit of any industrial, commercial, or scientific equipment, or
    - is paid in connection with the sale on credit of any merchandise by one enterprise to another.
39. Interest paid to government or central bank.
40. When the beneficial owner is
    - the government of the other contracting state, entity, or any governmental institution or
    - a company which is a resident of the other contracting state and at least 25% of its capital is owned directly or indirectly by the entities mentioned above.
41. If the following conditions are met:
    - When the beneficial owner is:
      - the government of the other contracting state, entity, or governmental institution or
      - a company which is a resident of the other contracting state and at least 25% of its capital is owned directly or indirectly by the entities mentioned above
    - When interest is paid in connection with loans guaranteed by the entities mentioned above.
42. When interest is paid:
    - to the government, including the local authorities, to the central bank or any financial institution controlled by that government, or on loans guaranteed by that government or
    - to the resident in the other contracting state.
43. If the following conditions are met:
    - When the beneficial owner is other contracting state.
    - When interest is paid in connection with loans and credits granted by bank.
44. Dividends paid by:
    - a resident of Poland to a resident of Malaysia who is subject to Malaysian tax in respect thereof or
    - a resident of Malaysia to a resident of Poland who is subject to Polish tax in respect thereof.
45. Interest paid to resident of Poland on an approved loan or a long-term loan.
46. Royalties paid to resident of Poland by resident of Malaysia and approved by the competent authority of Malaysia.
47. If the following conditions are met:
    - When the beneficial owner is
      - a contracting state, a political subdivision, or a local authority, or The National Bank of Poland or Banko de Mexico or

- a recognized pension or retirement fund provided that its income is generally exempt from tax in this state.
- When interest
  - is paid by any of entities mentioned above
  - arises in Poland and is paid in respect of a loan for a period not less than three years granted, guaranteed, or insured by Banco de Comercio Exterior, S.N.C., Nacional Financiera, S.N.C. or Banco National de Obras y Servicios Publicos S.N.C., or
  - arises in Mexico and is paid in respect of a loan for a period not less than three years granted, guaranteed, or insured by PKO S.A., Corporation of Credit Insurance, and Bank Handlowy in Warsaw.

48. If the following conditions are met:
    - When the beneficial owner is a bank or insurance company.
    - When interest is derived from bonds and securities that are regularly and substantially traded on a recognized securities market.
49. When dividends are paid to the company which holds directly at least 10% of the capital paying the dividends on the day they are paid and has done (or will do) so for an interrupted 24–month period from which that date falls.
50. When interests is paid:
    - by a resident of Pakistan to a Polish company or enterprise on loans approved by the Ministry of Finance of the Government of Pakistan
    - to the State Bank of Pakistan from sources in Poland, or
    - to Bank Handlowy in Poland from the sources in Pakistan.
51. For payments of any kind received in consideration for the use of, or the right to use:
    - any copyright, patent, trademark, design or model, plan, secret formula, or process
    - an industrial, commercial, or scientific equipment or
    - motion picture films, and works on films and videotapes for use in connection with television.
52. For payments received in consideration of technical know-how concerning industrial, commercial, or scientific experience.
53. Interests paid in respect of:
    - a bond, debenture, or other similar obligations of the government,  state, political subdivision, or local authority thereof or
    - a loan or credit extended, guaranteed, insured, or refinanced by:
      - Central Bank of Philippines – for Philippines
      - Central Bank of Poland – for Poland or
      - other lending institutions as specified and agreed in letters of exchange between competent authorities of the contracting states.
54. When dividends are paid to the company which holds directly at least 25% of the capital stock of the company paying the dividends for an uninterrupted 24 month period prior to the payment.
55. If the following conditions are met:
    - When the debtor of such interests is the government, a political subdivision, or local authority.
    - When the interest is paid to the government of other contracting state, a political subdivision, or local authority thereof, or an institution or body in connection with any financing granted by them under an agreement between the governments of the contracting states.
    - Loans or credit made on central banks of contracting states and any other financial institution controlled by the state and financing external business which may be agreed upon between the competent authorities of the contracting states.
56. Interests paid to government, administrative, territorial, or the central bank.
57. Dividends paid by:
    - the company which is a resident of Singapore to a resident of Poland (as long as Singapore does not impose a tax on dividends in addition to the tax chargeable on the profits or income of a company) or
    - to government of either contracting state with respect to shares in joint stock companies of that other state.
58. Interest paid to government.
59. Interests paid to government, local authorities, or the central bank.
60. Exempt income tax in Sri Lanka, not exceeding 33 1/3% on the company which pays dividends and other than the additional tax not exceeding 6% on companies whose shares are not movable property situated in Sri Lanka for the purpose of the law of Sri Lanka relating to Estate duty.
61. Interests:
    - received by any banking institution which is a resident of contracting state
    - derived from contracting state of the other contracting state either directly or through any agency or
    - accruing to any company, partnership, or other body of persons resident in the contracting state for any loans in money, goods, and services or in any other form, granted by them to the government of the other contracting state, or to a state corporation, or to any state institution, or to any other institution, to the capital of which, the other contracting state has made any contribution, or to a credit agency, or an undertaking in that other contracting state with the approval of the government of the same state.
62. For payment in consideration, for the use of, or the right to use, any copyrights or cinematograph films.
63. As long as Switzerland will not tax royalties paid to foreign recipients, the payments are taxed only in the country of residence of the recipient (currently there is no WHT in Switzerland).

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64. If the following conditions are met:
    - When recipient is a contracting state, or one of its local authorities, or the statutory body of either, including the central bank; or when interests are paid by a contracting state, or one of its local authorities, or the statutory body of either.
    - Such interest is paid in respect of any debt-claim or loan guaranteed, insured, or supported by a contracting state or another person acting on state's behalf.
65. Payments payable to contracting state or a state owned company in respect of tape or films.
66. Royalties made as consideration, for the alienation, or the use of, or the right to use, any copyright of literary, artistic, or scientific work, excluding cinematographic films or tapes for television or broadcasting.
67. When the beneficial owner is the government or a government institution.
68. When dividends are paid to a company which is the resident of the other contracting state and which holds directly at least 10% of the capital, paying the dividends on the day they are paid and has done (or will do so) for an uninterrupted 24–month period from which that date falls.
69. When interests are paid to the government, a political subdivision, or a local authority in connection with:
    - a loan granted, insured, or guaranteed by a governmental institution for the purposes of promoting exports
    - the sale on credit of any industrial, commercial, or scientific equipment, or
    - any loan granted by a bank.
70. When the beneficial owner is a company which holds directly at least 10% of the outstanding shares of the voting stock of the company paying the dividends.
71. When the beneficial owner is a company which holds directly at least 20% of the capital of the company paying the dividends.
72. When the beneficial owner is:
    - the government or a local authority or
    - the National Bank of Poland or the Central Bank of Uzbekistan Republic.
73. For payment of any kind, received in consideration, for the use of, or the right to use:
    - any patent, design or model, plan, secret formula, or process or
    - any information concerning industrial or scientific experience.
74. When interest is paid in respect of a loan made, guaranteed, or insured by the state or agreed public body.
75. Provided that Chile introduces a tax exemption on royalties in a DTT with another OECD country.
76. Treaty allows application of the domestic tax rate.
77. As long as Iceland does not levy tax at source of income, interest is taxable only in the contracting state of which the beneficial owner of the interest is a resident.
78. When interest is paid to the government, a political subdivision, or a local authority in connection with:
    - a loan granted, insured, or guaranteed by a governmental institution for the purposes of promoting exports
    - a sale on credit of any industrial, commercial, or scientific equipment
    - any loan granted by a bank
    - in respect of a bond, debenture, or other similar obligations of the government of a contracting state, or of a political subdivision or local authority thereof, or
    - to the other contracting state, or to a political subdivision or local authority thereof.
79. The interest arising in one contracting state might be exempt from tax in this contracting state in the amount agreed to by this contracting state provided that the transaction the interest arises from was permitted by this contracting state.
80. Provided that any new contribution is made to the capital of a company resident in Sri Lanka by a company resident in Poland.

## *Tax administration*

### *Returns*

The annual CIT return should be submitted to the tax office within three months following the end of the tax year.

### *Payment of tax*

The same deadline as the CIT return applies to the settlement of the annual CIT liability. In financial terms, the final settlement is not significant, since most of the annual liability is paid by CIT advances throughout the tax year.

The CIT advances should be paid for each month by the 20th day of the following month. Entities that started business activities (except for companies organised as a result of certain transformations) and entities whose gross sales revenue (including VAT) in the prior tax year did not exceed EUR 1,200,000 are entitled to opt to make advance settlements on a quarterly basis (instead of a monthly basis).

# Portugal

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## Significant developments

2011 is a year of significant changes in the Portuguese tax regime.

### Memorandum of Understanding / Financial aid by the European Fund for Financial Stability

A Memorandum of Understanding (MoU) has been concluded between the Portuguese Republic and the European Commission, the European Central Bank, and the International Monetary Fund (IMF), within the scope of the Council Regulation (EU) No. 407/2010 of 11 May 2010, which establishes a European Financial Stabilisation Mechanism.

The MoU includes the measures agreed upon and to be implemented under the financial assistance to be granted to Portugal by the European Fund for Financial Stability. These measures should be introduced between 2011 and 2014. Technical memorandums with more detail on the measures announced are still expected.

These following measures impacting corporate tax have been announced:

**Corporate income tax (CIT)**

- Elimination of all reduced CIT rates.
- Limitation of deductions of losses in previous years according to the taxable matter,
- Reduction to three years of the carryforward period for tax losses.
- Revocation of subjective tax exemptions.
- Curbing of tax benefits, namely those subject to the sunset clause, as foreseen in the Tax Benefits Code.
- Strengthen of company car taxation rules.
- Limitation to 20% (currently 30%) of the reduction of the tax rates applicable in the Autonomous Regions of Madeira and Azores, in comparison to the ones applicable in the mainland (the CIT rate applied in Azores should increase from 17.5% to 20%).

**Value-added tax (VAT)**

- Reduction of VAT exemptions (including the current exemption on postal services).
- Increase of the VAT rate on electricity and gas, currently subject to the reduced VAT rate of 6%.
- Reorganisation of the VAT schedules, with transfers of categories of goods and services from the reduced and intermediate VAT tax rates to the standard (and higher) one.
- Introduction of amendments to the regional finance law to limit the reduction of VAT in Autonomous Regions of Madeira and Azores to a maximum reduction of 20% (currently 30%), in comparison to the rates applicable in the mainland (meaning an increase of the higher VAT rate applicable in Madeira and Azores from 16% to 18%).

**Excise duties**

- Increase of car sales tax.
- Reduction of car tax exemptions.
- Increase of taxes on tobacco products.
- Indexation of excise taxes to core inflation.
- Introduction of electricity excise taxes.

**Property taxes**

- Reassessment of the property values for the purpose of property transfer tax.
- Substantial reduction of the temporary exemptions for owner-occupied dwellings.
- Regular revaluation of real estate for tax purposes (annually, for commercial establishments and every three years in case of housing).

**Fight against tax evasion, fraud, and shadow economy**

- Reallocation of staff within the Tax Administration to increase the audit teams.
- Strengthen the auditing powers of the Central Tax Administration to exercise control over the whole Portuguese territory, including tax exemption regimes (e.g. Madeira International Business Centre).
- Reserve to the Central Tax Administration the power to issue interpretative rulings on taxes with national scope, in order to assure its uniform application.

**Tax courts and litigation**

- Implementation of tax arbitration until the third quarter of 2011.
- Setting up of a temporary task force of judges to clear cases worth above 1 million euros (EUR).
- Establishment of an integrated information technology system between the revenue administration and the tax courts.
- Establishment of special chambers within the tax tribunals, specialised to handle large cases and assisted by a specialised technical staff pool.
- Charging interest on the outstanding debt over the whole appeal period using an interest rate above market levels.
- Impose a special statutory interest on non-compliance with a tax court decision.



### *2011 State Budget*

The 2011 State Budget Law was published in the Portuguese Official Gazette of 31 December 2010, and the most significant amendments introduced on matters of corporate income tax (CIT) are summarized below:

- Mechanism for the elimination of economic double taxation on distributed dividends:
  - The partial tax relief of 50% on dividends received by Portuguese resident parent companies from European Union (EU)(including Portugal) and European Economic Area (EEA) subsidiaries was revoked (this applied in case the minimum shareholding/acquisition cost or the ownership period were not verified).
  - The full deduction by a Portuguese parent company of dividends received from EU (including Portugal) and EEA subsidiaries will now depend on a minimum shareholding of 10% (now also applicable for holding companies), irrespective of the acquisition value (formerly, if the acquisition value was of at least EUR 20 million, the minimum percentage was not required).
  - Holding companies (SGPS) can no longer eliminate economic double taxation on dividends received from subsidiaries when the underlying profits were not subject to effective taxation (formerly, this rule only applied for operational parent companies; SGPS were excluded).

- Dividends paid by Portuguese subsidiaries to EU, EEA, or Swiss parent companies are exempt from domestic withholding tax (WHT) under the EU Parent/Subsidiary Directive to the extent that the parent company owns a minimum shareholding of 10%, irrespectively of the acquisition costs (formerly, if the acquisition value was of at least EUR 20 million, the minimum percentage was not required).
- Capital losses and other losses related to shareholdings are no longer tax deductible to the extent that the reduction in value results from a tax-free dividend distribution (i.e. where the mechanism for elimination of economic double taxation was applied) made in the previous four years.
- The domestic WHT rate applicable to capital income earned by non-resident companies is increased from 20% to 21.5%.
- Companies in a tax loss situation for two consecutive years can only deduct those tax losses in the third upon legal certification of accounts issued by a statutory auditor.
- Special Tax Regime for Group Taxation: when determining the group's taxable profit (or tax loss), the individual group member's taxable profits (or tax loss) can no longer be adjusted for profits distributed between group entities.
- General increase of the rates of autonomous taxation (additional taxation) applicable to expenses incurred on the acquisition of light passenger vehicles and motorcycles, excluding vehicles that are solely powered by electrical energy.
- All other autonomous taxation rates are increased by 10%, if the taxpayer has tax losses in the same fiscal year.
- The amount of CIT assessed cannot be lower than 90% (formerly 75%) of the amount that would have been assessed in the absence of tax benefits/special tax regimes.
- The banking sector is subject to a new contribution regime ('Contribuição sobre o Sector Bancário' or Bank Levy).

### *The Stability and Growth Program for 2010-2013*

In March 2010, the Portuguese Government presented to the Parliament the Stability and Growth Program for 2010-2013 ('Programa de Estabilidade e Crescimento' or PEC). PEC is the Portuguese Government's strategy to reduce public deficit, reducing tax benefits and increasing tax revenues, while at the same time aiming a structural reform towards modernisation and competitiveness of the Portuguese economy.

On 30 June 2010, a set of measures was approved within the PEC, entering into force on 1 July 2010. The relevant tax measures approved were as follows:

- Implementation of a State surtax ('Derrama Estadual') of 2.5% levied on the income subject to and not exempt from CIT, exceeding EUR 2 million, assessed by resident taxpayers carrying out a commercial, industrial, or agricultural activity and by non-residents with a permanent establishment (PE) in Portugal.
- Increase of the stamp duty rate in the case of consumer's credit. It may now reach 1% of the funds granted, in the case of credit granted for five years or more.

On 26 July 2010, the introduction of a 20% tax on capital gains obtained on the sale of shares, corporate bonds, and other debt securities realised by mixed and closed investment funds (formerly exempt from taxation) was approved under the PEC. An exemption from taxation on capital gains still applies to open investment funds that hold the securities for more than 12 months.

## *Taxes on corporate income*

Two thresholds of taxable income determine the application of the following tax rates:

- Taxable income up to EUR 12,500 is subject to CIT at the rate of 12.5%.
- Taxable income in excess of EUR 12,500 is subject to CIT at the rate of 25%.

Entities that do not carry out a commercial, industrial, or agricultural activity as their main activity are subject to a 21.5% CIT rate on the global amount of their taxable income.

Lower CIT rates apply in the Autonomous Regions of Madeira and Azores, respectively 20% (10% reduced CIT rate), and 17.5% (8.75% reduced CIT rate).

It is expected that the lower CIT rate applicable to taxable income up to EUR 12,500 is abolished, following the Memorandum of Understanding between the Portuguese Republic and the European Commission, the European Central Bank, and the IMF, which covers the financial assistance to be granted to Portugal by the European Fund for Financial Stability.

Resident companies in Portugal are taxed on their worldwide income. Tax is also applicable to Portugal-source income attributable to a PE of a non-resident company in Portugal. Special WHT rates apply to income generated in Portugal that is attributable to non-residents without a PE in Portugal *(see the Withholding taxes section for more information)*.

### *Surtaxes*

The following surtaxes may also apply:

- A local surtax ('Derrama') of up to 1.5% of taxable income, prior to the deduction of any available carryforward tax losses, is levied in certain municipalities. The local surcharge is assessed and paid when filing the CIT return.
- A state surtax ('Derrama Estadual') at the rate of 2.5% of the taxable income exceeding EUR 2 million, prior to the deduction of any available carryforward tax losses, is levied on resident taxpayers carrying on commercial, industrial, or agricultural activity and by non-residents with a PE in Portugal. This is paid in several instalments.



## *Corporate residence*

A resident company is one whose head office or effective management is located in Portugal.

### *Permanent establishment (PE)*

Under Portuguese tax law, any fixed place of business in Portugal through which the business of an enterprise is wholly or partly carried on is deemed to constitute a PE in Portugal.

A fixed place of business comprises, among others, a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources, and also building site or a construction or installation project if it lasts more than six months (time period may differ considering the applicable tax treaty).

A PE may also be deemed to exist in case of a person (a dependent agent), which is not an independent agent, acting, in the Portuguese territory on behalf of a company, with powers to intermediate and conclude binding contracts for that company, within the scope of its business activity.

No PE should exist where a fixed place of business in Portugal is used solely for carrying out ancillary or preparatory activities, or, in case a company carries out its activities in Portugal through a broker, general commission agent, or other agent of an independent status, acting in the normal course of its business, bearing all related business risks.

Additionally, the term PE shall be deemed not to include the following actions:

- Use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise.
- Maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery.
- Maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise.
- Maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise.
- Maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.
- Maintenance of a fixed place of business solely for any combination of activities mentioned above, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

## *Other taxes*

### *Value-added tax (VAT)*

Portuguese VAT is applicable at the standard rate of 23% (16% in the self-governing regions of Madeira and the Azores), at an intermediate rate of 13%, and at a reduced rate of 6% (8% and 4% in Madeira and the Azores). An increase of the standard rate in Madeira and Azores (to 18%) is expected, following the Memorandum of Understanding (MoU) between the Portuguese Republic and the European Commission, the European Central Bank, and the IMF, which covers the financial assistance to be granted to Portugal by the European Fund for Financial Stability.

Following a revision of the respective reduced rates lists, several goods and services that in 2010 were subject to the reduced or intermediate VAT rates are now subject to the standard VAT rate, namely gyms, flowers and ornamental plants, as well as some legal services. Further changes are expected following the MoU.

Restaurant services, basic canned foods, fruit jellies, fats, honey, coffee, natural water, fruit juices, decorative flowers, petroleum for heating and marked diesel fuel for agriculture and fishing activities, and certain ecological equipment are subject to the intermediate VAT rate of 13%. Basic food, some pharmaceutical products, milk products, and certain services are subject to the reduced VAT rate of 6%. Exports and intra-EU supplies of goods are zero-rated.

The implementation of Council Directive 2008/8/EC led to significant changes of the national VAT legislation on the deemed place of supply of services, defining two general rules as of 1 January 2010.

The general rule for taxation of business-to-business ('B2B') services is the place where the customer is established or has a PE, has a permanent address, or usually resides.

For business-to-consumer ('B2C') services, the general rule remains the place where the supplier is established. As of 1 January 2011 the place of supply of organisations of cultural, artistic, sporting, scientific, educational, entertainment, or similar events is determined according to the general rule; on 1 January 2013 and 1 January 2015, additional adjustments to the VAT rules will become effective.

The existing proceeding for obtaining a VAT refund in another EU member state other than the member state of establishment has been replaced by a new electronic proceeding, with a four month average payment term.

### *Surcharges*
The following surcharges (autonomous taxes), self-assessed with the corporate tax, are levied at the rates provided:

- Representation and entertainment expenses: 10%.
- Company car expenses: 10%.
- Mileage allowance: 5%.
- Per diem allowance: 5%.
- Non-documented payments: 50% (70% for partially or fully exempted taxpayers).
- Company car expenses for which acquisition cost exceeds certain limits as established in the law: 20%.
- Dividends distributed to exempt taxpayers regarding participations held for less than one year: 20%.
- The total amount of the expenses incurred with any compensation paid as a result of the termination of functions of managers or board members, if not related to the productivity targets previously established under the existing labour relation; or the amount that exceeds the remuneration that would be received by the manager or the board member until the term of the labour agreement, in case of redundancy prior to that term; or in all cases, if the liability for the payment is shifted to another entity: 35%.
- The total amount of the expenses incurred with bonuses paid to managers or board members if the respective amount corresponds to more than 25% of the annual salary and exceeds EUR 27,500: 35%.



All the above-mentioned surcharges are increased by 10% if the taxpayer has tax losses in the same tax year.

### *Customs duties*
Custom duties are regulated by the Community Customs Code. Therefore, the rules foreseen for the import and export of goods in Portugal are similar to the rules applicable in other EU member states.

The custom duties' rates applied in Portugal vary according to the origin of the goods. There are several origin agreements which exempt from custom duties the importation of goods from certain countries or that determine reduced rates.

### *Excise duties*
There are different types of excise duties, such as:

- petroleum and energy products tax
- alcohol and alcoholic beverages tax
- tobacco tax, and
- vehicle tax.

The tax applicable to petroleum and energetic products depends on the goods supplied, namely it varies between EUR 650/1,000 l for leaded petrol and EUR 2.78/gJ for natural gas used as fuel.

The tax applicable to alcohol and alcoholic beverages also depends on the type of good supplied, varying between EUR 7.11/hl for a certain type of beer and EUR 1,031.57/hl for spirits.

The tax applicable to tobacco also varies in accordance with the type of product supplied, namely it varies between 60% of the sale price for fine-cut tobacco for the rolling of cigarettes and 13% of the sale price for cigars and cigarillos.

The tax applicable to vehicles varies in accordance with the type of vehicle, the fuel used, and the cylinder of the vehicle. The higher taxation is applicable for cars used for the transport of passengers using petrol as fuel and the lower taxation is applicable for motorcycles.

Furthermore, the introduction in consumption of the products subject to excise duties is simplified, considering that as from 1 April 2010 the arrival of these goods from other EU member states is supported through an electronic document (e-DA).

As from 1 January 2011, the electronic document (e-DA) may also be issued by Portuguese entities to export the above goods and certify winery products. It is also possible to change or cancel an electronic document received.

### *Stamp duty*

Stamp duty is payable on a wide variety of transactions and documents, at rates that may be set in specific amounts or on a percentage basis. Important examples include the following:

| Item | Stamp duty (%) |
|---|---|
| **Loans (on the principal)** | |
| With determined term, over 1 year | 0.5 to 0.6 |
| Current account/overdraft/credit with undetermined term or determined term under 1 year | 0.04 per month or fraction |
| **Credit to consumers** | |
| With a term up to 1 year/current account, overdraft, or other form of credit with undetermined term | 0.07 per month or fraction |
| With a term equal to or higher than 1 year | 0.9 |
| With a term equal to or higher than 5 years | 1 |
| **Guarantees** | |
| Undetermined / 5 or more years | 0.6 |
| Over 1 year | 0.5 |
| Under 1 year or with undetermined term | 0.04 per month or fraction |
| Bank interest and fees | 4 |
| Insurance premiums | 3 to 9 |
| Real estate purchases and sales | 0.8 |
| Donations and inheritances | 10 |
| Sale of business as a going concern | 5 |

### *Property tax (IMI)*

Imposto Municipal sobre Imóveis (IMI) is a municipal property tax upon which the taxable basis is calculated by reference to a formula based on objective criteria, such as the construction cost per square meter, area, age, construction quality, and comfort indexes.

Following the Memorandum of Understanding between the Portuguese Republic and the European Commission, the European Central Bank, and the IMF, which covers the financial assistance to be granted to Portugal by the European Fund for Financial Stability, reassessments of the tax value of real estate are expected (increase to close the market value).

IMI is levied at the following rates, in addition to corporate or individual tax assessed on actual income generated by real estate:

| Property type | IMI (%) |
|---|---|
| Urban real estate | 0.4 to 0.7 |
| Urban real estate (valued under the new rules) | 0.2 to 0.4 |
| Rural real estate | 0.8 |

Note that the tax rate of IMI on properties owned by entities resident for tax purposes in a blacklisted territory is 5%.

The list of countries, territories, and regions that provide a more favourable tax regime is presented below:

| | | | |
|---|---|---|---|
| Andorra | United Arab Emirates | Isle of Man (5) | Saint Helena |
| Anguilha | Falkland Islands or Malvinas | Marianas | Saint Lucia |
| Antígua and Barbuda | Fiji Islands | Marshall Islands | Saint Kitts and Nevis |
| Netherlands Antilles | Gambia | Mauritius | San Marino |
| Aruba | Grenada | Monaco | Saint Pierre and Miquelon |
| Ascension Island | Gibraltar (5) | Montserrat | St. Vicente and the Grenadines |
| Bahamas | Guam | Nauru | Seychelles |
| Bahrain | Guyana | Christmas Island | Swaziland |
| Barbados | Honduras | Niue Island | Svalbard (4) |
| Belize | Hong Kong | Norfolk Island | Tokelau |
| Bermuda (5) | Jamaica | Sultanate of Oman | Kingdom of Tonga |
| Bolívia | Jordan | Pacific Islands (3) | Trinidad and Tobago |
| Brunei | Queshm Island | Palau Islands | Tristan da Cunha |
| Channel Islands (1) | Kiribati | Panama | Turks and Caicos |
| Cayman Islands (5) | Kuwait | Pitcairn Island | Tuvalu |
| Cocos (Keeling) | Labuan | French Polynesia | Uruguay |
| Cyprus | Lebanon | Porto Rico | Vanuatu |
| Cook Islands | Liberia | Qatar | British Virgin Islands (5) |
| Costa Rica | Liechtenstein | Solomon Islands | United States Virgin Islands |
| Djibouti | Luxembourg (2) | American Samoa | Yemen Arab Republic |
| Dominica | The Maldives | Western Samoa | |

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Notes

1. Alderney, Guernesey (5), Jersey (5), Great Stark, Herm, Little Sark, Brechou, Jethou e Lihou.
2. Just for Luxembourg holdings (Law of 31/7/1929 and Grand-Duchy Decision of 17/12/1938).
3. Not included in the remaining numbers.
4. Spitsbergen Archipelago and Bjornoya Island.
5. The Portuguese Authorities have signed several Agreements on Exchange of Information for tax purposes that will allow the identification of applications outside of Portuguese territory and any facts non-declared. The Portuguese Authorities will ask to each jurisdiction elements that are considered relevant to the accurate assessment of the tax situation of a specific taxpayer, including information on the movement of funds as well as ownership of companies, foundations, trusts, funds or other entities (Jurisdictions Covered: Andorra; Antigua and Barbuda; Belize; Bermuda; British Virgin Islands; Cayman Islands; Dominica; Gibraltar, Guernsey; Isle of Man; Jersey; Liberia; Santa Lucia; St. Kitts and Nevis; Turks and Caicos).). The Portuguese Parliament has approved the Agreements with Bermuda, Cayman Islands, Andorra, and Gibraltar.

### *Property transfer tax (IMT)*

Imposto Municipal sobre as Transmissões Onerosas de Imóveis (IMT) is a municipal tax payable in Portugal on the onerous transfer of local real estate. The tax is levied on the purchaser, and the taxable basis is the same as for IMI or the price agreed upon by the contracting parties, whichever is higher.

The IMT rates are set at 5% for rural real estate and 6.5% for urban real estate and land for construction. For non-residents located in blacklisted jurisdictions, the rate is 8%.

### *Bank Levy*

Credit institutions whose head office and place of effective management is in Portugal, local subsidiaries of credit institutions whose head office and place of effective management are outside Portugal, and branches of credit institutions whose head office and place of effective management are outside the European Union, are subject to the Bank Levy ('Contribuição sobre o Sector Bancário').

The Bank Levy It is levied on (i) the liabilities, according to the approved accounts, reduced by Tier 1 and Tier 2 capital and by the guaranteed client deposits, at rates ranging from 0.01% to 0.05% and (ii) the notional amount of the off balance financial derivative instruments.

The taxable base to consider is the following:

- Base I - Liabilities, which are defined as the set of elements accounted for in the balance sheet which represent liabilities towards third parties, irrespective of their form or nature. Excluded from the taxable base are, amongst others, items that are accounted for as equity, liabilities for defined benefit retirement plans, provisions, and liabilities concerning the revaluation of financial derivatives.
- Base II - The notional amount of off-balance sheet financial derivatives, excluding hedging derivatives and back to back derivatives.

The taxable base is calculated by reference to annual average of the monthly balances of the qualifying items, as reflected in the accounts approved regarding the year to which the bank levy relates to.

A tax rate of 0.05% applies on Base I and a rate ranging from 0.0001% to 0.0002% applies on Base II.

The computation and payment of this contribution must be made by the last day of June, through an official form.

The Bank Levy is not deductible for CIT purposes.

## *Branch income*

Branch profits are taxed on the same basis as corporate profits. Income remitted by a branch to the head office is not subject to taxation.

## *Income determination*

Taxable income is based on the accounting income adjusted according to the specific provisions of the tax legislation, when applicable.

### *Inventory valuation*

Inventories are valued at the lower of the following values: cost or net realisable value. The first in first out (FIFO) and average-cost methods of valuation are accepted. The last in first out (LIFO) method is not allowed.

Inventory adjustments are deductible for tax purposes on the amount accounted for in the tax year, capped at the difference between the acquisition or production value and, if lower, the net realisable value (duly documented) with reference to the balance sheet.

### *Capital gains*

The positive net difference between capital gains and capital losses arising from the disposal of fixed assets or shares, held for more than one year, is taxed as part of normal income.

Capital gains and capital losses are determined by the difference between the sales proceeds, deducting any related cost, and the acquisition value, deducing impairment losses and tax deductible depreciation or amortisation, adjusted by the inflation index (in the case of at least two years of ownership).

Only half the amount of the negative difference between capital gains and capital losses arising from the disposal of shares or other negative net worth variations related to participations or other parts of the equity of a company, such as supplementary capital contributions, are considered for purposes of assessing the taxable income.

In certain circumstances, only 50% of the net gains on disposal of tangible fixed assets or shares are taxed, provided the sales proceeds are reinvested.

Capital losses regarding shares owned for less than three years when acquired from related companies, from blacklisted entities or from Portuguese companies subject to a special tax regime are not deductible. Capital losses are also not tax deductible if the shares are transferred to related parties to blacklisted entities or to Portuguese resident entities subject to a more favourable tax regime.

Capital gains/losses realised by holding companies (‘Sociedade Gestora de Participações Sociais’ or SGPS) are not taxed/deductible, if the underlying shares have been held for more than one year (or three years if the shares were acquired from related parties, offshore companies, or Portuguese resident entities subject to a special tax regime).

### Dividend income

For Portuguese-resident companies holding shares in other Portuguese companies, or in companies resident in Portuguese African Speaking countries, or in companies resident in the EU or the EEA (meeting the EU Parent /Subsidiary Directive 90/435/CEE), 100% of the dividends distributed are excluded from the taxable income. In case of Portuguese, EU, and EEA subsidiaries, the shares should represent at least 10% of total capital and have been held for at least one year (this minimum holding period should be met before or after distribution).

This also applies to regional development corporations (Sociedades de desenvolvimento regional), investment companies, securities dealers, and insurance companies (where technical reserves are concerned).

The deduction of the dividends, when distributed by Portuguese, EU, or EEA subsidiaries only applies if the underlying income has been subject to effective taxation.

### Foreign income

A Portuguese company is taxed on all its foreign income. Taxes paid abroad can be offset against corresponding Portuguese tax *(see Foreign tax credit in the Tax credits and incentives section for more information)*.

## Deductions

### Depreciation, amortization, and depletion

The qualifying cost of an asset for tax purposes is the acquisition or production cost.

Depreciation must be computed by using the straight-line method or the declining-balance method. The latter cannot be applied to buildings, passenger vehicles, furniture, social welfare equipment, or second-hand assets. Straight-line rates of depreciation are normally consistent with rates privately used by business and industry and are increased, for the purposes of applying the declining-balance method, by coefficients of:

- 1.5 if assets have a useful life of less than five years.
- 2 if useful life is five or six years.
- 2.5 for useful lives in excess of six years.

Different depreciation methods may be applied without previous approval from the Tax Authorities (annual depreciation cannot, however, exceed the depreciation resulting from using either the straight-line or declining-balance methods).

Some examples relating to the maximum straight-line depreciation rate are as follows:

| Type of asset | Rate (%) |
|---|---|
| Office building | 2 |
| Industrial building | 5 |
| Electronic equipment | 20 |
| Computers | 33.33 |
| Ordinary tool & paintings | 25 |
| Engines & machine tools | 12.5 |
| Office equipment | 20 |

| Type of asset | Rate (%) |
|---|---|
| Furniture | 12.5 |
| Software | 33.33 |
| Light passenger vehicles | 25 |

Rates can be reduced by 50% in any one year at the taxpayer's option. If the reduction is more than 50%, the difference is allowed for tax purposes at a future date. Any depreciation in excess of the maximum allowed must be subsequently adjusted in the accounting records to be allowed for tax purposes in future years. A total of 60% of additional depreciation on revaluation of fixed assets, as permitted by law from time to time, is allowed for tax purposes.

Depreciation rates of tangible assets may be increased by 25% in the case of companies with a schedule of two shifts (for three shifts, 50%), given the faster deterioration of those assets.

Assets with an acquisition value lower than EUR 1,000 can be depreciated in the acquisition year, unless the assets are part of a set of elements that should be depreciated as a whole.

Depreciation of yachts and airplanes that are not essential for business activities is not allowed as a cost for tax purposes.

Depreciation of passenger cars and certain other vehicles on the part of their cost of acquisition that exceeds certain amounts (as defined by law), with reference to their acquisition value, is also disallowed as a cost for tax purposes. The following caps apply (i.e. disallowed cost above the values below):

- EUR 40,000 of acquisition cost, in the case of vehicles acquired until 31 December 2010.
- EUR 30,000 of acquisition cost, in the case of vehicles acquired from 1 January 2011 onwards.
- EUR 45,000 of acquisition cost, in the case of electric vehicles acquired from 1 January 2011 onwards.
- EUR 25,000 of acquisition cost, in the case of vehicles acquired from 1 January 2012 onwards.
- EUR 50,000 of acquisition cost, in the case of electric vehicles acquired from 1 January 2012 onwards.

Development expenses, patents, trademarks, licenses, and similar rights may be amortised for tax purposes if acquired for a limited period of time.

Expenses relating to assets generated internally are deductible for tax purposes in the tax year in which the cost is incurred.

Goodwill cannot be amortised for tax purposes (unless subject to an effective economic amortisation approved by the Portuguese tax authorities).

### *Interest on shareholder loans*

If the rate applicable to interest and other compensation regarding loans provided by the shareholders to the company is higher than the Euro Interbank Offered Rate (EURIBOR) 12-month rate rounded up with a spread of 1.5% (at the date the loan was granted), the amount paid in excess is not tax deductible. This rule does not apply when the shareholder is a resident of a tax treaty country or when the interest rate is at arm's length under the transfer pricing provisions.

According to the 2011 State Budget, in the case of small and medium-sized companies, shareholders' loans with an interest rate of EURIBOR 12 M plus a spread up to 6% is tax deductible.

### *Bad debts*
Impairment losses on doubtful debts are deductible for tax purposes when an insolvency or recovery has been requested or the credits have been claimed in court.

The annual amount of accumulated impairment losses on doubtful debts due for more than six months, with evidence that measures towards its perception were taken, is capped at the following percentages of the debts:

- More than 6 and less than 12 months: 25%
- More than 12 and less than 18 months: 50%
- More than 18 and less than 24 months: 75%
- More than 24 months: 100%

Amounts guaranteed by insurance or mortgage, or due or secured by the state, autonomous regions, or municipalities, or due by related parties (e.g. 10% shareholding) are not considered as doubtful debts, and the respective impairment loss is disallowed for tax purposes.

The ageing of bills of exchange is calculated from the date when the respective payment is due.

Uncollectable debts are allowed as tax deductible costs if supported under insolvency, recovery enforcement, or in an out-of-court conciliation procedure for the viability of insolvent companies or companies in difficult economic situation (mediated by the Institute for the Support of Small and Medium-Sized Enterprises or IAPMEI). This rule applies to the amount of the uncollectable debts which were not deducted for tax purposes as impairment losses (or for which the amount was insufficient).

### *Organisational and start-up expenses*
Start-up and research expenses are deductible for tax purposes in the respective tax year. Transitional adjustments of remaining start-up expenses incurred prior to the adoption of the new accounting system ('Sistema de Normalização Contabilística' or SNC) should be written off the balance sheet against equity and are deductible over a five-year period.

### *Charitable contributions*
Donations to authorised charitable institutions are allowable up to 0.8% of turnover, with the possibility of the cost being raised up to 150%. Donations to authorised cultural institutions are allowable up to 0.6% of turnover, with the possibility of the cost being raised up to 130%.

Donations to the state, municipalities, and foundations where the state or municipalities participate in the initial capital are fully deductible, with the possibility of the cost being raised up to 140%. Special application may be made by certain entities in order to be included under the referred regime.

Donations of computers, software equipment, training, and consultancy in the area of computers granted to the state, municipalities, foundations, museums as well as to authorised charitable and cultural institutions are allowable up to 0.8% of turnover, with the possibility of the cost being raised up to 140%.

### *Vacation accrual*

Vacation pay and vacations subsidies are tax deductible in the year in which the benefit accrues, regardless of the year in which payment is made.

### *Pension expenses*

Pension, invalidity, and health schemes are tax deductible up to a rate of 15% of annual staff expenses, provided they are available to all employees and the management and disposition of the benefits are outside the control of the taxpayer, such as under an insured scheme with vested benefits.

A specific regime applies for deduction of the additional (mandatory) contributions made to pension funds by insurance companies as a result of the adoption of the new accounting system (SNC). These contributions are not considered for purposes of computing the maximum annual amount accepted as a cost, but are considered as a cost in accordance with an annual instalment plan, during a term of five years that began in 2008.

### *Taxes*

All taxes other than corporate tax, state surtax, and municipal surtax constitute a normal business expense.

### *Other significant items*

The costs borne from the acquisition of social passes are regarded as tax-deductible costs to the extent the employer attributes them on a general basis.

Uninsured losses, including indemnities to third parties, are disallowed unless the risk could not be insured.



Non-documented expenses are not tax deductible and are subject to a 50% tax surcharge for fully taxable entities.

In the course of 2011, exceptional write-downs arising from the substitution of invoicing programs or equipments, replaced due to software certification requirements, are considered as impairment losses, without the need of obtaining an approval by the tax authorities.

In the course of 2011, expenses on the acquisition of certified invoicing programs and hardware will be accepted as a cost for tax purposes in the relevant fiscal year.

### *Net operating losses*

Tax losses can be carried forward for four years. Carryback of losses is not allowed. The tax losses carried forward are lost if one of the following situations occurs:

- Change in direct ownership of the company of at least 50% shareholding or voting rights.
- Change in the scope of the business as stated in the articles of association or, regardless of any formal change, if the nature of the activity carried out by the company is substantially modified.

In special cases of economical merits, the Ministry of Finance may authorise the use of tax losses upon a request filed by the taxpayer before those changes occur.

Companies intending to deduct tax losses for the third consecutive year are required to request a legal certification of accounts by a Statutory Auditor (if their accounts are not audited).

### *Payments to foreign affiliates*
A Portuguese corporation is allowed to deduct royalties, interest, and other costs paid to foreign affiliates, provided the amounts are at arm's length. Service fees paid are allowed if there is adequate proof that the service was effectively rendered, has economic substance, and qualifies as indispensable for the generation of taxable revenue, as well as if the amount is at arm's length.

## *Group taxation*

The taxation of group income can be obtained by presenting a special form to the tax authorities for companies with a head office and effective management in Portugal. Such group taxation may apply, provided one of the companies, directly or indirectly, holds 90% or more of the statutory capital of the others and more than 50% of the voting rights. Tax grouping generally enables the group companies to offset losses incurred by one company against profits of another company. Tax losses obtained prior to the beginning of the tax grouping can be carried forward only against the particular company's taxable income.

To be taxed under this regime, the group companies must meet the following conditions:

- Must be tax resident in Portugal.
- Must be subject to the normal regime of taxation at the highest corporate tax rate.
- Must maintain a minimum holding participation of 90%.
- All companies must be held by the parent company for more than one year (excluding newly incorporated companies).
- Cannot be dormant for more than one year.
- Cannot be dissolved or insolvent.
- Cannot have tax losses in the three years prior to the regime application, unless the companies have been held by the parent company for more than two years.
- Cannot have a tax period different from that of the parent company.

Additionally, the parent company:

- Should not be controlled by any other Portuguese-resident company that fulfils the requirements to be the parent company.
- Should not have renounced to the application of this regime in the three previous years.

When the regime comes to an end or when one company ceases to qualify for this regime, the tax losses obtained during the regime cannot be carried forward and deducted against future individual taxable income of the companies.

### *Transfer pricing*
The tax authorities are entitled to adjust taxable income if the taxpayer and another individual or entity, due to their special relationship, have established particular

conditions which diverge from the conditions normally agreed upon between independent entities and distort the results that would arise if those relations were at arm's length. For tax years starting on or after 1 January 2002, Portugal has implemented detailed transfer pricing legislation which broadly follows the Organisation for Economic Cooperation and Development (OECD) guidelines.

An Advance Pricing Agreement (APA) mechanism has been introduced for taxpayers and Portuguese Tax Authorities (PTA) to establish agreements on a taxpayers' future transfer pricing policy. This aims to guarantee compliance with the arm's-length principle (ALP). This regime applies to transactions carried out with related parties and between a PE and the respective head office.

The conclusion of an APA implies the payment of a charge calculated with reference to the taxpayers' turnover, capped at EUR 35,000. This charge is reduced by 50% in the case of a renewal or revision of an existing APA.

The assessment of an APA procedure takes 180 days for unilateral APAs, and 360 days for bilateral or multilateral APAs. This period is reduced to 100 business days for APAs concluded in connection with a relevant investment project in Portugal, as foreseen in the Tax Investment Code ('Código Fiscal do Investimento').

For the Portuguese Tax Authority PTA to confirm compliance of the transfer pricing method(s) with the terms and conditions set out in the APA, the taxpayer must prepare an annual report. The report must be made available to PTA before the last business day of May in the year following that in which the transactions took place (i.e. when the tax year corresponds to the calendar year). Failure to comply invalidates the APA.

### *Thin capitalisation*

Where loans from non-EU-resident related parties exceed twice the parties' capital in the borrowing Portuguese entity, the interest on the excess borrowing is not tax deductible. This rule may not apply if the company (as long as it is not resident in a blacklisted territory) proves under a safeguard clause, that takes into account the type of activity, the sector in which it operates, the dimensions, and other relevant criteria, that it would be possible to obtain the same loan on similar terms from an independent entity.



### *Controlled foreign company (CFC) regime*

Profits derived by an affiliate resident in a blacklisted offshore jurisdiction or in a jurisdiction where it is subject to an effective tax rate equal to or lower than 60% of the Portuguese standard CIT rate, are imputed to the Portuguese shareholder, provided it holds, directly or indirectly, a minimum holding participation of 25% (10% if more than 50% of the capital is held by Portuguese shareholders). Upon distribution of the profits, a deduction is available for previously imputed income.

## *Tax credits and incentives*

### *Foreign tax credit*

Taxes paid abroad can be offset against corresponding Portuguese tax capped at the lower of (i) the tax liability corresponding to the foreign income, net of costs directly or indirectly incurred, or (ii) the foreign tax paid. In both cases, it is limited to the foreign tax as foreseen in the applicable double-taxation treaty. No carryforward of foreign tax is allowed.

### *General tax benefits and incentives*
Following the Memorandum of Understanding between the Portuguese Republic and the European Commission, the European Central Bank, and the IMF, which covers the financial assistance to be granted to Portugal by the European Fund for Financial Stability, it is expected in general a curb of the existing tax benefits. Details of the measures are still expected.

### Contractual tax incentives
Relevant investment projects up to 2020 (minimum investment of EUR 5,000,000) that qualify for strategic economic interest and promote the creation of jobs are eligible for tax incentives, as foreseen in the Tax Benefits Code and the Investment Tax Code.

These are granted on a case-by-case basis under a government contract for a period not exceeding ten years and include a tax credit of 10% to 20% of the investment and exemptions or reductions from property transfer tax, property tax, and stamp duty.

### Investment funds
Portfolio investment funds are taxable at the following final rates:

| Portfolio investment fund activity | CIT Rate (%) |
|---|---|
| Capital gains (net of capital losses) on shares held less than 12 months, realised by closed or mixed investment funds | 20 |
| Capital gains (net of capital losses) on shares held greater than 12 months, realised by open investment funds | 0 |
| Other income: | |
| Earned in Portugal | 20/25 |
| Earned abroad | 20/25 |

Real estate investment funds are subject to corporate tax at the following rates:

| Real estate investment fund activity | CIT Rate (%) |
|---|---|
| Rents (net of expenses) | 20 |
| Real estate capital gains (net of capital losses) | 12.5 |
| Capital gains (net of capital losses) on shares held less than 12 months, realised by closed or mixed real estate investment funds | 20 |
| Capital gains (net of capital losses) on shares held greater than 12 months, realised by open real estate investment funds | 0 |
| Other income: | |
| Earned in Portugal | 20/25 |
| Earned abroad | 20/25 |

Income paid by portfolio and real estate investment funds to individuals is not subject to taxation. Income paid to companies is taxed as normal income, and taxes paid by the fund are considered as payment on account against the final CIT due.

### Funds of funds
Income paid by investment funds of funds is exempt from CIT. Other income is subject to the same taxation as investment funds. Income received by individuals is not subject to further taxation. Income received by companies is taxed at the standard CIT rate on 40% of the respective amount as normal income.

### Pension funds
Pension funds are exempt from CIT and real estate transfer tax.

### Contractors for NATO infrastructures
Contractors for NATO infrastructures are exempt from CIT.

### Net young employment creation
150% of the costs related to net increase job creation, under labour contracts without term, for employees up to 35 years (including) of age and for long-term unemployed individuals may be deducted from taxable income. For this purpose, the fixed remunerations paid and the contributions made by the employer to social security should be considered. The maximum amount of annual increase on deductible costs for each eligible employee is 14 times the national minimum retribution (EUR 485 in 2011).

As of 2011, the increase in 50% of the expenses incurred with the same employer is applicable to more than one employee provided that there are no special relations.

This tax benefit is not cumulative with any tax benefits or other incentives (e.g. social security) concerning the same employee.

This deduction applies for a period of five years for each employee.

### Inland region investment
Companies pursuing an economic activity of industrial or service rendering nature in inland regions have the following tax benefits:

- A reduced CIT rate of 15%.
- In case of establishment of new entities in the referred regions, the CIT rate is reduced to 10% during the first five years of activity.
- Tax losses can be carried forward for seven years.
- Depreciation and amortization concerning investment expenses up to EUR 500,000 (excluding land acquisition and passenger cars), can be deducted, with an increase of 30%.
- Social security costs, concerning net employment creation, can have an increase of 50%.



### Research and development (R&D) (Sistema de Incentivos Fiscais em Investigação e Desenvolvimento Empresarial or SIFIDE)
Portuguese tax resident companies carrying out commercial, industrial, or agricultural activities, and non-resident companies with a PE in the Portuguese territory, are allowed to deduct from the CIT due, up to the respective amount, the value of eligible expenses incurred with R&D, in a double percentage as follows:

- Base rate: 32.5% of the R&D expenses incurred; this rate is increased by 10% in case of small and medium-sized companies that do not benefit from the incremental rate of 50% (applicable to entities that had completed two years of activity).
- Incremental rate: 50% of the difference between the R&D expenses made in the tax year and the average amount of the R&D expenses made in the previous two years, up to the limit of EUR 1,500,000.
- The incremental rate is increased to 70% and the deduction limit is increased to EUR 1,800,000 with respect to expenses incurred with the employment of people with a doctorate degree.

The expenses that, due to insufficient tax due, cannot be deducted in the tax year they were incurred can be carried forward for six years.

### Tax regime aimed at fostering investment (Regime Fiscal de Apoio Ao Investimento or RFAI)

The tax regime aimed at fostering investment, which establishes several tax incentives to investment realized within specific business sectors, will remain in force during 2011.

Among other incentives, companies will still benefit from a deduction against CIT otherwise payable (capped at 25% of the CIT due) of 20% (for qualified investments lower than EUR 5 million) or 10% (for qualified investments higher than EUR 5 million) of the qualified investment; from being able to carry forward any unused credit for four years; and from an exemption from property transfer tax, property tax (IMI), and stamp duty on the acquisition of real estate for investment purposes. The property transfer tax exemptions are subject to the approval of the municipality where the real estate is located and where the investment is made.

### Dividends from entities resident in the Portuguese Speaking African countries (Países Africanos de Língua Oficial Portuguesa or PALOP) and in East Timor

The payment of dividends from entities resident in Portuguese Speaking African countries (Angola, Cape Verde, Guinea-Bissau, Mozambique, and São Tomé e Príncipe) and in East Timor, are not subject to CIT at the level of the Portuguese parent provided that:

- The entity in Portugal is subject and not exempt to CIT.
- The entities in the PALOP and in East-Timor are subject to and not exempt from a corporate tax.
- The entity in Portugal holds a direct participation in the share capital of the subsidiary of not less than 25% for at least two years.
- Dividends distributed have been taxed at a rate of at least 10% and do not arise from a determined type of income expressly mentioned in the law.

### Loan interest and lease rentals on imported equipment

When paid by the State, regional authorities, and public services, loan interest and lease rentals on imported equipment can qualify for partial or full exemption from tax upon an appropriate application.

### Real Estate Investment Fund for Residential Lease (REIFRL)

A regime is applicable: (i) both to REIFRL and to Real Estate Investment Companies for Residential Lease (REICRL) incorporated in accordance with the Portuguese law within a term of five years following the entering into force of the State Budget for 2009; and (ii) to the real estate properties acquired by those entities during that same term, i.e. from 1 January 2009 until 31 December 2014.

The incorporation of the REIFRL will be done in accordance with the provisions applicable to the REIFs (Real Estate Investment Funds) laid down in the Portuguese law. The REIFRL portfolio is required to be comprised of at least 75% real estate properties located in Portugal destined for the lease of permanent residences.

The following benefits are established for this tax regime:

- CIT exemption on income obtained by REIFRLs.

- CIT exemption for the income obtained by participation unit holders, except for the capital gains arising from the sale of such participation units.
- Local property tax exemption established for the real estate properties destined for the lease of permanent residences that integrate the REIFRL.
- Municipal property transfer tax exemption on real estate property acquisition made within this regime by the REIFRL, as well as the acquisitions arising from the option for the acquisition by the lessees, until 2020, of the real estate properties that integrate the assets of the REIFRL.
- Stamp duty exemption is established for the acts arising from the transfer of the real estate properties by means of the conversion of holdings rights in real estate properties into a lease right with the option of acquisition in respect of the same real estate property by the lessee.

The above-referred tax regime and respective exemptions will not be applicable to entities resident in a country or jurisdiction with a more favourable taxable regime included in the Decree-Ruling published by the Ministry of Finance.

### Incentives to urban rehabilitation

Incentives are applicable to real estate property covered by rehabilitation projects undertaken between 1 January 2008 and 2020.

Real estate investment funds incorporated between 2008 and 31 December 2012 may benefit from:

- CIT: the income obtained by real estate investment funds is tax exempt when the funds are incorporated in accordance with the Portuguese law, and respective assets are comprised of at least 75% real estate subject to rehabilitation projects in qualifying areas.
- Property transfer tax: urban property (buildings or autonomous units) destined for permanent residence and located in a rehabilitation area may benefit from an IMT exemption on the first transfer of such urban property upon undertaking of rehabilitation works. The granting of this exemption depends on a decision in this respect of the municipality of the area of the real estate property.
- Property tax: the IMI exemption granted in respect of urban properties subject to rehabilitation works is extended from eight to ten years (it is granted for a five years term and renewable for an additional five-year period). Again, the granting of this exemption depends on a decision in this respect of the municipality of the area of the real estate property.



## *Tax benefits and incentives for non-resident corporate entities*

### Capital gains

Capital gains on the sale of shares and quotas held in a Portuguese company by a non-resident company may be tax exempt. However, there are some important exceptions, such as:

- Where the non-resident shareholder is owned more than 25%, directly or indirectly, by a Portuguese resident company.
- Where the non-resident shareholder is located in a country that is included in a blacklist from the Ministry of Finance.
- Where the assets of the company sold consist mainly of immovable property.

### Government and corporate bonds

Interest and capital gains on government and corporate bonds are tax exempt (where held by entities not located in blacklisted offshore jurisdictions) under certain conditions.

### Interest paid by resident credit institutions

Interest paid by resident credit institutions to non-resident financial companies deriving from loans as well as gains arising from swap transactions are tax exempt.

### Interest obtained by resident credit institutions

Interest obtained by non-resident credit institutions derived from term deposits held on resident entities authorised to receive such deposits are tax exempt.

### *Madeira and Azores international business centre*

Qualifying industrial, shipping, international services (e.g. holding and trusts) and financial entities licensed in Madeira or in the Santa Maria Island (Azores) international business centres before 31 December 2000 are eligible for a CIT exemption until 31 December 2011.

The European Commission extended the existing regime and approved a new regime for entities licensed to operate in the Madeira International Business Centre (MIBC) in the period 2007-2013, which is applicable until 31 December 2020.

The 2007 MIBC special tax regime applies to companies licensed until 31 December 2013 and provides, besides full exemptions from taxation to non-resident shareholders and service providers, for the following reduced CIT rates for these entities, on their qualifying foreign source income, based on thresholds of income and subject to job creation requirements:

- 4% between 2011 and 2012.
- 5% from 2013 to 2020.

Azores and Madeira international business centre based companies generally benefit from Portugal's network of double taxation agreements (DTA). EU laws and regulations apply to Azores and Madeira.

Companies licensed under the previous regime will have the same benefits, but will not be tax exempt on their qualifying foreign source income, being subject to the reduced rates mentioned above (and subject to the same requirements).

## *Withholding taxes*

### *General withholding tax rates*

| Recipient | Residents (%) (1) | Non-residents (%) (1) |
|---|---|---|
| Dividends | 21.5 (2) | 21.5 (3) |
| Interest | 21.5 | 21.5 |
| Royalties | 16.5 | 15 |
| Interest & royalties EU Directive | N/A | 5 (4) |
| Banks deposits | 21.5 | 21.5 |
| Property income | 16.5 | 15 (1) |
| Service charges | 0 | 15 (5) |

| Recipient | Residents (%) (1) | Non-residents (%) (1) |
|---|---|---|
| Other | 16.5 | 20 |

Notes

1. For residents, tax withheld constitutes a payment on account of final corporate or individual income tax due. For non-residents, tax withheld is the final tax unless in case of property income, in which case it is a payment on account.
2. Not subject to WHT in the case of holdings of at least 10%.
3. Not subject to WHT if the EU Parent /Subsidiary Directive 90/435/EC applies.
4. From 1 July 2009 until 30 June 2013, the applicable rate will be reduced to 5% and will be 0% from 1 July 2013 onwards.
5. Not subject to WHT if a tax treaty is applicable.

### *Tax treaty rates*

Tax treaties reduce the above-mentioned rates as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Algeria (3) | 10/15 | 15 | 10 |
| Austria (1, 2) | 15 | 10 | 10/15 |
| Belgium (2) | 15 | 15 | 10 |
| Brazil (3) | 10/15 | 15 | 15 |
| Bulgaria (3) | 10/15 | 10 | 10 |
| Canada (3) | 10/15 | 10 | 10 |
| Cape Verde | 10 | 10 | 10 |
| Chile (3, 9, 10) | 10/15 | 5/10/15 | 5/10 |
| China, P.R. | 10 | 10 | 10 |
| Colombia (12) | - | - | - |
| Cuba (3) | 5/10 | 10 | 5 |
| Czech Republic (3) | 10/15 | 10 | 10 |
| Denmark (2) | 10 | 10 | 10 |
| Estonia | 10 | 10 | 10 |
| Finland (2, 3) | 10/15 | 15 | 10 |
| France (2, 4, 5) | 15 | 10/12 | 5 |
| Germany (2, 6) | 15 | 10/15 | 10 |
| Greece (2) | 15 | 15 | 10 |
| Guinea Bissau (12) | - | - | - |
| Hong Kong (13) | 5/10 | 10 | 5 |
| Hungary (3) | 10/15 | 10 | 10 |
| Iceland (3) | 10/15 | 10 | 10 |
| India (3) | 10/15 | 10 | 10 |
| Indonesia | 10 | 10 | 10 |
| Ireland, Rep. of (2) | 15 | 15 | 10 |
| Israel (11) | 5/10/15 | 10 | 10 |
| Italy (2) | 15 | 15 | 12 |
| Korea, Rep. of (3) | 10/15 | 15 | 10 |
| Kuwait (12) | - | - | - |
| Latvia | 10 | 10 | 10 |
| Lithuania | 10 | 10 | 10 |
| Luxembourg (2, 6) | 15 | 10/15 | 10 |
| Macau | 10 | 10 | 10 |

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| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Malta (3) | 10/15 | 10 | 10 |
| Mexico | 10 | 10 | 10 |
| Moldova | 5/10 | 10 | 8 |
| Mozambique | 10 | 10 | 10 |
| Morocco (3) | 10/15 | 12 | 10 |
| Netherlands (2) | 10 | 10 | 10 |
| Norway (3) | 10/15 | 15 | 10 |
| Pakistan | 10/15 | 10 | 10 |
| Panama (12) | - | - | - |
| Poland (3) | 10/15 | 10 | 10 |
| Romania (3) | 10/15 | 10 | 10 |
| Russia (3) | 10/15 | 10 | 10 |
| Singapore | 10 | 10 | 10 |
| Slovakia (3) | 10/15 | 10 | 10 |
| Slovenia (3) | 5/15 | 10 | 5 |
| South Africa (3) | 10/15 | 10 | 10 |
| Spain (2, 3) | 10/15 | 15 | 5 |
| Sweden | 10 | 10 | 10 |
| Switzerland (3) | 10/15 | 10 | 5 |
| Tunisia | 15 | 15 | 10 |
| Turkey (3, 8) | 5/15 | 10/15 | 10 |
| Ukraine (3) | 10/15 | 10 | 10 |
| United Kingdom (2, 3) | 10/15 | 10 | 5 |
| United States (3) | 5/15 | 10 | 10 |
| Venezuela (7) | 10 | 10 | 10/12 |

Notes

1. The lower of the listed rates applies to royalties when the beneficiary holds 50% or less of the paying company's share capital.
2. There is no WHT on dividends if the EU Parent/Subsidiary Directive applies.
3. The lower of the listed rates applies to dividends when the beneficiary directly holds 25% or more of share capital. Depending on each DTT, a two year holding period may be required.
4. The lower of the listed rates applies to interest on debentures raised in France after 1 January 1965 or on significant loans or debentures raised in Portugal or abroad under major development projects listed in the treaty annex.
5. The lower of the listed rates applies to bank loans, but if interest is payable from Portugal, the bank loans must qualify as being of economic or social interest or fall under an approved development plan.
6. The lower of the listed rates applies to interest received by financial institutions.
7. The lower of the listed rates applies to technical assistance.
8. The lower of the listed rates applies on interest related to loans with a minimum maturity of two years.
9. The rate of 5% regarding interest applies to bonds interest or other securities transacted in the stock market. The rate of 10% applies to loans from banks or insurance companies or credit selling of equipment.
10. The rate of 5% regarding royalties applies to equipment lease.
11. The rate of 10% applies if the company which is paying the dividends is a resident of Israel and the dividends derive from profits which are subject to tax in Israel at a rate which is lower than the normal rate of Israel company tax. The rate of 5% applies if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends.
12. Treaty signed, not yet in force; wording of the treaty not yet known.
13. The rate of 5% on dividends applies if the beneficial owner is a company (other than a partnership) which holds directly at least 10 % of the capital of the company paying the dividends.

## Tax administration

### Returns

The tax year is, as a general rule, the calendar year, and the annual corporate tax return must be submitted by electronic data transmission by the last day of May of the year following the year of income.

A different tax year is allowed in the case of companies obliged to the accounting consolidation and of PEs of non-resident entities, which can adopt the tax period of the non-resident company. If this option is taken, the new tax period must be maintained for a minimum of five years.

Other entities may apply for a different tax period based on economic grounds. In these situations (i.e. whenever the tax year ends on a date other than 31 December), the annual corporate tax return shall be submitted by electronic data transmission by the last day of the fifth month following the year end.

The system is one of self-assessment.

### Payment of tax

Tax is paid in instalments. Three payments on account due on 15 July, 15 September, and 15 December of the year in which taxable income arises correspond to 90% of the previous year's corporate tax assessment (for taxpayers with a turnover above EUR 498,797; 70% if below this amount). A last instalment is paid (or received) through self-assessment upon filing the annual tax return in May of the following year.

If the tax year ends on a date other than 31 December, interim payments take place in the seventh, ninth, and twelfth months of the tax year. Filing of the annual tax return together with the final payment is in the fifth month following the close of the tax year.

Given the introduction within PEC (in 2010) of a state surtax of 2.5% on the excess of taxable income above EUR 2,000,000, three additional payments on account are due on the same dates as the interim payments. The additional payments on account correspond to 2% of taxable income above EUR 2,000,000, assessed in the previous year.

Payments on account are not required if the previous year's corporate tax assessment is less than EUR 199.52 and may be suspended upon declaring that no further tax is due in respect of the current year. However, interest is assessed at a rate of 4% if this results in postponing more than 20% of the tax that would otherwise have been paid.

In particular situations, a special payment on account is due of a minimum of EUR 1,000 up to EUR 70,000, paid in March, or in March and October (the third or the third and tenth month of the tax year if it ends on a date other than 31 December).

### Statute of limitations

The statute of limitation period is four years, but this period can be extended in case of tax losses.

### Anti-avoidance

A general anti-avoidance provision is in force, pursuant to which contracts and other acts are ineffective whenever it is demonstrated that they were tax driven to reduce taxation that would be due under contracts bearing a similar economic effect, in which case taxation would be based on the latter.

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# Puerto Rico

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## Significant developments

### Act 1 of 31 January 2011 (Act 1) - Internal Revenue Code for a New Puerto Rico

As part of the anticipated tax reform of the Puerto Rico government, Act 1 of 31 January 2011, known as the Internal Revenue Code for a New Puerto Rico (Act 1 or the New Tax Code), represents the second phase of what has been described by the Executive Branch of the Puerto Rico government as one of the most comprehensive pieces of Puerto Rico tax legislation since the Puerto Rico Internal Revenue Code of 1994, as amended (the 1994 Code). Act 1 is effective on 1 January 2011, for taxable years beginning after 31 December 2010 (unless otherwise provided).

The normal tax introduced by Act 1 is 20%, applicable only to corporations and certain partnerships and limited liability companies (LLCs) treated for income tax purposes as corporations (corporate taxpayers). Act 1 has also eliminated or adjusted some corporate tax deductions. In addition, corporate taxpayers are now subject to simplified and lower tax rates. For example, the surtax credit of 25,000 US dollars (USD) established by the 1994 Code was changed by Act 1 for a deduction of USD 750,000, the 5% recapture or recovery of tax for differences in tax rates has been eliminated, resulting in an effective tax rate of nearly 30%.

Notwithstanding the above-mentioned changes introduced by Act 1, corporate taxpayers may elect to be taxed based on the provisions of the 1994 Code. The election should be made with the return for the taxable year 2011 and will be final and irrevocable for said year as well as the next four taxable years (i.e. five years in total).

Act 1 changes the definition of what constitutes a brother-sister relationship in a controlled group of entities and also further expands and standardises the definition of related parties and related group of entities through the interplay of three definitions (i.e. controlled group, related group of entities, and related parties). Act 1 also provides for changes in the reorganisations area, a broader definition of a Type D tax-free reorganisation, and new guidelines similar to those in Section 382 are introduced, among others.

Different than in the 1994 Code, partnerships no longer are subject to tax at the entity level, unless they elect to be treated as a corporate taxpayer, an election that is available only for partnerships in existence as of 1 January 2011. Instead, the partners are now subject to tax on their distributive share of the partnership's income. In the case of LLCs, these continue to be taxed as corporate taxpayers unless they elect to be treated as partnerships (i.e. pass-through entities). Said election is automatically made (i.e. pass-through treatment in Puerto Rico) to the extent the LLC is treated as a pass-through entity in the United States or other foreign jurisdiction. Partners and members of a partnership and LLC, respectively, will be deemed to be engaged in a

Puerto Rico trade or business as it relates to their distributive share of income or loss on the partnership and LLC in Puerto Rico. Accordingly, their distributive share of income will be subject to estimated payment requirements.

### *Regulations 7970 of 29 December 2010 (Regulations)*

Regulations 7970 were issued on 29 December 2010, expanding various areas covered under Act 154 *(see below),* such as the definition of tangible property that has been manufactured in Puerto Rico, the definition of value of personal property and services, the definition of acquisition, the application of the 10% tests, the application of the anti-abuse rule, and transfer pricing adjustments, among others. Also, the Regulations to Act 154 brought new tax credits against the 4% excise tax.

The tax credits available to offset the excise tax liability are the following:

- General credit.
- Alternative credit based on gross receipts.
- Alternative credit when taxable acquisitions exceed certain thresholds.
- Additional credit for incremental increase in employees.
- Credit for controlled groups with facilities in multiple municipalities.
- Credit for economically disadvantaged or critical industrial suppliers.
- Knowledge corridor and research and development investment credit.

If the credits totally offset the 4% tax, the offshore entity needs to calculate the tax based on the sourcing rules as provided by Act 154.

### *Act 171 of 15 November 2010 (Act 171)*

Act 171 represents phase one of the anticipated tax reform of the Puerto Rico government. This Act is effective for tax years beginning after 31 December 2009, unless otherwise provided. Significant developments this Act brought include the increase in the net operating loss (NOL) carryforward period, some sales and use tax (SUT) amendments, and special rules for the determination of the useful life when using the straight-line depreciation method for property used in a trade or business, among others.



In addition, for taxable year 2010, Act 171 provides a tax credit (dollar for dollar) for corporations, partnerships, and individuals. For corporations and partnerships the credit is 7% of the tax due, provided the entities have complied with the Christmas Bonus requirements, including applicable payments to their employees. This credit is against the regular tax, surtax, and recapture amounts but is not allowed against the alternative minimum tax. Furthermore, this credit is neither refundable nor carried forward.

### *Act 154 of 25 October 2010 (Act 154) - Offshore Income*

Companies with manufacturing operations in Puerto Rico may be subject to an excise tax on goods or services provided to offshore-related entities under a new provision signed into law 25 October 2010. Without much fanfare, nor public hearing, lawmakers met over a rare weekend session to formulate the basis of Act 154, which modifies the 1994 Code by:

- adopting a new source-of-income rule (source rule) and
- imposing a temporary (i.e. six-year) excise tax, scaled down from 4% to 1% over its lifespan, on purchases by offshore companies from related Puerto Rico sellers whose gross receipts exceed USD 75 million for any of the three preceding tax years. The

excise tax is imposed in lieu of the Puerto Rico income tax that otherwise would arise from application of the new source rule.

Enacted primarily to finance a tax reform initiative, which is intended to stimulate the struggling Puerto Rico economy, the new excise tax took effect 1 January 2011, and will affect many multinational corporations currently doing business in Puerto Rico. The effect of the new source rule will be to treat income from the resale of purchases from Puerto Rico affiliates by a foreign corporation or partnership (or non-resident alien), in part, as Puerto Rico-source income effectively connected with the conduct of a Puerto Rico trade or business. To the extent a related Puerto Rico subsidiary has gross receipts in excess of USD 75 million, the foreign corporation is subject to the new excise tax in lieu of income tax otherwise due under the new source rule, and the Puerto Rico entity will pay the tax on the parent's behalf.

Entities currently operating in Puerto Rico that enjoy a tax exemption should not see their tax benefits affected, given that the new excise tax and sourcing rules apply only to related foreign corporations. However, at the consolidated level, this tax could represent a significant increase in effective tax rate for the Puerto Rico jurisdiction if (i) it is ultimately concluded that this excise tax is not creditable at the United States or foreign country level or (ii) the foreign corporation, due to its tax circumstances, cannot be benefited with a foreign tax credit in the United States or elsewhere.

Act 154 does not address the effect and treatment of transfer pricing adjustments introduced at year-end as they relate to the imposition of the excise tax. Act 154 also does not specifically address the compliance requirements applicable to foreign corporations deemed to be engaged in a trade or business in Puerto Rico by virtue of the amended provisions related to sources of income. Furthermore, the effect that Act 154 might have on other Puerto Rico filing requirements is yet to be determined.

Because there were no hearings or opportunity for debate with respect to the Act, there are many unanswered questions and issues associated with the new rules.

## *Taxes on corporate income*

A domestic corporation is taxable in Puerto Rico on its worldwide income. A foreign corporation engaged in trade or business in Puerto Rico is taxed at the regular corporate tax rates on income from Puerto Rico sources that is effectively connected income and at a 29% WHT rate on its Puerto Rico-source gross income not effectively connected with that business.

The current corporate income tax (CIT) rate is comprised of a 20% normal tax and a graduated surtax (computed on the 'surtax net income') up to a maximum combined and effective tax rate of 39%. The 'surtax net income' is basically the net taxable income subject to regular tax less a surtax credit in the amount of USD 25,000.

| Net income subject to surtax (USD) | Surtax (USD) |
|---|---|
| Not over 75,000 | 5% |
| Over 75,000 but not over 125,000 | 3,750 plus 15% of the excess over 75,000 |
| Over 125,000 but not over 175,000 | 11,250 plus 16% of the excess over 125,000 |
| Over 175,000 but not over 225,000 | 19,250 plus 17% of the excess over 175,000 |
| Over 225,000 but not over 275,000 | 27,750 plus 18% of the excess over 225,000 |

| Net income subject to surtax (USD) | Surtax (USD) |
|---|---|
| Over 275,000 | 36,750 plus 19% of the excess over 275,000 |

If the net income subject to regular tax exceeds USD 500,000, a 5% tax will be imposed over the excess. Nevertheless, the total tax determined shall not exceed 39%.

Act 1 was enacted into law on 31 January 2011 and is effective for tax years beginning after 1 January 2011. This Act simplified the surtax rates, as follows: (i) 5% for income up to USD 1,750,000 and (ii) USD 87,500 plus 10% of income in excess of USD 1,750,000 for a maximum nominal tax rate of nearly 30%. This latter 10% surtax might only be applicable up to 2013, leaving the maximum nominal tax rate at nearly 25% from 2014 thereafter, provided certain fiscal and economical conditions are met. The determination of the applicable surtax rate is now made on a consolidated basis for controlled groups and related companies, whereas the net taxable income of all the entities subject to tax in Puerto Rico within said groups has to be combined for the determination of the 5% or 10% applicable surtax rate. The surtax credit of USD 25,000 established by the 1994 Code has been changed by Act 1 for a deduction of USD 750,000.

The 5% recapture or recovery of tax for income in excess of USD 500,000 has been eliminated by Act 1.

### *Temporary provision – 5% surtax over the tax liability*
A 5% additional tax will be imposed on the income tax liability determined (not on the taxable income) for corporations, partnerships, and trusts whose gross income exceeds USD 100,000. This provision is effective for taxable years commenced after 31 December 2008 and before 1 January 2012. This 5% surtax, which is not creditable against the tax liability of future years, is treated as a separate tax. The special surtax also applies to the tax on capital gains. For those corporate taxpayers in the maximum tax bracket, this special surtax will increase effective tax rate from 39% to 40.95%.

The 5% above-mentioned temporary special surtax applicable up to 2012 has been eliminated by Act 1 for tax years beginning after 1 January 2011.



### *Alternative minimum tax (AMT)*
In regards to AMT, the tax rate has been reduced by Act 1 from 22% to 20%. In addition, for certain companies purchasing personal property from related parties, the tentative AMT will now be the greatest of the above-mentioned 20% or 1% of said purchases of personal property. For AMT purposes, expenses paid or incurred for services performed by a related party outside Puerto Rico are considered a permanent adjustment in the determination of the alternative minimum net income (i.e. non-deductible for AMT purposes).

### *Tax on improper accumulation of income*
A surtax of 50% is imposed on corporations that improperly accumulate earnings to prevent the imposition of tax on shareholders or partners, rather than paying the earnings out as dividends. The tax is not imposed on accumulated earnings and profits but is imposed on the net income for the year computed without taking capital loss carryover or NOL carryover deductions, and reduced by the following items: Puerto Rico income taxes paid or accrued, disallowed net capital losses, and charitable contributions in excess of the deductible amount. The net income does not include industrial income exempted from income taxes under Industrial Incentives Acts. However, an exempt business can be subject to the penalty tax on non-exempt income.

# Puerto Rico

## *Corporate residence*

A corporation organised or created under the laws of Puerto Rico is a domestic corporation. A domestic corporation is a resident corporation even if it does not conduct business operations in Puerto Rico. A corporation created elsewhere is considered a foreign corporation.

### *Permanent establishment (PE)*

The Puerto Rico tax codes do not provide specific guidance on PE. Facts and circumstances need to be analysed in order to determine if a corporation has created a PE in Puerto Rico or not. However, having an office or fixed place of business in Puerto Rico may deem the corporation to be engaged in a trade or business in Puerto Rico (i.e. having a PE).

### *New source rules pursuant to Act 154*

Act 154 introduced new source rules, which are segregated into two parts. The first part treats a non-Puerto Rico resident manufacturing entity as having an office or fixed place of business in Puerto Rico merely as a result of engaging in transactions above a certain threshold with a related Puerto Rico entity. The second part treats a portion of the income earned by a non-Puerto Rico resident entity as Puerto Rico-source income.

The new source rule applies where a non-Puerto Rico resident purchases goods and services from a related company that manufactures personal property or performs services in Puerto Rico that account for 10% or more of the total gross receipts of the seller from sales of such property or services in Puerto Rico, or at least 10% of the purchase cost of personal property and services acquired by the purchaser, for the taxable year or any of the three prior taxable years.

Where the new source rule applies, a portion of the income of the non-Puerto Rico resident purchaser from the sale outside of Puerto Rico of personal property manufactured or produced in whole or part in Puerto Rico by the related Puerto Rico seller will be treated as Puerto Rico-source income that is effectively connected with the conduct of a Puerto Rico trade or business. The portion of the non-Puerto Rico resident's income that is treated as Puerto Rico source is determined under an equally weighted, four-factor (i.e. purchases, sales, property, and payroll) formulary apportionment method. Where the purchaser fails to provide adequate documentation regarding the formulary apportionment factors, 50% of the income of the non-Puerto Rico resident purchaser from the sale outside of Puerto Rico of personal property manufactured or produced in whole or part in Puerto Rico by the related Puerto Rico seller will be treated as sourced where the property is manufactured or produced (i.e. Puerto Rico). The source rule also will apply to agency and commissionaire arrangements, in addition to buy-sell transactions involving related parties. In addition, the source rule contains an anti-abuse provision that disregards a transaction, for purposes of the source rule, where one of the principal purposes of the transaction is avoidance of the source rule.

The source rule is effective for income accruing after 31 December 2010 and is intended to be a permanent change to Puerto Rico law.

## Other taxes

### Sales and use tax (SUT)

SUT was introduced in Puerto Rico on November 2006, eliminating, for the most part, the general excise tax regime. As a general rule, the SUT shall be applied, collected, and paid on all transactions of taxable items in Puerto Rico. Taxable items consist of tangible personal property, taxable services, admissions, and what is known as bundled transactions. Excluded from this definition are professional associations and certain membership fees; stamps issued by professional associations, the Commonwealth of Puerto Rico, or the federal government; human blood, tissue, and organs; maintenance fees paid to resident associations; air and maritime tickets; real property; and bingos, raffles, and lottery. Other transactions that are exempt from SUT include export transactions; duty-free stores located at airport or maritime ports; prescription medicines; insulin; taxable items acquired for certain manufacturing operations (e.g. raw materials); and food and ingredients for food (except for prepared food, diet supplements, sweets, and carbonated beverages).

SUT is imposed at the state level at a 5.5% and an additional 1.5% at the municipal level, for an aggregate tax of 7%. The 7% tax should be remitted to the Puerto Rico government as follows: 6% to the Puerto Rico Treasury Department (PRTD) and the remaining 1% to the corresponding municipality. However, there are some municipalities that have entered into an administration agreement with the PRTD by which the PRTD will collect the entire 7% of the sales and use tax from merchants and remit the 1% to the municipality (collected on the municipality's behalf).

Every natural or juridical person who does or wishes to do business of any kind in Puerto Rico shall request registration in the Merchant's Registry of the PRTD at least 30 days before starting operations. Once the registration application is filled out and approved, the Secretary of Treasury will grant a Merchant's Registration Certificate. This certificate constitutes the merchant's authorisation to do business in Puerto Rico, and confirms the merchant's obligation as a withholding agent. The Merchant's Registration Certificate shall be displayed, at all times, in a visible place for the general public in the commercial establishment for which it was issued. Please note that if a merchant is doing business in one or more of the 78 municipalities in Puerto Rico, the merchant only needs to register with the PRTD.



Unless specifically exempted, all persons selling taxable items are required to file a monthly tax return. This return shall be delivered to the PRTD no later that the tenth day of the calendar month following the month during which the sales occurred. If the merchant wishes to claim any exemption corresponding to taxable items, the merchant needs to file the monthly return and claim the exemption in it.

Prior to the approval of Act 171, merchants whose SUT deposits exceeded USD 30,000 were required to file the monthly SUT return and remit the payment electronically. This Act reduces this threshold to USD 12,000 for transactions that occur after 31 December 2010. In addition, the 1994 Code provides that merchants with volume of business of USD 500,000 or more should remit the SUT withheld electronically. This Act amends this section to decrease the threshold to USD 200,000 for transactions that occur after 31 December 2010.

Act 1 provides for a credit for purchases of products manufactured in Puerto Rico for purposes of SUT. In general, the credit will be 10% of the excess of the purchases of eligible products over the average of the purchases of eligible products for three out of 10 prior taxable years. This credit could be carried forward until exhausted. Is important to note that the credit used will be considered taxable income for income tax purposes of the year the credit is taken.

### *Excise taxes*

Although the SUT replaced the excise tax system, there are certain articles that continue to be subject to a special excise tax, such as cigarettes, fuels, crude oils, vehicles, alcoholic beverages, cement, sugar, plastic products, among others.

#### New source rules pursuant to Act 154

Companies with manufacturing operations in Puerto Rico may be subject to an excise tax on goods or services provided to offshore-related entities under Act 154 of 2010. This Act created a new excise tax that works in tandem with the new source rules provided by this Act as well. Where the excise tax applies, it is in lieu of the tax that otherwise would arise from the application of the new source rule. Under the new excise tax rule, offshore purchasers that acquire goods from Puerto Rico sellers with gross receipts in excess of USD 75 million for any of the three preceding taxable years and that otherwise meet the source-of-income rule thresholds (set forth above) are subject to a new excise tax equal to the 'applicable percentage of the value' of such personal property or services, which is essentially a scaled-back percentage. The excise tax rate phases out over a six-year period as follows:

- 4.00% between 1 January 2011 and 31 December 2011.
- 3.75% between 1 January 2012 and 31 December 2012.
- 2.75% between 1 January 2013 and 31 December 2013.
- 2.50% between 1 January 2014 and 31 December 2014.
- 2.25% between 1 January 2015 and 31 December 2015.
- 1.00% between 1 January 2016 and 31 December 2016.

Regulations 7970, issued in December 2010, provide the following tax credits to offset the excise tax mentioned above:

1. General credit: up to USD 4 million for 2011 and a reduced amount going forward on the same proportion that the excise rate is reduced.
2. Alternative credit based on gross receipts: in lieu of the above-mentioned credit, and provided the gross receipts per average monthly number of employees in Puerto Rico is less than USD 550,000, a credit of up to USD 7 million for 2011 and a reduced amount going forward on the same proportion that the excise rate is reduced.
3. Alternative credit when taxable acquisitions exceed certain thresholds: in lieu of the above-mentioned credits, if taxable acquisitions equals or exceed USD 4 billion, average monthly employees engaged in manufacturing or production in Puerto Rico is at least 400, and payroll equals or exceeds USD 20 million, then the credit for 2011 could be between USD 20 million and USD 80 million.
4. Additional credit for incremental increase in employees: for taxpayers meeting the requirements established in credit 3 above, an additional credit of USD 187,500 for each additional 25 employees over the employee baseline, up to a maximum of USD 3,750 million, will be available. A reduced credit will be available for years after 2011 on the same proportion that the excise rate is reduced.
5. Credit for controlled groups with facilities in multiple municipalities: in addition to credits 1 and 2 above but in lieu of credits 3 and 4 above, in the case of a controlled group that has one or more members that are engaged in manufacturing and production or manufacturing services in facilities located in three or more different municipalities in Puerto Rico as of 24 October 2010, a credit of USD 5 million per each municipality shall be allowed for each facility that has a monthly average of more than 30 employees, up to a maximum credit of USD 20 million. A reduced

credit will be available for years after 2011 on the same proportion that the excise rate is reduced.

6. Credit for economically disadvantaged or critical industrial suppliers: additional credit of 100% or 150% of increase in purchases from economically disadvantaged or critical industrial suppliers over the average purchases for the last two years.
7. Knowledge corridor and research and development (R&D) investment credit: additional credit of 100% of direct contributions to the Puerto Rico Science, Technology, and Research Trust or Special Economic Development Fund and of the excess R&D invested in Puerto Rico over the average investment for the two last years, subject to certain limitations.

The excise tax is collected by the Puerto Rico seller on receipts from the sale of personal property or services rendered to a related offshore purchaser. The tax has to be deposited with the Secretary of the Treasury on or before the 15th day of the month following the sale. Each person required to collect the excise tax must file a quarterly excise tax return on 30 April, 31 July, 31 October, and 1 January and pay any remaining tax liability not deposited on a monthly basis, as outlined above.

Act 154 sets forth the process for which a credit may be claimed for (i) taxes paid to any of the states of the United States on the acquisition of personal property and services and (ii) taxes paid to Puerto Rico by another member of the taxpayer's controlled group on a series of purchases.

### *Personal property taxes*

Every corporation engaged in a trade or business in Puerto Rico which on 1 January of each year owns personal property used in its trade or business within Puerto Rico, whether it is leased to another entity, is subject to tax on such property. The tax is self-assessed by the corporation and it is paid together with the filing of an annual return. The tax ranges between 5.08% and 8.23%, depending on the municipality. A 5% statutory discount is available if payment is made in full on the return due date (15 May of each year).

In general, all personal property not specifically exempted, including cash, finished goods inventory, supplies, and depreciable property, is subject to the tax. The personal property tax is generally based on the book value of the asset as of 1 January. Finished goods inventory, however, is assessed on the average of the monthly balances for the 12-month period preceding 1 January of each year.

The valuation of the personal property subject to tax is determined by multiplying the book value of such property by the applicable tax rate determined by the municipality in which the property is located. If the book value of depreciable property is below its estimated residual value, the property should be assessed at its estimated residual value.

### *Real property taxes*

The property tax system is administered by the Municipal Revenue Collection Center (MRCC). The tax on real property is directly assessed by the MRCC and may be paid in two instalments. The tax, (which varies from a minimum of 7.80% to a maximum of 10.23%, depending on the municipality) is applied to an amount based on the hypothetical fair market value (FMV) of the relevant property in the year 1957. In general terms, this hypothetical FMV normally ranges between 40% and 50% of the cost of the property.

### Municipal license tax

Every corporation is required to file an annual volume-of-business declaration with each of the municipalities in which it establishes or conducts business operations during the year. The declaration must indicate the actual volume of business (i.e. net sales, gross income from any service rendered, and other gross receipts) attributable to each municipality. When a business operates in more than one municipality but does not receive income in all of them, the license tax shall be computed based on a distribution of sales apportioned to each municipality by square feet of the building used in each municipality.

For a non-financial business, the license tax payment varies from a minimum of 0.20% to a maximum of 0.50%, depending on each municipality. The payment must be made in two equal instalments on or before 15 July and 15 January on the basis of the volume of business generated by the entity during its accounting year ended within the immediately preceding calendar year before the due date of the declaration. A 5% discount its available when the tax is fully paid on the declaration due date (on or before five working days after 15 April of each year).

For the first six months after a new business is established, the new company is generally exempt from the municipal license tax, provided that the business informs the municipality that it has established a new business in the municipality within the first 30 days of operations and request the provisional license tax as established in each municipality. A copy of the municipal license is generally requested as a perquisite for obtaining other licenses and permits in Puerto Rico.

## Branch income

Corporations operating in Puerto Rico as a branch may be subject to a 10% tax on the dividend equivalent amount (commonly known as the branch profit tax or BPT). The BPT should be determined and paid along with the CIT return. There would not be an income tax withholding at source at the time cash transfers are made by the Puerto Rico branch to its home office outside of Puerto Rico.

## Income determination

The gross income of a corporation generally includes business income, profits from the sale of property, interest, dividends, and income derived from any source unless specifically exempted by law.

A corporation’s net income is generally calculated in accordance with the method used for financial statement purposes, except for various items of income and expenses, which are treated differently. For example, the cash method of accounting may not be used by a corporation with inventory or with an average annual gross income in excess of USD 1 million. Long-term contract methods and the installment method can be used for regular tax calculations.

The annual accounting period may be on the basis of the calendar year, a fiscal year ending on the last day of a month or a 52/53 week year.

### Inventory valuation

In general, inventory is valued at the lower of cost or market. Retail merchants can use the retail method of accounting.

### *Capital gains*
Tax-advantaged treatment is provided for net long-term gains (holding period of more than six months) from the sale of capital assets. For corporations, net long-term capital gains, reduced by any short-term capital losses, are subject to an alternative (preferential) tax of 15% in lieu of the regular CIT rates.

### *Dividend income*
Dividends from a corporation that derives 20% or more of its profits from sources within Puerto Rico are taxable in Puerto Rico. However, a dividend-received deduction may apply.

### *Interest income*
Interest income is generally taxable, except interest from obligations of the federal government or any state, or territory, or political subdivisions; the District of Columbia; and the Commonwealth of Puerto Rico or any of its instrumentalities or political subdivisions.

### *Royalty income*
Royalties from property located in Puerto Rico or from any interest in such property are included in gross income.

### *Other income*
Service fees are generally taxable as ordinary income.

## *Deductions*

All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business are deductible by corporations operating in Puerto Rico.

### *Depreciation*
A reasonable depreciation allowance is deductible for the exhaustion, wear and tear, and obsolescence of property used in business. The most common depreciation method used by corporations is the straight-line method. Nevertheless, any other consistent method may be used in lieu of the straight-line method as long as it is in accordance with the recognised trade practice. In addition, a corporation (other than one that is exempt under an Industrial Incentives Act) can elect an accelerated depreciation method for new or used tangible property acquired by purchase, on taxable years commencing after 30 June 1995.

For property acquired after 31 December 2009, when using the straight-line depreciation method, the useful life has to be determined based on the same rules of accelerated depreciation.

| Assets | Useful life (years) |
|---|---|
| 3 year property (e.g. computers, electronic equipment) | 3 |
| 5 year property (e.g. automobiles, transportation equipment) | 5 |
| 10 year property (e.g. furniture and fixtures, printing equipment) | 10 |
| 15 year property (e.g. air transportation equipment, natural gas plants) | 15 |
| 20 year property (e.g. vessels, land improvements) | 20 |
| Real property leased for residential purposes | 30 |

| Assets | Useful life (years) |
|---|---|
| Other real property | 35 |

In addition, Act 171 provides that for intangibles (other than goodwill) acquired or created after 1 September 2010, the deduction is calculated using the straight-line method over the lower of a useful life of 15 years or the intangible useful life.

### *Dividends-received deduction*
All corporations engaged in trade or business in Puerto Rico are entitled to an 85% deduction on dividends received from a domestic corporation but not in excess of 85% of the net income of the corporation. A 100% dividend-received deduction applies for dividends received from taxable controlled domestic corporations (if ownership in a corporation is 80% or more).

### *Employee remuneration*
Corporations may deduct payments of reasonable salaries or other compensation for services actually rendered.

### *Insurance premiums*
Insurance premiums paid or accrued on risks related to a trade or business are deductible as well as premiums on group life policies covering employees, where the beneficiary is not the corporation. No deduction is allowed for premiums paid to an insurance company not authorised to provide insurance in Puerto Rico or through an agent or broker not authorised to operate in Puerto Rico.

### *Charitable contributions*
For tax years beginning after 31 December 2010, deductions for allowed charitable contributions are limited to 10% of net income, computed regardless of the contributions. Prior to 1 January 2011, charitable contributions were limited to 5% of net income.

### *Rent expense*
Corporations are entitled to a rent expense deduction if the rented property is used in the business.

### *Meals and entertainment*
Meals and entertainment expenses are deductible, subject to a 50% limitation. Travelling expenses are fully deductible if the trip is for business purposes.

### *Automobiles expenses*
A corporation is allowed to depreciate non-cargo automobiles used in trade or business over a five year useful life (three years in the case of sales persons) up to a maximum base of USD 25,000 for a maximum annual depreciation of USD 5,000. However, Act 1 increased the maximum base to USD 30,000, allowing a maximum annual depreciation of USD 6,000 for taxable years beginning after 31 December 2010.

On the other hand, pursuant to Act 1, non-cargo automobile maintenance expenses (e.g. gas, repairs, insurance) are no longer deductible for taxable years beginning after 31 December 2010. Instead, a deduction based on mileage, not yet determined by the Secretary of the Treasury, will be allowed.

### *Taxes*
A corporation is allowed a deduction for taxes paid (except for Puerto Rico CIT), including income tax paid to the United States, its other possessions, and any foreign country. The deduction is in lieu of claiming a foreign tax credit.

### *Other significant items*
The cost of incidental repairs (not adding value to the property) is deductible as business expenses.

Subject to certain limitations, savings and retirement plans for the benefit of the employees are deductible, if qualified by the Secretary of the Treasury.

### *Net operating losses (NOLs)*
All corporations are generally entitled to the NOL deduction in computing their tax. NOLs may be carried over for seven years (there are no carryback provisions). Also, losses from sales or exchanges of capital assets are allowed only to the extent of gains from such sales or exchanges. The carryforward period in this instance is, however, five years.

Act 171 increases the NOL carryforward period from seven taxable years to ten taxable years for NOLs generated from taxable years beginning after 31 December 2004 and before 31 December 2012.

### *Payments to foreign affiliates*
Management fees paid to a foreign affiliate are deductible to the extent that they are reasonable compensation for the services rendered. However, the Secretary of the Treasury has the authority to reallocate items of income and expense to properly reflect the Puerto Rico taxable income.

## *Group taxation*

Puerto Rico does not have group taxation rules. In other words, corporations can not file a consolidated return for Puerto Rico CIT purposes.



### *Transfer pricing*
There are no specific transfer pricing rules in Puerto Rico.

### *Thin capitalisation*
There are no specific thin capitalisation rules in Puerto Rico.

## *Tax credits and incentives*

A corporation engaged in specific eligible activities may apply for a reduced CIT rate through the request of a Tax Exemption Grant to the Puerto Rico Office of Industrial Tax Exemption pursuant to Act 73 of 28 May 2008.

### *Tax rate incentives*
Exempt entities may elect one of the following two scenarios:

- General scenario: 4% CIT rate with a WHT rate on royalty payments of 12%. Under this scenario, the amount of WHT on the royalty payments is creditable against the 4% CIT.

- Alternate scenario: 8% CIT rate with a WHT rate on royalty payments of 2%. Under this scenario, the WHT on royalty payments is creditable against the 8% CIT.

Companies may elect one of these scenarios at the time of applying for the benefits under the act. However, there are other possibilities:

- 4% fixed income tax rate on IDI, excluding income from certain investments provided by section 2(j).
- Existing exempt businesses currently taxed at a rate of 2% to 4% under the 1998 Act may continue to enjoy the same tax rate under the new act when it is determined by the Secretary of the Puerto Rico Economic Development (the Secretary) that said tax rate is in the best interest of Puerto Rico and the existing business complies with an employment commitment of at least 80% of its average employment during the three preceding years before the application of exemption under the new act. Note that the secretary could require a minimum income tax payment equal to the average income tax paid during said period.
- Pioneer industries are eligible for a 1% CIT rate.
- Activities for the development in Puerto Rico of intangible property are eligible for a 0% CIT rate.
- Any exempt business having operations at a municipality located in a 'low or intermediate development zone' may reduce its CIT rate by an additional 5%.
- Any exempt business having operations in Vieques and Culebra may be totally exempt from income taxes during the first ten years of operations as established in the new act. The remaining years covered by its tax decree may qualify for a 2% CIT rate.

### *Special deductions*
Special deductions are eliminated, except for capital investment in buildings, structure, machinery and equipment, and the NOLs carryforward.

### *Credits*
#### Credit for purchases of Puerto Rico manufactured product
Subject to certain limitations, the credit for purchases of products manufactured in Puerto Rico will remain at 25% (35% in the case of recycled products).

#### Job creation credit
There is a credit for every incremental job applicable to exempt business starting operations after 1 July 2008. The amount of the credit (maximum of USD 5,000 per each employment) depends upon the location of the industrial development zone.

#### Research and development investment credit
A 50% credit is granted for the eligible investment in research and investment activities, including operational expenditures, clinical trials, infrastructure, renewable energy, or intellectual property.

#### Energy investment credit
A 50% credit is granted for the eligible investment in the acquisition of machinery and equipment for the creation of energy.

#### Energy cost credit
There is also a 3% credit (which could be increased up to 10% if certain employment requirements are met) for payments made to the Puerto Rico Power Authority during the corresponding taxable year. This credit is available for a ten-year period starting as

of 1 July 2008. Additional credits (for the purpose of reducing the cost of energy) may be available to industrial units subject to certain limitations.

### Technology transfer credit

A 12% credit (2% in the case of exempt businesses that opted for the alternate tax) is available for payments made to resident entities for the use or privilege of using intangible property in Puerto Rico.

### Strategic projects investment credit

There is a 50% credit for eligible investment in strategic projects, including activities for the design, development, and construction of dams.

### Industrial investment credit

There is a 50% credit, up to a maximum of USD 8 million, for cash invested in the purchase of 50% or more of the stock or operating assets of an exempt business that is in the process of shutting down operations, amount used to start-up small or medium-exempt business, or amounts used for a substantial expansion of an exempt business.

Several of the above-mentioned credits were also made available to entities operating under prior tax incentives acts.

On 3 January 2011, the PRTD issued Circular Letter 11-01 and Informative Bulletin 11-01 to introduce the new electronic system for integrated tax credits (CCI System, for its name in Spanish). Also, these communications introduced new processes to claim such credits against the income tax, notify of the sale of such credits, and to request the vouchers for the utilisation of these credits against the corporation's utilities, if applicable.

The CCI System will allow the PRTD to maintain an updated registry of the tax credits already granted.

### *Property tax incentives*

Similar to the previous incentives laws, the current act allows for a 90% property tax exemption on personal and real property. However, the current act introduced a methodology for the classification and assessment of real property owned by the exempt businesses. Under the provisions of the current act, a taxpayer can self-assess one's real property tax responsibility (similar to the current personal property tax system) and remit the related tax liability due along with a real property tax return (to be issued by the MRCC) by 15 May of each year. The self-appraisal method is only applicable to real property that has not been appraised by the MRCC and is mainly limited to machinery and equipment classified as real property. Note that this method is not available for assets such as land, building, and building equipment.

### *Municipal license tax and other municipal tax incentives*

The current act did not introduce many changes regarding treatment of exempted businesses for municipal license tax purposes. The tax exemption remains at the same 60% as it was under the 1998 Act. Exempt businesses operating in Vieques or Culebra are 90% exempt; small or medium-exempt businesses are 75% exempt; and central or regional corporate headquarters providing managerial services to affiliated companies are 100% exempt during the first five years after becoming eligible for the exemption.

## Withholding taxes

Corporations not engaged in a trade or business in Puerto Rico are subject to a 29% WHT at source on certain gross income items (considered fixed or determinable, annual or periodical (FDAP)) from Puerto Rico sources.

FDAP income may include interests received from a related person, rents, royalties, salaries, annuities, compensation, remuneration, and net capital gains. However, if the payment received is from dividends and partnership profits, a 10% WHT should apply.

The payer, as a withholding agent, is responsible for the deduction and remittance of the 29% (10% in the case of dividends) to the Puerto Rico Treasury Department. Such tax is due on or before the 15th day of the month following the receipt of the income by the non-resident corporation and it is reported in Form 480.31 'Deposit Slip of Non-residents Income Tax Withheld at Source'. An annual informative return is also required to be filed (Form 480.30 'Non-residents Annual Return of Income Tax Withheld at Source') no later than 15 April of the following year.

### Tax treaties

There are no tax treaties between foreign countries and Puerto Rico. However, the Puerto Rico Supreme Court has recognised that, although Puerto Rico is generally not a signatory party to a treaty entered into by the United States, if an international treaty does not explicitly exclude Puerto Rico, the treaty would be applicable to Puerto Rico.

## Tax administration

### Annual report

Every corporation is required to file an annual corporation report with the Puerto Rico Department of State. This annual report must be filed by the 15th day of April along with a USD 100 annual fee and a balance sheet as of the close of operations of the prior year. The report should be filed through the Puerto Rico Department of State's website. If the volume of business exceeds USD 3 million, the annual report must be accompanied by a balance sheet certified by a certified public accountant (CPA) licensed in Puerto Rico. In the event that the volume of business does not exceed USD 3 million, a balance sheet prepared under generally accepted accounting principles (GAAP) by a person with a general knowledge in accounting has to be submitted along with the corporate annual report. An extension of 60 days, an additional 30 day period may be requested, for filing the annual report can be obtained if timely requested. The Secretary of State is authorised to impose penalty for failure to timely or accurately file the annual corporate report that would be between USD 100 and USD 1,000 if a non-profit corporation, and between USD 500 and USD 2,000 if a for-profit corporation.

### Returns

The Puerto Rico tax system is based on the principle of self-assessment. A corporate taxpayer is required to file an annual income tax return (generally Form 480.20) by the 15th day of the fourth month following the close of its tax year. In general terms, a taxpayer can obtain an additional extension of three months to file its income tax return. Failure to timely file can result in penalties. Any tax not covered with the estimated tax payments should be paid along with this return.

A corporate taxpayer may also be subject to file a personal property tax return by 15 May and/or a volume of business declaration by the 5th business day after 15 April.

### *Payment of tax*

A corporation must substantially satisfy its annual income tax liability, if any, through estimated income tax payments. The amount of estimated income taxes should be paid on equal instalments on the 15th day of the fourth, sixth, ninth, and 12th month of the taxable year of the corporation. The estimated payments should equal or exceed 90% of the actual tax for the year or, in the case a CIT return was filed by the corporation in the preceding year, 100% of such tax liability. Failure to pay the tax by the due dates indicated above may result in a penalty of 10% of the instalment due.

### *Audited financial statements*

Accounting records must be prepared in accordance with the general accepted accounting principles (GAAP) followed in the United States. Domestic corporations (i.e. incorporated in Puerto Rico) with volume of business of more than USD 3 million must include, with their CIT return, audited financial statements of the Puerto Rico operations for the accounting year ended on or before the preceding 31 December. The financial statements should be submitted with an audit report issued by a CPA licensed in Puerto Rico. Nevertheless, foreign corporations with volume of business of more than USD 1 million must include, with their CIT return, audited financial statements of the Puerto Rico operations.

Act 1 increases the threshold requirement for foreign corporations to USD 3 million. Also, qualified and disclaimer opinions are now allowed to the extent that the qualification or disclaimer does not result from a restriction in scope. However, no adverse opinions are allowed. All groups of related entities engaged in a trade or business in Puerto Rico are required to file consolidated financial statements (CFS), which should contain a consolidating schedule, also subject to audit procedures, with columns showing the financial position and the result of operations of the parent company and each of the subsidiaries. Said schedule should also contain the eliminating entries and the consolidated balance sheet. The determination of the gross income threshold for purposes of the audited financial statement requirement should be made taking into consideration the volume of business of all the entities within a controlled group. In the case of foreign entities, these will be able to submit audited financial statements with their Puerto Rico operations on a stand-alone basis; in other words, the CFS will not be required. The requirement for audited financial statements will not apply to non-for-profit organisations.



With respect to the municipal license and personal property tax filings, the threshold amount for the audited financial statements requirement is gross revenues of more than USD 3 million regardless the corporate residency (i.e. foreign or domestic).

# Qatar

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## Significant developments

### Publication of Final Executive Regulations

The executive regulations related to the Qatar tax law, which contain guidance on how the Qatar tax authorities will interpret and apply the provisions of the Qatar tax law in practice, were published in the official gazette on 1 June 2011. These regulations provide greater clarity in respect of matters that were previously uncertain. The regulations will enter into effect as of 1 July 2011.

### Qatar Financial Centre (QFC)

The QFC tax law became effective as of 1 January 2010. QFC entities are subject to tax in respect of activities undertaken pursuant to their QFC licence at the rate of 10%.

## Taxes on corporate income

Income Tax Law No. 21 of 2009 came into force with effect from 1 January 2010 and replaced the previous tax law, Law No. 11 of 1993. Key highlights of the law include the reduction of the tax rate to a flat tax rate of 10%, the elimination of progressive tax rates (with the top rate of 35% under the previous tax law), a shift to 'source based taxation' from an 'activity based test', and the introduction of withholding tax (WHT).

Note that the information provided in this section is directed towards non-QFC entities with Qatar source income.

An entity that is wholly or partially foreign owned and that derives income from sources in Qatar is taxable in Qatar. In the case of a joint venture, the tax liability of the joint venture is dependent upon the foreign partners' share of the joint venture's profit. Currently, no corporate income tax is levied on a corporate entity that is wholly owned by Qatari nationals and Gulf Cooperation Council (GCC) nationals.

Unless specifically exempt from tax, an entity will be taxable in Qatar if it has generated Qatar-source income, regardless of the place of its incorporation. Even if an entity has been granted an exemption from Qatar tax, the entity may be required to submit a tax return.

Taxable income generally is subject to a flat corporate income tax rate of 10%, with certain exceptions available. In prior periods, tax was levied at differing rates on different portions of income, with the first 5 million Qatari riyals (QAR) of income being taxed at an appropriate effective tax rate of 24% and any income in excess of QAR 5 million being taxed at 35%.

Since 1 January 2010, the following tax rates apply in the specific circumstances noted:

- If a special agreement has been reached with the government of the State of Qatar prior to 1 January 2010, the rate specified in the agreement continues to apply. If no rate is specified in the agreement, a rate of 35% will be used.
- The rate applied with respect to oil operations, as defined in Law No. 3 of 2007, may not be less than 35%.
- Payments made to non-residents with respect to certain service activities not connected with a permanent establishment (PE) in Qatar are subject to withholding tax *(see the Withholding taxes section)*.

The amount of tax payable is reduced for companies that are partly foreign owned, depending on the extent of local ownership.

## *Corporate residence*

It is important to recognise that residence is not the basis used to determine whether an entity is taxable in Qatar. Accordingly, a tax exposure in Qatar may arise even if a company is not resident in Qatar. Residence is therefore primarily relevant when considering whether WHT will apply on payments received rather than the typical form of corporate taxation on taxable income.

A company is resident in Qatar if it is incorporated in accordance with Qatari laws, its head office is situated in Qatar, or its place of effective management and control is in Qatar.

## *Other taxes*

### *Value-added tax (VAT)*
Qatar currently imposes no sales tax or value-added tax (VAT) on operations in Qatar.

### *Customs duties*
Customs duties are applied to goods with an origin outside the GCC countries, normally at a rate of 5%. Higher rates sometimes apply for specific types of goods, such as tobacco products. Temporary import exemptions are sometimes available.



## *Branch income*

The profits of a branch owned by a foreign parent entity are subject to the same tax rules as apply to other forms of taxable entities.

## *Income determination*

Corporate income tax is levied on a company's Qatar source income. Some examples of Qatar source income include:

- Income derived from an activity carried on in Qatar.
- Income derived from contracts wholly or partially performed in Qatar.
- Income from real estate situated in Qatar, including income from the sale of shares of companies with assets consisting of mainly real estate situated in Qatar.
- Income from shares in companies resident in Qatar or listed on Qatar's stock market.
- Interest arising in Qatar.

- Bank interest realised outside Qatar if it results from the taxpayer's activity in Qatar.

### *Capital gains*
Any chargeable gains on the sale of capital assets are taxed as ordinary income.

### *Exemptions*
Certain types of income are exempt from Qatar tax, such as the income generated by Qatar-based companies that are wholly owned by Qatari nationals.

### *Self-employed contractors*
Any Qatar-sourced income generated by self-employed contractors is subject to taxation in Qatar. However, employment income is outside the scope of Qatar tax.

## *Deductions*

Taxable income is determined after deducting all expenditures, costs, and losses incurred to generate gross income, particularly the following:

- Interest on loans used in the activity.
- Employee costs (including salaries, wages, gratuities, and other end of service benefits).
- Tax depreciation of fixed assets.
- Losses resulting from the sale of assets.
- Bad debts approved by the tax authorities in accordance with the criteria set out in the tax law.
- Donations, gift aid, and subscriptions to charitable, humanitarian, scientific, cultural, or sporting activities paid in Qatar to government authorities or public bodies, provided the value does not exceed 5% of net profit in the year in which the deduction is claimed.
- A deduction is usually available for expenses that are considered ordinary rather than 'capital' in nature and incurred in generating Qatar-source revenue.
- Rents.
- Insurance premiums.
- Taxes and duties other than the income tax provided for in the law.

### *Depreciation and depletion*
Depreciation should be calculated in accordance with rates specified by the Qatar tax law and the related regulations.

### *Net operating losses*
Losses may be deducted from net income during the year. Losses can be carried forward for three years after the year in which they were incurred. Losses cannot be carried back.

### *Allocations of overheads to branches*
The branch's share of the head office expenses (i.e. indirect or allocated overheads) generally is deductible only up to a certain limit. The deduction is capped at 3% (1% for banks) of the total revenue less certain other costs under the previous tax law.

## Group taxation

There is no definition of a 'group' for Qatar tax purposes; therefore, there is no concept of group taxation.

An anti-avoidance provision was introduced by the Qatar tax law, and the executive regulations have made it clear that this provision will be applied to related-party transactions.

### Anti-avoidance provision

The anti-avoidance provision gives the Qatar tax authorities wide powers to counteract transactions that have been carried out with a tax avoidance purpose. These powers include substituting an arm's-length value or recharacterising transactions.

## Tax credits and incentives

### Qatar Science and Technology Park

Qatar has established the Qatar Science & Technology Park (QSTP), which is aimed at entities with research and development activities. QSTP entities can be fully exempt from Qatar tax; however, tax exempt entities are required to file tax returns.

### Other tax exemptions

An application for a tax exemption may be made for certain projects that are considered to be strategically significant to the Qatar economy. The exemptions are generally granted for a period of three or six years (reduced from five or ten years under the previous tax law). Applications for an exemption are assessed based on certain criteria set out in the Qatar tax law.

Notwithstanding the fact that an exemption is granted, an entity that is exempt is still required to file a tax return under the Qatar tax law.

## Withholding taxes



### Mechanics of the WHT system

WHT was introduced in Qatar for the first time on 1 January 2010. WHT is levied on certain payments made to non-residents in relation to royalties and technical services (the applicable rate is 5%) and on interest, commissions, brokerage fees, directors' fees, attendance fees, and any other payments for services carried out wholly or partly in Qatar (the applicable rate is 7%). WHT on interest is currently suspended until further notice; however, this is expected to be a temporary measure. This suspension is expected to be lifted once the final executive regulations are issued. It is understood that the final executive regulations will clarify the circumstances in which WHT would apply going forward to payments of interest.

The company that makes the payment to its foreign supplier is required to withhold the tax and remit to the tax department the funds that were withheld by the 16th day of the following month. In the event that the company does not make a payment to the tax department, the company will be liable for a penalty equal to the amount of unpaid tax due, in addition to the WHT.

# Qatar

### *Retention system*

Pursuant to circulars issued by the tax department, a retention system is in place whereby certain final contract amounts are required to be retained from payments made by Qatari entities to foreign entities in connection with work performed in Qatar. However, a practice has developed over time whereby 5% to 10% of each payment is retained rather than the final contract payment. All ministries, government departments, public, semi-public, and private establishments and Qatar taxpayers are required to retain these amounts until the recipient entity provides a final tax clearance, which is obtained from the Qatar tax authorities. Where WHT is not deducted, the retention system currently continues to apply. We understand that the Qatar tax authorities will issue further guidance on the retention rules under the new tax law in due course.

### *Tax treaties*

Qatar has a growing network of double tax treaties with over 30 double tax treaties currently in force. The withholding tax rates under these treaties in respect of dividends, interest, and royalties are as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Effective date |
|---|---|---|---|---|
| Armenia | 5/10 (1) | 5 | 5 | 1 Jan 2008 |
| Azerbaijan | 7 | 7 | 5 | 1 Jan 2009 |
| Belarus | 0/5/10 (2) | 5 | 5 | 1 Jan 2008 |
| China (PRC) | 10 | 10 | 10 | 1 Jan 2009 |
| Cuba | 5/10 (3) | 10 | 5 | 1 Jan 2009 |
| Cyprus | 0 | 0 | 5 | 1 Jan 2010 |
| France | 0 | 0 | 0 | 1 Jan 2007 |
| India | 5/10 (4) | 10 | 10 | 1 Jan 2001 |
| Indonesia | 10 | 10 | 5 | 1 Jan 2008 |
| Italy | 5/10 (3) | 5 | 5 | 1 Jan 2010 |
| Korea, Republic of | 10 | 0/10 (11) | 5 | 1 Jan 2010 |
| Lebanon | 0 | 0 | 0 | 1 Jan 2010 |
| Luxembourg | 0/5/10 (2) | 0 | 5 | 1 Jan 2011 |
| Macedonia | | | | 1 Jan 2009 |
| Malaysia | 5/10 (4) | 5 | 8 | 1 Jan 2010 |
| Malta | 0 | 0 | 5 | 1 Jan 2010 |
| Nepal | 10 | 10 | 15 | 1 Jan 2010 |
| Netherlands | 0/10 (5) | 0 | 5 | 1 Jan 2010 |
| Norway | 5/15 (6) | 0 | 5 | 1 Jan 2010 |
| Pakistan | 5/10 (4) | 10 | 10 | 1 Jan 2001 |
| Poland | 5 | 0/5 (10) | 5 | 1 Jan 2010 |
| Romania | 3 | 3 | 5 | 1 Jan 2004 |
| Russia | 5 | 5 | 0 | 1 Jan 2001 |
| Serbia | 5/10 (4) | 10 | 10 | 1 Jan 2011 |
| Seychelles | 0 | 0 | 5 | 1 Jan 2008 |
| Singapore | 0 | 5 | 10 | 1 Jan 2008 |
| Slovenia | 5 | 5 | 5 | 1 Jan 2011 |
| Sri Lanka | 10 | 10 | 10 | 1 Jan 2008 |
| Switzerland | 5/10/15 (7) | 0 | 0 | 1 Jan 2011 |
| Turkey | 10/15 (8) | 10 | 10 | 1 Jan 2009 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Effective date |
|---|---|---|---|---|
| United Kingdom | 0/15 | 0 | 5 | 1 Jan 2011 |
| Venezuela | 5/10 (4) | 0/5 (9) | 5 | 1 Jan 2008 |

Notes

1. 5% if capital exceeds USD 100,000, and 10% in all other cases.
2. 0% if the beneficial owner is a company which owns at least 10%, 5% if 10% direct participation is held by an individual who has resided in the relevant state for a period of at least 48 month, and 10% in all other cases.
3. 5% if the beneficial owner is a company which has owned directly or indirectly at least 25%, and 10% if participation is less than 25%.
4. 5% if the beneficial owner is a company which owns at least 10%, and 10% in all other cases (i.e. less than 10% shareholding).
5. 0% if the beneficial owner is a company which owns at least 7.5%, and 10% in all other cases (i.e. less than 7.5% shareholding).
6. 5% if the beneficial owner is a company which owns at least 10%, and 15% in all other cases (i.e. less than 10% shareholding).
7. 5% if the beneficial owner is a company which holds directly at least 10%, 10% if the beneficial owner is an individual which holds directly at least 10%, and 15% in all other cases.
8. 10% if the beneficial owner is a company which has owned at least 25%, and 15% in all other cases (i.e. less than 25% shareholding).
9. 10% if income is derived from immovable property, and 0% in all other cases.
10. 0% where the beneficial owner of the interest carries on business in the other contracting state where the interest arises (i.e. through a PE therein), and 5% if the contracting company does not have a PE.
11. 0% if interest arising in contracting state is derived from government debt, and 10% if the contracting company does not have a PE.

## *Tax administration*

### *Returns*

The tax year is generally the same as the calendar year, although advance approval may be sought from the Qatar tax authorities to use a company's accounting year end.

The tax return is due within four months from the date of a company's tax filing period.

### *Payment of tax*

The tax payable is based on the tax declaration and should be paid on the same day that the tax return is due.

### *Late filing penalties*

The Qatar tax law contains a penalty regime, which imposes a penalty for the late filing of a tax return. In addition, a penalty applies where there is there is a late payment of tax.

### *Objection and appeals process*

It is possible for a taxpayer to initially object directly to the tax department regarding a decision related to a tax position. If the objection is unsuccessful with respect to altering the tax department's decision, an appeal may be made by the taxpayer to the Tax Appeals Committee. Based on the Tax Appeals Committee's decision with respect to the appeal, a final appeal may be made by either the tax department or the taxpayer to the administrative chamber of the court. The law prescribes time limits for each stage of the appeal process.

### *Accounting and audit requirements*

A company's corporate income tax return is required to be accompanied by audited financial statements if the company's capital or profit exceeds QAR 100,000, or the head office is situated outside Qatar. The audit report must be signed by a Qatar registered auditor.

Qatar tax law requires accounts to be prepared in accordance with International Financial Reporting Standards (IFRS).

### *Accounting record retention*

All accounting books, registers, and documents relating to activity in Qatar are required to be retained in Qatar for a ten-year period.

# Romania

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## Significant developments

### Corporate taxation

The minimum tax was repealed as of 1 October 2010. As a result, for taxpayers subject to the minimum tax for the first part of 2010, the year 2010 was split into two different fiscal periods, which also affected the periods available for carryforward of fiscal losses.

The withholding tax (WHT) on dividend payments made both to residents and non-residents (European Union (EU) or European Free Trade Area (EFTA)) has been increased from 10% to 16% *(see the Withholding taxes section for more information)*.

As of 1 January 2011, Romania-sourced interest and royalty payments of an affiliated company, resident in a EU or EFTA member state, are exempt from WHT, provided certain conditions are met (stated by the Interest-Royalties Directive) *(see the Withholding taxes section for more information)*.

The Romanian Fiscal Code reintroduced the 3% income tax for micro-companies, with restrictive conditions for application. The tax is optional in the sense that qualifying taxpayers may apply for the micro-company tax regime or continue to be profit taxpayers.

Large and medium size taxpayers have to submit fiscal forms electronically for returns with a submission deadline of 25 November 2010 onwards. For other categories of taxpayers, electronic submission is still optional.



### Value-added tax (VAT)

As of 1 July 2010, the standard VAT rate was increased from 19% to 24%.

Supplies of cereals and industrial crops performed on the Romanian territory between companies registered for VAT purposes will be subject to the reverse charge mechanism. The measure applies until 31 May 2013.

A taxable person who does not exceed the exemption threshold of EUR 35,000 during a calendar year may request, by 20 January of the following year, deregistration from the records of the persons registered for VAT purposes in order to apply the special exemption regime.

The threshold for importers wishing to obtain a VAT deferment certificate has been reduced to 100 million Romanian lei (RON) (formerly the threshold was RON 150 million). In addition, the time period which is taken into consideration for qualifying is now either the past calendar year or the last 12 consecutive months.

### Excise duties
There have been substantial changes to the duty-free and tax warehouse regimes and the related authorisations.

Excise duty rates for alcoholic beverages and related intermediate products have been increased. (i.e., the level of excise duties has risen for fermented still beverages, other than beer and wines, from EUR 0/hl to EUR 100/hl of product, and for intermediary products from EUR 65/hl to EUR 165/hl) .

Mandatory guarantees should be established for the production, processing, and storage, as well as for the movement, of excise goods under the excise duty suspension regime. The total level of excise duty on cigarettes was increased from EUR 74/1,000 cigarettes to EUR 76.60/1,000 cigarettes. The minimum excise duty payable was also increased from EUR 67.34/1,000 cigarettes to EUR 73.54/1,000 cigarettes, and it will be further increased to EUR 74/1000 cigarettes from 1 July 2011. Also, as of 1 July 2011, the method for computation of the specific excise duty for cigarettes will change.

The level of excise duties on gasoline increased from EUR 452/tonne to EUR 467/tonne and on diesel from EUR 347/tonne to EUR 358/tonne.

## Taxes on corporate income

The standard profit tax rate is 16% for Romanian companies and foreign companies operating through a permanent establishment (PE) in Romania. Resident companies are taxed on worldwide income, unless a double tax treaty (DTT) stipulates otherwise.

The profit tax liability due from nightclubs and gambling operations cannot be less than 5% of the revenue obtained from such activities.

The 3% income tax for micro-companies has been reintroduced as of 1 January 2011, with restrictive conditions for application. The tax is optional in the sense that qualifying taxpayers may apply for the micro-company tax regime or continue to be profit tax payers.

## Corporate residence

A company is considered resident in Romania if it was set-up under Romanian law or has its place of effective management in Romania.

Starting in 2010, the tax code introduced the concept of 'legal person set-up in accordance with European legislation'. Such legal persons become tax residents if they establish (or transfer) their registered office in Romania. As a result, such entities are subject to the same tax treatment as Romanian legal persons for taxation of profits and dividends.

### Permanent establishment (PE)
PE is defined as being the place through which the activity of a non-resident is conducted, fully or partially, directly or through a dependent agent.

Once a PE is created, Romania has the right to tax the profits of the foreign enterprise derived from the activity performed on its territory.

The Romanian legislation explicitly states three conditions that should be met simultaneously in order to trigger a PE:

- A place of business must exist (e.g. premises, machinery, or equipment).
- The place of business must be fixed (i.e. must be established at a distinct place with a certain degree of permanence).
- The activity should be carried out through this fixed place of business (i.e. there are people dependent on the enterprise and conducting its business in the country where it is located).

The registration, filing, and payment requirements for a PE are similar to those for a Romanian company.

## Other taxes

### Value-added tax (VAT)

As of 1 July 2010, the standard rate of VAT has been increased from 19% to 24% and is applied to all supplies of goods and services (including imports) that do not qualify for an exemption (with or without credit) or for the VAT reduced rate.

The reduced VAT rate is 9% and is applicable to admission fees at museums, historical monuments, architecture and archaeological monuments, zoos and botanical gardens, fairs and exhibitions, cinema tickets, supply of school manuals, books, newspapers and periodicals, supply of prostheses and orthopaedic products (except for dentures), medicine for human and veterinarian use, and accommodation in hotels or in areas with a similar function.

Some operations are exempt with credit (i.e. right to deduction) for input VAT, including: export of goods; transport and related services; intra-community supply of goods; international transport of passengers; certain operations performed in free-trade zones and free warehouses; supply of goods to a bonded warehouse, a VAT warehouse, and related services; supply of foreign goods which are placed under suspensive customs regimes; supply of services in connection with goods placed under customs suspensive regimes; supply of goods and services to diplomatic missions, international organisations, and North Atlantic Treaty Organisation (NATO) forces.

VAT exemption without credit applies to a range of activities, including banking, finance, and insurance. However, some financial services are also subject to a 24% VAT (e.g. factoring, debt collection, managing, and depositing certain equity papers).

There are also operations that are exempt with credit (i.e. deduction right) for input VAT, such as the following:

- Export of goods, transport, and related services.
- Intra-community supply of goods.
- International transport of passengers.
- Goods placed in free trade zones and free warehouses.
- Supply of goods to a bonded warehouse, a VAT warehouse, and related services.
- Supply of goods, which are placed under suspensive customs regimes.
- Supply of services in connection with goods placed under suspensive customs regimes.
- Supply of goods and services to diplomatic missions, international organisations, and NATO forces.

VAT on imported goods continues to be paid at customs, except for taxable persons registered for VAT purposes that obtain an import VAT deferment certificate from the customs authorities. For these taxpayers, the VAT is not paid at customs but is shown in the VAT return as both input and output VAT. The import VAT deferment is available only to companies for which the value of the imports performed in the previous year/ previous 12 months has reached the threshold of minimum RON 100 million.

The rules for establishing the place of supply of goods and services (and therefore the place of VAT taxation) are fully aligned with the Recast of the EU Sixth VAT Directive. Services provided by offshore entities to Romanian companies with deemed place of supply in Romania are subject to Romanian VAT.

### Reduced VAT at the rate of 5% for sale of buildings

Companies selling buildings can apply for a reduced VAT, at the rate of 5%, in the following cases:

- The buildings are part of a social policy, such as homes for the elderly, retirement homes, orphanages, or rehabilitation centres for children with disabilities.
- The building is supplied as housing to an individual or family and has a maximum useful surface of 120 square metres and a value of less than RON 380,000 (exclusive of VAT).

### Reverse charge mechanism

Under the VAT reverse charge mechanism, VAT is not actually paid, but only shown in the VAT return as both input and output tax, provided the beneficiary is registered for VAT purposes.

The reverse charge mechanism applies for services performed by offshore entities, and the place of supply is where the beneficiary is established or has a fixed establishment (e.g. consultancy, marketing services, telecommunications, and electronically supplied services). This is possible provided the suppliers are not established in Romania for VAT purposes.

Supplies of cereals and industrial crops performed on the Romanian territory between companies registered for VAT purposes will be subject to the reverse charge mechanism. The measure applies until 31 May 2013.

### VAT compliance

As a general rule, the fiscal period is the calendar month. For taxable persons registered for VAT purposes whose previous year-end turnover did not exceed EUR 100,000, the fiscal period is the calendar quarter.

Taxable persons must keep complete and detailed records for calculation of VAT liabilities.

VAT returns should be submitted to the tax authorities by the 25th day of the month following the end of the fiscal period; the VAT is due by the same date. The VAT return should be submitted using an electronic carrier.

Taxable persons not registered for VAT purposes are required to pay VAT and to submit a special VAT return on services rendered by non-residents, which have a deemed place of supply in Romania. These obligations must be fulfilled by the 25th day of the month following that in which the services are performed.

Taxable persons are required to file twice yearly for acquisitions and supplies of goods and services performed on Romanian territory, based on the existence of invoices.

### *Customs regulations*

Customs values are determined and declared by importers in accordance with the provisions of the World Trade Organisation (WTO) Customs Valuation Agreement (i.e. the Agreement pertaining to the implementation of Article VII of the General Agreement on Trade and Tariffs (GATT)).

For chain transactions with goods intended for import, the customs value may be determined, under certain conditions, based on the price in any of the transactions in the chain ('first sale principle'). This way, the customs value can be determined based on a price lower than that paid or payable by the importer (e.g. based on the price of the first transaction in the chain).

The customs value can be modified within 12 months of the acceptance of the customs declaration for the release of the goods for free circulation, in specific cases (e.g. in the case of defective goods).

Under specific conditions, determining customs value upon import is possible, even if certain elements that need to be added to the customs value are not quantifiable on the importation date (e.g. licence fees, royalties) or are missing.

The customs authorities may inspect the customs value either during the customs clearance or during a post-import audit (the customs authorities are entitled to perform such an audit during a five-year period following the date of import).

It is also possible to amend or invalidate the customs declaration, as follows:

- Amendment of the customs declaration before the customs clearance is obtained.
- Invalidation of the customs declaration within 90 days of the customs clearance being obtained.
- Amendment after the customs clearance is obtained, which can be performed at the request of the traders within five years of the customs clearance date.

#### Customs duties

The customs duties are those specified in the EU Common Customs Tariff and are expressed as a percentage applied to the customs value (i.e. *ad valorem* taxes) or as a fixed amount applied to a specific quantity (i.e. specific taxes).

Agricultural products (i.e. products from chapters 1–24 of the EU Common Customs Tariff) are subject to specific taxation.

In certain cases (e.g. meat), the customs duty rate is established with regard to the cost, insurance, and freight (CIF) or the entry price of the products. In other cases, the customs duty rate is established by adding additional duties, such as agricultural components, to the *ad valorem* tax.

#### Customs representation

Legal entities established in non-EU states can declare goods by indirect representation. The indirect representation can be used for customs regimes such as transit or temporary importation.

Moreover, legal entities established in non-EU states can occasionally declare goods on their own or through direct representation, provided that the customs authorities consider this to be justified.

Customs brokers can be authorised to use the local customs clearance procedure or to submit simplified customs declarations for the companies they represent (either directly or indirectly). Any Romanian legal person can act as an indirect representative for a sole person using the simplified customs clearance procedures.

#### Authorised Economic Operator (AEO) status

Operators that obtain AEO status benefit from simplifications regarding customs inspection, obtaining customs authorisations, and performing customs formalities.

Moreover, through the AEO certificate, the holder is recognised by the customs authorities as a reliable person, giving comfort as regards observance of the safety and security standards.

#### Customs rulings

Companies can obtain rulings ('binding tariff information' or BTI) from Romanian customs authorities regarding the tariff classification of imported goods that are binding for the customs authorities for a six-year period, whenever goods identical to those described in the BTI are imported.

A similar type of ruling can also be obtained regarding the origin of goods (binding origin information or BOI). The BOI is valid for a three-year period.

### *Environmental taxes*

As of 1 January 2011, all producers of electric and electronic equipment (EEE) have to provide a guarantee to the Environmental Fund for the EEE placed on the market. The guarantee consists either in a bank guarantee letter or collateral, a waste recovery insurance policy, or adhering to one of the authorised collective organisations with attributions regarding EEE waste management, which acts on behalf of the producers.

As of 1 January 2011, a new tax of RON 2/litre is levied on any shortfall of targeted waste recovery for industrial oils and lubricants placed on the market.

### *Property taxes*

#### Building tax

For buildings owned by companies, the building tax rate is set by the Local Council at between 0.25% and 1.5% of the entry value of the building, adjusted by the value of reconstruction, consolidation, modification and extension works, and the revaluation, if applicable. If the building has not been revaluated in the previous three years, the tax rate is increased by the Local Council by 5% to 10%. The taxable value of fully depreciated buildings is reduced by 15%.

Building tax is paid twice a year, by 31 March and 30 September, in equal instalments. As a general rule, if the building tax due for the entire year is paid in advance by 31 March, a reduction of up to 10% may be granted by the Local Council.

#### Land tax

Owners of land are subject to land tax established at a fixed amount per square metre, depending on the rank of the locality where the land is located and the area or category of land use, in accordance with the classification made by the Local Council.

Companies are not subject to land tax on land where buildings are sited.

Similar to building tax, land tax is paid twice a year, in equal instalments, by 31 March and 30 September. A 10% reduction is granted for full advance payment of this tax by 31 March.

### *Excise duties*

#### Harmonised excisable products

The following products are subject to harmonised excise duties: ethyl alcohol and alcoholic beverages, tobacco products, energy products (e.g. unleaded petrol, diesel oil, gas, coal), and electricity.

Excise duties are due when excise goods are released for consumption (e.g. imported into Romania, taken out of an excise duty suspension regime).

Excisable products can be produced, transformed, held, and received under a duty suspension arrangement only in a tax warehouse, which should have prior approval from the tax authorities. Such excisable products can also be received from within the European Union under excise duty suspension arrangements by registered consignees.

Ethyl alcohol and other alcoholic products are exempt from the payment of excise duties if they are denatured and used in the nutritional, pharmaceuticals, or cosmetics industry. There are also exemptions for ethyl alcohol and other alcoholic beverages when used in a manufacturing process, provided that the final product does not contain alcohol, or as samples for analysis, for necessary production tests, or for scientific purposes.

Some energy products, subject to movement control, can be purchased to be used for purposes excepted from excise duty, provided that an end-user authorisation is obtained and the payment of excise duties is secured.

In some cases, traders can claim a refund of the excise duties paid (e.g. excise duty paid for goods released for consumption in Romania, but intended for consumption in other EU Member States; excise duties paid for goods released for consumption and then returned to the production tax warehouse for recycling, reprocessing, or destruction; excise duties paid for goods acquired from the European Union or imported and then returned to the suppliers).



Before being released for consumption in Romania, spirit-based beverages and tobacco products have to be marked with duty stamps. The responsibility for such marking lies with the tax warehouse keepers, registered consignees, and importers releasing such goods for consumption.

For cigarettes, the excise duty owed is equal to the sum of the specific excise duty and the ad-valorem excise duty. The specific excise duty expressed in EUR/1,000 cigarettes is annually determined based on the ponderate medium retail price, the legal percentage related to the ad-valorem excise duty and the total excise duty.

As of 1 July 2010, the level of the minimum excise duty for cigarettes has risen from 91% to 96%.

The current level of excise duties on gasoline and diesel are EUR 467/tonne, and EUR 358/tonne, respectively.

Companies selling fuel in gas stations have to register with the tax authorities.

### Other excisable products

Other excisable products are green coffee, roasted coffee (including coffee with substitutes), and soluble coffee (including blends with soluble coffee).

Companies performing exports or intra-community supplies of coffee may benefit from the refund of the excise duty paid for the coffee used as raw materials.

Traders purchasing coffee are entitled to a refund of the excise duties paid, if the products are exported, supplied to another EU Member State, or returned unchanged to the supplier.

### *Social contributions*

Employers must pay social security contributions, calculated on the gross salary costs, as follows: 20.8%, 25.8%, or 30.8%, depending on working conditions. The monthly contribution is capped at five average gross salaries multiplied by the number of insured individuals.

Other contributions payable by employers for employees, calculated on gross salary costs, are as follows:

- Contribution for medical leaves: 0.85%
- Health fund: 5.2%
- Unemployment fund: 0.5%
- Guarantee fund: 0.25%
- Work accidents insurance fund: 0.15% to 0.85%

## *Branch income*

### *Branch*

A foreign company can set up a branch in Romania, as long as the branch only operates in the same field of activity as the parent company.

Profits derived by the branch are taxed at the standard profit tax rate of 16%.

### *Representative offices*

Representative offices are often established as a first step to operating in Romania. A representative office can undertake only auxiliary or preparatory activities, cannot trade in its own name, and cannot engage in any contractual activity. A representative office can perform only a limited range of activities without being considered a PE for profit tax purposes.

Representative offices are subject to a yearly flat tax of EUR 4,000 (payable in local currency, i.e. RON). It has to be paid in two instalments, by 25 June and 25 December. If a representative office is set up or closed down during a year, the tax due for that year is prorated on the basis of the number of months the representative office operated in that fiscal year.

## Income determination

The taxable profit of a company is calculated as the difference between the revenue derived from any source and the expenses incurred for the purpose of obtaining taxable income during a fiscal year, out of which non-taxable income is deducted and non-deductible expenses are added.

### *Inventory valuation*

The methods permitted for inventory valuation under Romanian law are standard cost, detailed sale price, average (weighted) cost, first in first out (FIFO), and last in first out (LIFO).

Assets are generally valuated at their acquisition cost, production cost, or market value. Fixed assets may be revaluated at certain points in time for various purposes.

### *Capital gains*

Capital gains earned by a Romanian resident company are included in ordinary profits and are taxed at 16%. Capital losses related to sale of shares are, in general, tax-deductible. Capital gains obtained by non-residents from real estate property located in Romania or the sale of shares held in a Romanian company is also taxable in Romania. However, the income may be subject to treaty protection.

### *Dividends, interest, and royalties*

Dividends received by a Romanian company from another Romanian company are not subject to the profit tax, but are subject to a final WHT of 16%.

Dividends received by a Romanian company from a foreign company are taxed at the normal profit tax rate in Romania. Credit is available for tax paid abroad.

Dividends received from a foreign or Romanian legal person from all member countries of the European Economic Area (EEA) are not taxable if the Romanian legal person has held a minimum of 10% of the shares in the foreign legal person for an uninterrupted period of at least two years on the date when the dividend is paid.

Interest and royalty payments by Romanian companies to other Romanian companies are taxable income in the hands of the beneficiary.

### *Foreign income*

Resident companies are taxed on worldwide income, unless a DTT stipulates otherwise. However, in case of foreign subsidiaries of Romanian companies, income is not taxed in Romania until remitted back. Otherwise, there is no specific tax deferral regime in place.

## Deductions

From the deductibility standpoint, expenses fall into three categories in Romania: deductible expenses, limited deductibility expenses, and non-deductible expenses.

### *Deductible expenses*

As a general rule, expenses are deductible only if incurred for the purpose of generating taxable income. The following expenses are considered as being incurred for the purpose of generating taxable income:

- Expenses incurred for marketing, market research, promotion within existing or new markets, participation in fairs and exhibitions, business missions, and publishing of own brochures.
- Advertising expenses incurred in promoting the company, products, or services, based on written contracts, as well as costs associated with the production of the materials necessary for broadcasting advertisements, including goods granted as samples, for product testing at selling units, as well as other goods and services granted to stimulate sales.
- Research and development expenses that do not meet the requirements to be recognised as intangible assets for accounting purposes.
- Expenses incurred for environmental protection and resource conservation.
- Expenses incurred for improvement of management; information technology (IT); the introduction, maintenance, and development of quality management systems; and obtaining quality compliance confirmation.
- Bad debts expenses in any of the following cases: the bankruptcy procedure of the debtor was closed based on a court decision; the debtor is deceased, and the receivable cannot be recovered from the heirs; the debtor is dissolved or liquidated; the debtor has major financial difficulties affecting its entire patrimony.
- Travel and accommodation expenses related to business trips in Romania or abroad by employees and directors, and also individuals assimilated to these positions (directors based on mandate and secondees whose costs are covered by the Romanian company); this also includes transport of personnel to/from the workplace.
- Expenses incurred from professional training and development of employees.
- Expenses incurred in relation to work safety, prevention of work accidents and occupational diseases, the related insurance contributions, and professional risk insurance premiums.
- Expenses incurred from acquisition of packaging during their useful life.
- Fines, interest, penalties, and other increased payments due under commercial contracts.
- Expenses incurred from services aimed at enhancing efficiency, optimising the restructuring of the operational and/or financial activity of taxpayers, are now explicitly provided as deductible expenses.

### *Limited deductibility expenses*
The deductibility of certain expenses is limited as follows:

- Interest and foreign exchange losses under thin capitalisation rules *(see the Group taxation section for more information)*.
- Depreciation of assets under fiscal depreciation rules *(see below)*.
- Perishable goods capped as set by the relevant central administration bodies.
- Protocol expenses, up to the limit of 2% of the difference between total taxable revenue and total expenses related to taxable revenue, except for protocol and profit tax expenses.
- Daily allowances for expenses from domestic and foreign travel by employees, up to the level of two and a half times the ceiling set for public institutions.
- Social expenses up to 2% of salary expenses, including maternity allowances, expenses for nursery tickets, funeral benefits, and allowances for serious or incurable diseases and prostheses, as well as expenses for the proper operation of certain activities or units under taxpayers' administration (e.g. kindergartens, nurseries, health services supplied for occupational diseases and work accidents prior to admission to health establishments, canteens, sports clubs, clubs); expenses incurred under a collective labour agreement.

- Health insurance premiums for employers, up to the limit of EUR 250 per year, per person; private pension insurance premiums, up to the limit of EUR 400 per year, per person.
- Taxes and contributions paid to non-governmental organisations and professional associations related to the taxpayer's activity, up to the limit of EUR 4,000 per year.
- Expenses from operation, maintenance, and repair of vehicles used by individuals in company leadership and management positions, within the limits of one vehicle per person.

### *Non-deductible expenses*
Expenses which are specifically non-deductible include, among others, the following:

- Domestic profit tax and profit tax paid in foreign countries.
- Expenses related to non-taxable revenues (note that revenues from dividends have no corresponding expenses).
- Expenses related to WHT supported by Romanian taxpayers on behalf of non-residents.
- Interest, fines, and penalties due to Romanian or foreign authorities.
- Expenses incurred from management, consultancy, assistance, or other supply of services if no contracts or any other lawful agreements are entered into and the beneficiary cannot justify the supply of such services for the activities performed and their necessity.
- Sponsorship and patronage expenses and expenses for private scholarships; however, taxpayers are granted a fiscal credit up to 0.3% of turnover and 20% of the profit tax due, whichever is lower.
- Other salary and/or similar expenses (if not taxed at the level of the individual), except for those specifically exempted from individual income taxation.
- Expenses incurred from insurance premiums unrelated to company assets or business, save for those regarding goods which are bank collateral on loans used to conduct the activity for which the taxpayer is authorised or those used under rental or leasing contracts.
- Bad debt expenses in excess of the deductible provision *(see below)*.
- Expenses recorded without 'justifying' documents.
- Expenses in favour of shareholders, other than those related to goods, or services provided by the shareholders at market value.
- Expenses incurred from fixed assets impairments (i.e. losses in value defined as provisory adjustments by the accounting regulations transposing European Accounting Directives).
- During the period 1 January 2011 to 31 December 2011, fuel expenses for company vehicles weighing under 3,500kg and with fewer than nine passenger seats (including the driver's seat) and used exclusively for passenger transport. Exceptions are vehicles used in the following activities:
  - Intervention, repair, safety and security, courier services, transporting staff to and from the work place, TV vans, cars used by sales agents and recruitment agents.
  - Paid transportation services and taxi activities.
  - Rental.
  - Driver schools.

### *Depreciation*
Romanian law distinguishes between fiscal and accounting depreciation. Companies should maintain a separate record to reflect the separate computation of the fiscal and the accounting depreciation. Any accounting revaluations of fixed assets are not taken into account in computing the tax depreciation.

Assets are generally depreciated using the straight-line method. However, accelerated or digressive depreciation methods may be used to determine fiscal depreciation, while the accounting depreciation method may be different.

Accelerated depreciation (50% deduction from the book value in the first year of operation) can be used for technological equipment and other tools, installations, computers and related peripherals.

The useful lives to be used for tax purposes are the ones stated in the Official Fixed Assets Catalogue, published under government decision. Ranges are provided for classes of fixed assets, from which the taxpayers can choose the useful life (e.g. office and housing buildings: 40–60 years, commercial buildings: 32–48 years, commercial furnishings: 9–15 years, automobiles: 4–6 years).

Land cannot be depreciated.

### *Fiscal losses*

Profit tax is not deductible, nor are late payment interest and fines related to tax liabilities or social security obligations.

### *Provisions and reserves*

Amounts used for setting up or increasing reserves or provisions are deductible as follows:

- Setting up or increasing the legal reserve fund to a limit of 5% of the yearly accounting profit before tax (with adjustments) until it reaches 20% of the share capital.
- Provisions for doubtful debts recorded after 1 January 2006, up to the limit of 30% if the related receivables meet the following conditions simultaneously:
  - Booked after 1 January 2004.
  - Not collected for a period exceeding 270 days from the due date.
  - Not guaranteed by another person.
  - Due by a person not affiliated with the taxpayer.
  - Included in the taxable income of the taxpayer.
- Bad debt provisions, if all the following conditions are met:
  - Receivables are booked after 1 January 2007.
  - The debtor is a company declared bankrupt by a court ruling.
  - Receivables are not guaranteed by another person.
  - The debtor is not a related party.
  - Receivables were included in the taxable income of the taxpayer.
- Specific provisions established by credit institutions, non-banking financial institutions, and other similar entities.
- Technical reserves set up by insurance and reinsurance companies, in accordance with their regulatory legal framework, except for the equalisation reserve.
- Risk provisions for transactions carried out on financial markets, in accordance with the rules issued by the National Commission of Movable Assets.

The reduction or cancellation of any provision or reserve deducted from the taxable profit, due to changing the destination of the provision or reserve, distribution towards shareholders in any form, liquidation, spin-off, merger or any other reason, is included in the taxable revenues and taxed accordingly. The reconstruction of the legal reserve is also non-deductible.

### *Net operating losses*

Companies are allowed to carry forward fiscal losses as declared in the yearly profit tax returns for a period of five years (for losses incurred prior to 2009) or seven years, based on a FIFO method. No related adjustment for inflation is allowed.

For foreign legal persons, this rule (i.e. carry forward of losses) applies only to revenues and expenses attributable to their PE in Romania.

Any loss incurred by a PE of a Romanian company located in a non-EU/EFTA member state or in a country which does not have a DTT in place with Romania is only deductible for tax purposes from the revenues derived by that PE, and losses can be carried forward only for a period of five years.

Carryback of losses is not available in Romania.

## *Group taxation*

There is no tax consolidation or group taxation in Romania. Members of a group must file separate returns and are therefore taxed separately. No provision exists for offsetting the losses of group members against the profits of other group members.

### *Transfer pricing*

Transfer pricing requirements are applicable to transactions between Romanian related parties as well as foreign related parties.

Transactions between related parties should observe the arm's-length principle. If transfer prices are not set at arm's length, the Romanian Tax Authorities have the right to adjust the taxpayer's revenues or expenses so as to reflect the market value.

Traditional transfer pricing methods (i.e. comparable uncontrolled prices, cost plus, and resale price methods), as well as any other methods that are in line with the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines (i.e. transactional net margin and profit split methods), may be used for setting transfer prices.

#### Transfer pricing documentation

Taxpayers engaged in related party transactions have to prepare and make their transfer pricing documentation file available upon the written request of the Romanian Tax Authorities.

Transfer pricing audit activity has significantly increased during the past year, and requests for presenting the transfer pricing documentation file have started to become common practice. We are aware of recent cases where the Romanian tax authorities adjusted the taxable result of a local taxpayer in accordance with the applicable regulations.

The content of the transfer pricing documentation file has been approved by order of the president of the National Agency for Tax Administration. The Order is supplemented by the Transfer Pricing Guidelines issued by the OECD Transfer Pricing Guidelines and the Code of Conduct on transfer pricing documentation for associated enterprises in the European Union Transfer Pricing Document (EUTPD).

The deadline for presenting the transfer pricing documentation file will not exceed three calendar months, with the possibility of a single extension equal to the period initially established.

Failure to present the transfer pricing documentation file or presenting an incomplete file following two consecutive requests may trigger estimation of transfer prices by the tax authorities, based on generally available information, as the arithmetic mean of three transactions considered similar.

**Advance pricing agreement (APA)**
Taxpayers engaged in transactions with related parties can request that the National Agency for Tax Administration issue an APA. These taxpayers can also schedule a pre-filing meeting to discuss the feasibility of the APA.

The request for an APA is filed together with the relevant documentation and payment evidence of the fee (ranging between EUR 10,000 and EUR 20,000). The required documentation is based on the EUTPD and suggests up-front the content of the APA.

The term provided by the Fiscal Procedural Code for issuance of an APA is 12 months for unilateral APAs and 18 months for bilateral and multilateral APAs. The APA is issued for a period of up to five years. In exceptional cases, such as long-term agreements, it may be issued for a longer period.

APAs are opposable and binding on the tax authorities as long as there are no material changes in the critical assumptions. In this view, the beneficiaries are obliged to submit an annual report on compliance with the terms and conditions of the agreement.

If taxpayers do not agree with the content of the APA, they can notify the National Agency for Tax Administration within 15 days. In this case, the agreement does not produce any legal effects.

### *Thin capitalisation*
If the company's equity is negative or the debt-to-equity ratio is higher than 3:1, all the interest expenses and the net losses from foreign exchange differences related to credits or loans with a reimbursement period longer than 12 months are non-deductible in the year in which they are booked. These expenses are carried forward to the following fiscal years, and they will become deductible when the debt-to-equity ratio becomes lower than 3:1.

The interest expenses and the net losses from foreign exchange differences related to loans from Romanian or foreign banks, leasing companies, and other entities expressly mentioned by law are fully deductible, without being limited by the debt-to-equity ratio.

Loans contracted directly or indirectly from Romanian or foreign banks, leasing companies, mortgage companies, and other entities expressly mentioned by the law are no longer taken into account when computing the debt-to-equity ratio.

The tax deductibility threshold for interest on foreign currency loans from non-financial institutions is 6%.

## Tax credits and incentives

### Foreign tax credits

Tax credits may be obtained in Romania for foreign taxes only if the DTT concluded between Romania and the foreign state applies and proper documentation confirming the tax was paid is available.

### Research and development (R&D) incentives

Companies can benefit from an additional deduction of 20% from the eligible expenses in respect of their research and development activities. Moreover, accelerated depreciation may be applied for devices and equipment used in the research and development activity.

### Dividend tax exemption for reinvestments

Distributed dividends are exempted from taxation as of 1 January 2009 if they are invested in the same or in another Romanian company's share capital.

To benefit from this exemption, dividends must be reinvested to preserve and increase the number of employees and to boost existing lines of business.

### Local tax exemptions for business located in industrial parks, and scientific and technological parks

**Industrial parks**

No property tax is due for buildings and constructions located in an industrial park. Also, land within industrial parks is exempt from land tax.

**Scientific and technological parks**

The incentives granted for the set-up and development of scientific and technological parks include:

- Lower taxes on tangible assets and land used by the park.
- Exemption of specific taxes on land.
- Deferred payment of VAT for materials, equipment, and connection to the public utilities networks during the investment period, until the park is put into operation.
- Development programmes for infrastructure, investments, and equipment endowments granted by the local and central public administration companies, and foreign financial assistance.
- Donations, concessions, and structural funds for development.

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## Withholding taxes

### Domestic dividend tax

Dividend payments by a Romanian company to another Romanian company are subject to 16% dividend tax.

Dividends received by a Romanian company from another Romanian company are not taxed if the beneficiary has held at least 10% of the Romanian company's shares for a continuous period of at least two years by the date of dividends payment.

### WHT for non-residents

Non-resident companies are subject to WHT at 16% on other revenues derived from Romania, such as interest, royalties, revenues from services performed in Romania, dividends, revenues obtained from management and consultancy, services (irrespective of where the services are performed), commissions, and revenues derived from liquidation of a Romanian legal entity.

A 25% WHT applies on gambling proceeds obtained by non-residents.

Certain specific provisions and exceptions apply to non-resident WHT, as follows:

- As Romania is an EU Member State, the provisions of the Parent-Subsidiary Directive are applied. Thus, dividends paid by Romanian companies to companies resident in one of the EU/EEA Member States are exempt from WHT if the dividend beneficiary has held a minimum of 10% of the shares of the Romanian company for a continuous period of at least two years by the date of dividends payment.
- Dividend and interest income obtained from Romania by EEA registered pension funds is exempt from WHT.
- Romania has implemented the Interest and Royalties Directive. As of 1 January 2011, payments of interest and royalties made by Romanian companies to companies resident in EU/EEA Member States and holding at least 25% of the share capital of the Romanian company for a continuous period of at least two years prior to the date of payment of interest or royalties are exempt from WHT.

To comply with European legislation, non-residents are required to present the certificate of tax residence and a declaration stating compliance with the necessary requirements, including that they are the beneficial owner of the income.

The following categories of income derived from Romania by non-residents are exempt from WHT:

- Bonds issued and/or guaranteed by the Romanian government.
- Revenues from consultancy services under free-financing agreements signed between the Romanian Government/public authorities and foreign Governments/public authorities or international governmental/non-governmental organisations.
- Revenues from international transportation and accessory services.
- Prizes paid from public funds.
- Income obtained from a partnership constituted in Romania by a non-resident company. Such income is to be taxed under title II of the Fiscal Code, with corporate profit tax.

### *WHT rates for companies, and rates under some DTTs*

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Commissions (%) |
|---|---|---|---|---|
| Non-Treaty | 16 | 16 | 16 | 16 |
| EU – Parent-Subsidiary Directive | 0* | N/A | N/A | N/A |
| EU – Interest and Royalties Directive | N/A | 0* | 0* | N/A |
| Australia | 5/15 | 10 | 10 | N/A |
| Austria | 0/5 | 0/3 | 3 | N/A |
| Belgium | 5/15 | 10 | 5 | 5 |
| Bulgaria | 10/15 | 15 | 15 | N/A |
| Canada | 5/15 | 10 | 5/10 | N/A |
| Cyprus | 10 | 10 | 5 | 5 |
| Czech Republic | 10 | 7 | 10 | N/A |
| Denmark | 10/15 | 10 | 10 | 4 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | Commissions (%) |
|---|---|---|---|---|
| Estonia | 10 | 10 | 10 | 2 |
| Finland | 5 | 5 | 2.5/5 | N/A |
| France | 10 | 10 | 10 | N/A |
| Germany | 5/15 | 0/3 | 3 | N/A |
| Greece | 25/45 | 10 | 5/7 | 5 |
| Hungary | 5/15 | 15 | 10 | 5 |
| Ireland | 3 | 0/3 | 3 | N/A |
| Israel | 15 | 5/10 | 10 | N/A |
| Italy | 10 | 10 | 10 | 5 |
| Japan | 10 | 10 | 10/15 | N/A |
| Luxembourg | 5/15 | 0/10 | 10 | 5 |
| Malta | 5/30 | 5 | 5 | 10 |
| Moldova | 10 | 10 | 10/15 | N/A |
| Netherlands | 0/5/15 | 0 | 0 | N/A |
| Norway | 10 | 10 | 10 | 4 |
| Poland | 5/15 | 10 | 10 | 0/10 |
| Portugal | 10/15 | 10 | 10 | N/A |
| Russia | 15 | 15 | 10 | N/A |
| Singapore | 5 | 5 | 5 | N/A |
| Slovakia | 10 | 10 | 10/15 | N/A |
| South Africa | 15 | 15 | 15 | N/A |
| South Korea | 7/10 | 0/10 | 7/10 | 10 |
| Spain | 10/15 | 10 | 10 | 5 |
| Sweden | 10 | 10 | 10 | 10 |
| Switzerland | 10 | 10 | 0 | N/A |
| Turkey | 15 | 10 | 10 | N/A |
| Ukraine | 10/15 | 10 | 10/15 | N/A |
| United Kingdom | 10/15 | 10 | 10/15 | 12.5 |
| United States | 10 | 10 | 10/15 | N/A |

*If certain conditions are met.



## Tax administration

### Returns

In Romania, the fiscal year is the calendar year. Annual profit tax returns have to be filed with the Romanian tax authorities by 25 April of the following year. Certain returns should be submitted monthly (e.g. the return on tax liabilities due to the consolidated general budget, the VAT return and social security contribution returns).

Large and medium sized taxpayers are obliged to file tax returns electronically for returns with a submission deadline of 25 November 2010 onwards. Other categories of taxpayers can also voluntarily file tax returns online as an alternative way of complying.

Taxpayers who during the period 1 January 2010 through 30 September 2010 were liable to pay profit tax will submit a single profit tax form for the entire year 2010.

The requirement to submit two fiscal forms, one for each fiscal period of 2010, lies only with those taxpayers who were required to actually pay minimum tax for at least one of the first three quarters.

- For 1 January 2010 through 30 September 2010, the submission and payment of the profit tax is to be made until 25 February 2011.
- For 1 October 2010 through 31 December 2010, the form will be submitted and the profit tax paid by:
  - 25 February 2011, for taxpayers who finalise their financial statements for the period 1 October 2010 through 31 December 2010 before this date.
  - 25 April 2011, for taxpayers who finalise their financial statements before this date. In this case, taxpayers will declare by 25 January 2011, using Form 100, the profit tax for Q4, at the level of the profit tax computed for Q3 2010.

### *Payment of tax*

Fiscal statements must be submitted quarterly, together with the related amount of tax, by the 25th day of the month following the end of the quarter.

Romanian banks and Romanian branches of foreign banks have to make quarterly advance profit tax payments of 25% of the total profit tax due for the previous year, adjusted by the inflation rate. For 2011, the inflation rate is 3.2%.

From 2012, regular corporate taxpayers will also have the obligation to make quarterly advance profit tax payments The payments are calculated as a quarter of the previous year's profit tax increased by the inflation rate, and the payments are due by the 25th day of the month following the end of the quarter.

Newly established companies (e.g. without a previous year history) or those which incurred fiscal losses in the previous year make quarterly advance payments at the level of the amount resulted from applying the profit tax rate on the accounting profit of the period for which the anticipated payment is made.

Annual profit tax returns have to be filed by 25 April the following year.

Non-profit organisations, taxpayers that obtain income mainly from crop production, have to declare and pay annual profit tax by 25 February.

### *Non-resident companies*

Non-resident companies deriving income from real estate property located in Romania or the sales of shares held in a Romanian company are obliged to declare and pay the related profit tax. Non-residents may appoint a tax agent to fulfil this requirement. However, if the payer of the income is a Romanian company or a PE, the non-resident companies have the obligation to pay and declare the profit tax.

For capital gains tax declaration and payment, the Romanian legislation requires the following tax returns to be submitted as follows:

- Quarterly statements, starting the 25th day of the month following the quarter in which the non-resident first earned capital gains taxable in Romania.
- An annual profit tax return.

The quarterly statements and annual return must be submitted during the entire period of time the non-resident is registered with the Romanian tax authorities, even if it no longer carries out transactions generating taxable revenues in Romania.

### *Late-payment penalty*
As of 1 October 2010, the late-payment interest is reduced from 0.05% to 0.04% for each day of delay, and the following late-payment penalties are due:

- 5% of the fiscal liabilities, if the payment is made after 30 days but before the expiry of the 90 days from the due date.
- 15% of the remaining unpaid fiscal liabilities, if the payment is made after 90 days from the due date.

Late-payment penalties for the fiscal claims due to local budgets are owed in the amount of 2% of the fiscal claims, calculated for each month or part thereof.

## *Other issues*

### *Mergers and acquisitions*
Mergers, spin-offs, transfers of assets, and exchanges of shares between two Romanian companies should not trigger capital gains tax.

In the case of a relocation of the registered office of a European Company (SE) and European Cooperative Society (SCE) from Romania to another EU Member State, there is no tax on the difference between the market value of the transferred assets and liabilities and their fiscal value, if certain conditions are met. There will also be no tax on such movements at the shareholder level. Therefore, a tax basis step-up may be achieved in the case of Romanian shareholders.

If a Romanian company has a PE in another EU Member State, and the Romanian company is dissolved as a result of a cross-border reorganisation, the Romanian tax authorities will not have the right to tax the former PE.

# *Russian Federation*

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## *Significant developments*

### *Recent significant changes in tax legislation*

#### Changes in dividend exemption rules and exemption of capital gains

Beginning in 2011, the requirement to invest at least 500 million Russian rubles (RUB) to be able to apply dividend exemption was abolished. In other words, starting from 2011, Russian companies will be able to apply a 0% profits tax rate on dividends received from their investments, provided that all of the following conditions are met:

- The owner (recipient of dividends) owns at least 50% of the capital of the payer of dividends or owns depository receipts entitling it to receive at least 50% of the total amount of paid dividends.
- The share or depository receipts have been owned for at least 365 calendar days on the day dividends are declared.
- The company-payer of dividends is not residing in 'offshore' zones with preferential tax regimes, the list of which is established by the Ministry of Finance.

Another significant exemption was introduced for capital gains from the sale or other disposal (including redemption) of shares in Russian entities (interests in Russian entities' charter capital), provided that, as of the date of sale, they have been continuously held by the taxpayer on the basis of a right of ownership or another proprietary right for more than five years. One of the following conditions must be met in order to apply a 0% tax:

- The shares have been non-listed securities over the entire period of the taxpayer's ownership of such shares.
- The shares are listed securities, and the company issuing shares has belonged to the technology/innovative sector of the economy over the entire period of the taxpayer's ownership of such shares.
- As of the date of acquisition by the taxpayer, the shares qualified as non-listed securities and, as of the date of their sale by this taxpayer or of another disposal (including redemption) by this taxpayer, they are listed securities of the high technology/innovative sector of the economy.

The beneficial tax treatment will only apply to shares and interests in charter capital acquired by taxpayers after 1 January 2011 (it means that the exemption may be first used in 2016).

As of 31 May 2011, both chambers of the Russian Parliament have approved a draft bill introducing a further exemption. According to the bill, income of foreign organisations (not performing activity in Russia through a PE) from the sale of certain listed securities of Russian entities (and their derivatives) would not be regarded as income derived from sources in Russia subject to withholding tax (WHT). The exemption would apply from 1 January 2011. The bill is yet to be signed by the President, but it likely will be soon. Please visit the Worldwide Tax Summaries website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

### Deduction of interest incurred under loan agreements in foreign currency

In 2011-2012, interest incurred under loan agreements denominated in a foreign currency are deductable for profits tax purposes within the threshold of the refinancing rate of the Central Bank of Russia (the rate was established as 8.25% starting from 3 May 2011) multiplied by 0.8.

### Innovation centre in Skolkovo

In September 2010, the Law on the Skolkovo Innovation Centre was adopted. Participants in the project will enjoy significant benefits, including tax benefits. The primary tax benefits are:

- Exemption from profits tax, VAT, and property tax.
- Reduced rates for employer's mandatory insurance contributions to the Russian Pension Fund (14%), the Social Insurance Fund (0%), the Federal Mandatory Medical Insurance Fund (0%), and the Regional Mandatory Medical Insurance Fund (0%).

### New Protocol to the Russia-Cyprus Double Tax Treaty (DTT)

Cyprus has historically been considered as one of the most popular jurisdictions for the acquisition and holding of Russian companies.

The Protocol, which amends the Russia – Cyprus DTT, was signed on 7 October 2010. The Protocol will enter into force in the year following the year in which it is ratified both by Russia and Cyprus.

Some of the principal changes to the DTT are as follows:

- Any interest reclassified by the Russian tax authorities as dividends (e.g. due to Russian thin capitalisation rules) will be subject to withholding tax rates for dividends.
- The meaning of the term 'dividends' will be extended.
- Income of mutual equity funds investing only in immovable property will be taxed as income from immovable property.



The following two amendments come into effect at different times:

- Capital gains of a resident of a contracting state from the sale of shares deriving more than 50% of their value from immovable property situated in the other contracting state can be taxed in that other contracting state (this provision will have effect as from the calendar year following the expiration of a period of four years from the date on which the Protocol enters into force).
- New version of Article 27 'Assistance in collection' will take effect upon the introduction by Cyprus of the necessary legal basis.

### Recent changes to customs legislation

The foundation of the Customs Union and deeper integration processes amongst Russia, Belarus, and Kazakhstan (hereinafter 'the CU') has resulted in some unification of the customs legislation of the members of the CU. The CU legislation introduces the united customs territory, within which no customs duties or economic restrictions will be applied (i.e. for trade between member countries of the CU). Members of the CU should apply unified customs tariffs and customs valuation methodology, general rules of non-tariff regulation, uniform technical regulations, etc.

Certain provisions of the legislation on the CU took effect on 1 January 2010, in particular the Common Customs Tariff (CCT) and the legislation on licensing/permissions. However, most of the legislation, which constitutes the legal framework for the Customs Union, including the Customs Code of the Customs Union (the CU Customs Code) took effect from July 2010.

Russian Law on customs regulation (issued in accordance with the CU Customs Code) came into force on 29 December 2010 and introduced further changes into customs legislation.

Starting from 1 January 2011, importers and exporters from members of the CU should use uniform templates of customs documents such as customs declaration, declaration of the customs value, etc. In accordance with Decision of the CU Commission, the new procedures for customs valuation came into force from 1 January 2011. However, the formation of the new customs legislation of the CU is not yet finished. Therefore, we expect that a significant number of new regulatory documents governing imports, exports, and customs clearance of goods will be adopted during 2011 and later.

## *Significant changes expected in 2012*

### Transfer pricing legislation

The preparation of the draft transfer pricing law for the 2nd hearing is currently being performed by the State Duma (the lower chamber of the Russian Parliament). It is possible that the Draft Laws will be enacted as of 1 January 2012. The new version of transfer pricing legislation contains the following provisions:

- A significant reduction in the list of transactions for which the Russian tax authorities may control prices for tax purposes.
- Expansion of the list of related parties.
- The introduction of the arm's-length principle as the fundamental principle of Russian transfer pricing rules.
- Formally introducing functional analysis as one of the comparability factors.
- The introduction of new profit based transfer pricing methods for determining market prices.
- The introduction of reporting and transfer pricing documentation requirements.
- The introduction of advance pricing agreements (APAs) for companies registered as 'large' taxpayers.

### Draft law on consolidated taxpayers

The law on consolidated taxpayers is expected to be adopted and come into force together with the new transfer pricing legislation. The consolidated taxpayer regime will only apply to profits tax. The draft law contains certain conditions for creating a consolidated taxpayer (including the total revenue and the total assets of a group). The thresholds are rather high; and as a result, only a limited number of Russian companies are expected to be able to satisfy them.

## *Taxes on corporate income*

### *Profits tax*

Corporations and their shareholders are taxed separately. The maximum profits tax rate for all taxpayers in the Russian Federation was established at 20% from 1 January 2009 (2% is paid to the federal budget and 18% is paid to the budgets of constituent regions). The amount payable to the budgets of constituent regions may be reduced by such regions, so the total minimum tax rate may be 15.5% (e.g. the rate of 15.5% is established for certain categories of taxpayers located in the Smolensk region, the Arkhangelsk region, the Samara region, the Kaluga region, the Ulyanovsk region).

Russian legal entities pay tax on their worldwide income (credit relief is available for foreign tax paid up to the amount of the Russian tax liability that would have been due on the same amount under Russian rules).

Foreign legal entities pay tax on Russia-source income derived through a permanent establishment (PE) (at the rate of 20%) and are also subject to WHT on income from Russian sources not related to a PE (at rates varying from 10% to 20%, depending on the type of income and the method used to calculate it).

## *Corporate residence*

The effective Russian tax legislation does not contain terminology of corporate residence. The tax system in Russia distinguishes between Russian and foreign legal entities on the basis of their incorporation.

### *Permanent establishment (PE)*

A PE is broadly defined as 'a branch, division, office, bureau, agency, or any other place through which a foreign legal entity regularly carries out its business activities in Russia'. Russia's various DTTs may define a PE differently. Conducting business through an agent also may create a taxable PE in Russia.

## *Other taxes*



### *Value-added tax (VAT)*

The VAT system, while not originally based on the European Union (EU) model, gradually is moving towards it. VAT applies to the value added by each element in the chain of production, from producer to consumer. The standard rate is 18% (with a lower rate of 10% for certain basic foodstuffs, children's clothing, medicines and medical goods, and printed publications). The same VAT rates are applied for the import of goods into Russia. Exports and related services are taxed at a zero rate of VAT.

The list of exempt goods and services includes basic banking and insurance services, educational services by certified establishments, the sale of certain essential medical equipment, passenger transport, and certain other socially important services. Most accredited offices of foreign legal entities (as well as the accredited employees of these offices) may be exempt from VAT on property rental payments. The exemptions from VAT carry no right to input credit in Russia; instead, input VAT is, in most cases, deducted for profits tax purposes.

Taxpayers are on an EU-type input-output VAT system, whereby, a VAT payer accounts for VAT on its full sales price, and deducts VAT incurred on inventory costs and other related expenses. VAT should be calculated on an accrual basis only.

The export of goods to destinations outside Russia, including the Commonwealth of Independent States (CIS) countries, transport and other services related to the export of goods from and import of goods into Russia, international passenger transport, sales to diplomatic functions, and certain other transactions are zero-rated with a right to offset input VAT. To apply the 0% rate and achieve input credit for exported goods, proof of the actual export must be available. A significant number of documents must be submitted to the tax authorities.

Under the reverse-charge mechanism, a Russian company must account for VAT on any payment it makes to a non-tax registered foreign company, if the payment is connected to the sale of goods or services in Russia. The VAT withheld is eligible for normal input VAT credit by Russian payers.

Russian VAT law contains EU-type place-of-supply rules for determining where services are supplied for VAT purposes. These rules divide all services into different categories for determining where they are deemed to be supplied for VAT purposes. For example, certain services are deemed to be supplied where they are performed, some where the ‘buyer’ of the services is located, and others where certain property is located.

Uniform invoicing for VAT purposes applies to all Russian-registered taxpayers that provide goods and services. Standard invoices are to be issued within five days after a supply of goods or services. A duplicate copy of the invoice is registered in a sales journal, and incoming invoices are recorded in a purchase book. Compliance with invoicing procedures is critical to the supplier’s ability to recover input VAT.

VAT returns are due on a quarterly basis. VAT must be paid to the Russian government after the end of each quarter in three instalments not later than the 20th day of each of the three consecutive months following the quarter.

### *Import VAT*
A limited range of goods is eligible for exemption from import VAT. The list of such goods includes, for example, humanitarian aid and goods designated for diplomatic corps. Relief from import VAT is available on certain machinery and equipment and their components and spare parts.

### *Import duties*
In addition to VAT, customs duties are levied on assets imported into the Russian Federation. The rate varies according to the tariff code of the goods imported and the country of origin (generally the rate varies from 0% to 20% of the customs value of imported goods). There is special relief from customs duties for qualifying goods contributed to the charter capital of Russian companies with foreign investments.

The foundation of the Customs Union and deeper integration processes amongst Russia, Belarus, and Kazakhstan (hereinafter ‘the CU’) has resulted in some unification of the customs legislation of the members of the CU. The CU legislation proposed the united customs territory, within which no customs duties or economic restrictions will be applied (i.e. for trade between member countries of the CU). Members of the CU should apply unified customs tariffs and customs valuation methodology, general rules of non-tariff regulation, uniform technical regulations, etc *(please refer to the Significant developments section for more details)*.

### *Customs processing fee*

Goods transported across the Russian Federation customs border are subject to a customs processing fee with a flat rate. The fee depends on a customs value of transported goods. Generally the fee is not significant.

### *Excise duty*

Excise taxes apply to the production and import of cars, tobacco, alcohol, petrol, and lubricants. Special excise rates for each type of excisable goods are established in the tax code. The rates are widely variable and are based on multiple factors.

### *Property tax*

The maximum property tax rate is 2.2%, and regional legislative bodies have the right to reduce this rate. The property tax base includes only the annual book value of fixed assets recorded on the taxpayer's balance sheet (including property leased out). Intangible assets, inventories, work-in-progress, and financial assets are not subject to property tax in Russia.

Certain types of property are exempt from the tax. Relief is also available to a limited number of categories of taxpayers.

### *Transport tax*

A transport tax is imposed on certain types of land, water, and air transport registered in Russia. Fixed rates apply (per unit of horsepower, gross tonnage, or unit of transport), which are differentiated based on engine capacity, gross tonnage, and type of transport. The actual rates in the regions may be subject to a maximum ten-fold increase/decrease by the legislative bodies of Russian Federation constituent subjects. Reporting and payment rules are established by regional legislative authorities.

## *Branch income*

Foreign legal entities pay tax on profits attributable to a PE. A PE's profits are computed on substantially the same basis as Russian legal entities, including the composition of tax-deductible expenses. The tax code does not provide specifically for the deductibility of expenses incurred abroad by a head office with respect to its PE in Russia (including a reasonable allocation of administration costs), although most DTTs provide for such an option.

If a foreign legal entity conducts free-of-charge preparatory and/or auxiliary services for the benefit of third parties, a PE is considered to have been formed, and the tax base is calculated as 20% of its expenses relating to such activities.

Foreign legal entities operating in Russia through a PE are to follow the filing and payment schedules established for Russian legal entities, although they do not make monthly advance payments, but pay profits tax on a quarterly and annual basis only.

## *Income determination*

The accounting period in Russia is a calendar year. Different periods are not permitted. The taxable base is calculated on an accrual basis (only small-scale taxpayers are still allowed to use the cash basis).

Taxable income is to be computed following the rules and principles established in the tax code. Taxpayers must maintain tax accounting registers. Statutory accounts may be used for computing tax items for which accounting methods are the same. In practice, most taxpayers use statutory accounts as a basis and apply adjustments to arrive at the taxable income.

### *Inventory valuation*

Inventory can be valued using one of the following methods: first in first out (FIFO), last in first out (LIFO), average cost, and individual unit cost.

### *Capital gains*

Capital gains are subject to the same 20% profits tax rate and are added to ordinary income to arrive at the taxable income.

Four separate tax baskets are calculated for tax purposes: (i) results from general operations, (ii) results from operations with listed securities, (iii) results from operations with non-listed securities, and (iv) results from operations with non-listed derivatives. A loss in one basket cannot be offset with income in another basket. Results from operations with listed derivatives are included into the general tax basket.

Gains from the sale of fixed assets and other property equal the difference between the sale price and their net book value for tax purposes. Losses resulting from the sale of fixed assets should be deducted in equal monthly instalments during the period, defined as the difference between their normative useful life and the actual time of use.

### *Dividend income*

Dividends received by Russian legal entities from Russian or foreign legal entities are taxed in Russia at a 9% flat rate.

Dividends received from ‘strategic investments’ are exempt from Russian income tax. An investment is considered strategic when:

- the owner (recipient of dividends) owns at least 50% of the capital of the payer of dividends or owns depository receipts entitling it to receive at least 50% of the total amount of paid dividends and
- the share or depository receipts have been owned for at least 365 calendar days on the day dividends are declared.

Dividends from companies residing in ‘offshore’ zones with preferential tax regimes are not eligible for the tax exemption. The list of offshore zones is established by the Ministry of Finance.

Tax on dividends from abroad withheld in the source country may be credited against Russian tax.

The standard 15% tax rate is applicable to dividends paid by Russian legal entities to foreign legal entities. The tax should be withheld by the Russian legal entity paying dividends. The tax may be reduced based on a relevant DTT, typically to 10% or 5% *(please see the Withholding taxes section for more details)*.

### *Interest income*

Interest income is taxed on the accrual basis. A standard tax rate of 20% is applied to interest income, except for interest on state and municipal securities, which is taxed at

0%, 9%, or 15%, depending on the type of security. The rate may be reduced (typically to zero) based on a relevant tax treaty.

### *Exchange gains and losses*

Foreign exchange gains and losses are recognised for tax purposes on the accrual basis. However, gains and losses from settlements in a local currency of amounts denominated in (tied to) a foreign currency are taxable (deductible) on payment.

### *Foreign income*

Russian legal entities pay tax on their worldwide income. Credit relief is available for foreign taxes paid up to the amount of the Russian tax liability that would have been due on the same amount under Russian rules.

The effective tax legislation does not contain provisions that allow tax deferral in respect to foreign income.

## *Deductions*

Expenses are deducted on the accrual basis. The main criteria for deductibility of expenses is that the expense is (i) incurred in the course of an income-generating activity, (ii) properly documented, and (iii) not mentioned in the tax code as non-deductible for tax purposes.

### *Depreciation and amortisation*

Two methods of depreciation are allowed: the straight-line method and the declining balance method. The ranges of useful life of assets for tax purposes are established in the Classification of Fixed Assets adopted by the Russian Government, for example:

| Fixed asset | Useful life (years) |
|---|---|
| Personal computer | 2 to 3 |
| Motor-car | 3 to 5 |
| Truck (capacity more than 5 tonnes) | 7 to 10 |
| Aircraft | 10 to 15 |
| Blast furnace | 20 to 25 |



Accelerated depreciation is permitted for leased property, where a special ratio of up to three may be applied (with some exceptions).

An upfront premium is allowed, which means that a taxpayer has the right to deduct 10% (from 1 January 2009: 30% for certain categories of fixed assets) of the cost of fixed assets purchased (or constructed) in the month when the depreciation started. The balance is depreciated over the useful life of the asset. A premium must be recaptured if a relevant asset is sold within five years of its acquisition.

Intangible assets are amortised over their useful life (or over ten years if their useful life cannot be established).

### *Interest expense*

From 1 January 2011 till 31 December 2012, interest expenses are deductible within the following limits:

- The average interest rate on similar loans obtained within one quarter from Russian lenders multiplied by 1.2.
- If there are no similar loans or at the taxpayer's discretion, the following limits are applied:
  - For loans denominated in a foreign currency: the refinancing rate of the Central Bank of Russia multiplied by 0.8 (the rate was established as 8.25% starting from 3 May 2011).
  - For loans denominated in rubles: the refinancing rate of the Central Bank of Russia multiplied by 1.8.

### *Bad debts*
Generally, losses in the form of bad debts written off are deductible. Companies may create a bad debt reserve. The method of accrual for a bad debt reserve for tax purposes may differ from that in financial accounting because it is based only on the overdue payment period (i.e. if the delay exceeds 90 days, the full amount of the account receivable is included into the reserve).

### *Research and development (R&D) expenses*
Generally, R&D expenses (including R&D with a negative result) are deductible within one year after completion. Certain R&D expenses may be deducted using a coefficient of 1.5. The list of such types of R&D is established by the government.

Significant changes to the tax treatment of R&D would be introduced by a bill that, as of 31 May 2011, has been approved by Russian Parliament and is waiting to be signed by the President.

### *Insurance premiums*
Expenses related to all types of obligatory insurance are deductible subject to state tariff limitations, where established. Voluntary insurance expenses are deductible to the extent that they relate to the insurance of damage and losses related to certain classes of assets, and the insurance of construction activity risks. Contract liability insurance expenses are deductible to the extent that such insurance is required by an international treaty to which Russia is a party or a generally accepted international trade custom.

Long-term life and pension insurance is deductible within a limit of 12% of the payroll fund. Voluntary medical insurance is deductible within a limit of 6% of the payroll fund.

### *Net operating and capital losses*
Tax losses may be carried forward ten years without limitation (i.e. they can be used to offset the entire taxable profit before a loss carryforward deduction). Carryback of losses, however, is not allowed.

Losses from the sale of fixed assets are recognised evenly during the remaining useful life.

Losses and income from different tax baskets can't be offset *(please see Capital gains in the Income determination section for more details)*.

### *Payments to foreign affiliates*
There are no special tax provisions regarding deducibility of payments to foreign affiliates for services provided. They may be deducted in full if the general deductibility criteria are met. Charges with respect to administrative support provided by foreign affiliates may be deductible, but due care should be taken with regard to documentary support of the nature and actual receipt of the service.

## Group taxation

At present, Russia does not allow any group relief.

A draft law introducing the option to file a consolidated profits tax return was approved in the first reading and is expected to be adopted together with new transfer-pricing legislation. According to the draft law, a consolidated taxpayer (CT) regime may be established provided that all companies-participants of the consolidated group meet a number of conditions, the most important of which are the following:

- The total amount of federal taxes accrued and recorded in the tax return for the calendar year preceding the year in which the CT is created exceeds RUB 15 billion.
- The total revenue from the sale of goods, products, work and services, and operating income in the financial reports of the calendar year preceding the year in which the CT is created exceeds RUB 100 billion.
- The total assets value reported as of the first day of the calendar year in which the CT is created exceeds RUB 1 trillion.
- The limit on a share in a direct or indirect holding in CT companies is 90%.
- The holding company must be a Russian legal entity.
- CT participants cannot have foreign representative offices.

The thresholds are rather high, and it is expected that only a few groups of companies will be able to apply the CT regime and, accordingly, the provisions in the law to exempt intra-group transactions from transfer pricing control from the tax authorities.

### Transfer pricing

Currently the tax authorities may examine the prices applied in ‘controlled’ transactions, including the following:

- Transactions between related parties.
- Barter transactions.
- Foreign trade transactions.
- Transactions in which the prices fluctuated by more than 20% within a short period of time.

The prices used in these transactions may only be adjusted for tax purposes if they differ from the market price by more than 20%. The three methods available to determine market price are: (i) comparable uncontrolled price (CUP) method, (ii) resale-minus method, and (iii) cost-plus method, which are applied in a strict hierarchy.



The preparation of a new transfer pricing law for the second hearing is currently being performed by the State Duma (the lower chamber of the Russian Parliament). It is possible that the Draft Laws will be enacted as of 1 January 2012 *(please see the Significant developments section for more details)*.

### Thin capitalisation rules

Under the Russian Tax Code, interest on loans received from foreign shareholders (as well as their Russian affiliates, or loans guaranteed by foreign shareholders or their Russian affiliates) owning more than 20% of capital is deductible, provided the loans do not exceed by three times the amount of equity (12.5 times for banks and leasing companies). If the loans exceed this limit, the excess interest on the loans will be reclassified for taxation purposes as dividends paid to foreign shareholders. Such dividends are not deductible for profit tax purposes and are subject to WHT at the rate of 15% (treaty benefits may apply to reduce the rate).

## Tax credits and incentives

At present, the following types of incentives exist in Russia:

- Regional incentives granted by regional or local authorities with respect to taxes paid to their budgets.
- Special tax regimes in special economic zones (SEZ).
- Incentives related to certain activities (e.g. activities related to R&D, information technology).
- Incentives related to particular projects (e.g. Skolkovo, Olympic Winter Games in Sochi).

The incentives are briefly described below.

It is also worth mentioning that the Russian tax legislation provides for special tax regimes to support small and medium-size businesses. Such regimes include a unified tax regime, simplified tax regime, and unified agricultural tax.

### Regional incentives

Regional incentives in the form of reduced tax rates for taxes payable to regional budgets (primarily profits tax and property tax) are granted to certain classes of taxpayers (typically large investors or entities operating in specific industries). The extent of regional incentives and the willingness of regional authorities to grant them have been diminishing over time.

### Special economic zones (SEZ)

The following types of SEZ are established in Russia:

- Technical research and implementation zones for scientific projects.
- Industrial production zones to develop industrial production.
- Tourism-recreation zones for the development and effective use of Russian tourist resources.
- Port zones.

SEZ residents may take advantage of different combinations of benefits, such as reduced profits tax, exemption from property tax and land tax, and, in some cases, exemption from customs duty and VAT.

### Activities incentives

The following ‘activities’ incentives are available to taxpayers in Russia:

- Certain R&D services are exempt from VAT.
- Certain R&D service-related expenses, as listed by the government, are deductible using a coefficient of 1.5.
- Fixed assets used in the sphere of science and technology may be amortised with an accelerated coefficient up to 3.
- Reduced rates for contribution payments to social funds are established for IT companies from 2010 to 2019.

### Special project incentives

The following ‘special project’ incentives are established in Russia:

- Participants in the Skolkovo innovation centre will enjoy a number of benefits, the primary of which are the following: exemption from profits and property taxes,

exemption from VAT obligations, and reduced rates for mandatory contributions to social funds.
- Olympic Winter Games (Sochi 2014). The Russian tax legislation provides certain tax exemptions for foreign and Russian organizers of the Games, marketing partners of International Olympic Committee, and official broadcasting companies in relation to their activity on the Games, as well as exemption from personal income tax for income received by sportsmen for participation in the Games.

### *Foreign tax credit*

Credit relief is available for foreign taxes paid up to the amount of the Russian tax liability that would have been due on the same amount under Russian rules.

## *Withholding taxes*

In accordance with the general provisions of the tax code, income received by a foreign legal entity and not attributed to a PE in Russia is subject to WHT in Russia (to be withheld at source). WHT rates are as follows:

- 15% on dividends and income from participation in Russian enterprises with foreign investments.
- 10% on freight income.
- 20% on some other income from Russian sources, including royalties and interest.
- 20% of revenue or 20% of the margin on capital gains (from the sale of immovable property located in Russia or shares in Russian subsidiaries where the immovable property located in Russia represents more than 50% of assets).

Taxation of the margin (rather than the gross amount of income received from the above sales) may be applied only if proper documentary support of expenses is available.

Tax should be withheld by the tax agent and paid to the Russian budget. WHT rates may be reduced under a relevant DTT, whose provisions may be applied based on confirmation of tax residence, to be provided by a foreign company to the Russian tax agent prior to the date of payment (no advance permission from the Russian tax authorities is required) and also provided general conditions are fulfilled (proof of beneficial ownership, etc.)



The Russian tax authorities recognise the terms of former USSR treaties until they are renegotiated by the Russian government, and the tax treaty network is continuously updated.

Cyprus has historically been considered as one of the most popular jurisdictions for the acquisition and holding of Russian companies. The Protocol, which amends the Russia – Cyprus DTT, was signed on 7 October 2010 and will enter into force after ratification by Russia and Cyprus. The most significant amendments deal with the term ‘dividends’ and taxation of capital gains from the sale of shares *(please see the Significant developments section for more details).*

The list below is current as of 20 May 2011, and indicates the WHT rates stipulated in the treaties.

# Russian Federation

| Recipient | Treaty benefits available from | Dividends (%) | Interest (%) (1) | Royalties (%) | Construction site duration before creation of PE (months) |
|---|---|---|---|---|---|
| Albania/RF | 1 January 1998 | 10 | 10 | 10 | 12 |
| Algeria/RF | 1 January 2009 | 5 (2)/15 | 0/15 | 15 | 6 and an aggregated period of more than 3 months in any 12-month period for furnishing of services |
| Armenia/RF | 1 January 1999 | 5 (3)/10 | 0 | 0 | 18 |
| Australia/RF | 1 January 2004 | 5 (4)/15 | 10 | 10 | 12 |
| Austria/RF | 1 January 2003 | 5 (5)/15 | 0 | 0 | 12 |
| Azerbaijan/RF | 1 January 1999 | 10 | 0/10 | 10 | 12 |
| Belarus/RF | 1 January 1998 | 15 | 0/10 | 10 | No special provisions in the relevant DTT; local tax legislation provisions should apply |
| Belgium/RF | 1 January 2001 | 10 | 0/10 | 0 | 12 |
| Botswana | 1 January 2010 | 5 (6)/10 | 0/10 | 10 | 6 |
| Brazil | 1 January 2010 | 10 (7)/15 | 0/15 | 15 | 9 |
| Bulgaria/RF | 1 January 1996 | 15 | 0/15 | 15 | 12 |
| Canada/RF | 1 January 1998 | 10 (8)/15 | 0/10 | 0 (9)/10 | 12 |
| China/RF | 1 January 1998 | 10 | 0/10 | 10 | 18 |
| Croatia/RF | 1 January 1998 | 5 (10)/10 | 10 | 10 | 12 |
| Cuba/RF | 1 January 2011 | 5 (11)/15 | 10 | 5 | 12 |
| Cyprus/RF | 1 January 2000 (12) | 5 (13)/10 | 0 | 0 | 12 |
| Czech/RF | 1 January 1998 | 10 | 0 | 10 | 12 and an aggregated period of more than 6 months in any 12-month period for furnishing of services |
| Denmark/RF | 1 January 1998 | 10 | 0 | 0 | 12 and an aggregated period of more than 365 days in any 18-month period for a drilling rig |
| Egypt | 1 January 2001 | 10 | 0/15 | 15 | 6 and an aggregated period of more than 6 months in any 12-month period for furnishing of services |
| Finland/RF | 1 January 2003 | 5 (14)/12 | 0 | 0 | 12 and 18-month period for particular types of construction works |
| France/RF | 1 January 2000 | 5 (15)/10 (16) /15 | 0 | 0 | 12 |
| Germany/RF | 1 January 1997 | 5 (17)/15 | 0 | 0 | 12 |
| Greece/RF | 1 January 2008 | 5 (18)/10 | 7 | 7 | 9 |
| Hungary/RF | 1 January 1998 | 10 | 0 | 0 | 12 |
| Iceland/RF | 1 January 2004 | 5 (19)/15 | 0 | 0 | 12 |

| Recipient | Treaty benefits available from | Dividends (%) | Interest (%) (1) | Royalties (%) | Construction site duration before creation of PE (months) |
|---|---|---|---|---|---|
| India/RF | 1 January 1999 | 10 | 0/10 | 10 | 12 (may be extended on agreement with the competent authorities) |
| Indonesia/RF | 1 January 2003 | 15 | 0/15 | 15 | 3 |
| Iran/RF | 1 January 2003 | 5 (20)/10 | 0 or 7.5 | 5 | 12 |
| Ireland/RF | 1 January 1996 | 10 | 0 | 0 | 12 |
| Israel/RF | 1 January 2001 | 10 | 0/10 | 10 | 12 |
| Italy/RF | 1 January 1999 | 5 (21)/10 | 10 | 0 | 12 |
| Japan/USSR | 1 January 1987 | 15 | 0/10 | 0 (22)/10 | 12 |
| Kazakhstan/RF | 1 January 1998 | 10 | 0/10 | 10 | 12 |
| Korea, Democratic People's Rep/RF | 1 January 2001 | 10 | 0 | 0 | 12 and an aggregated period of more than 6 months in any 12-month period for furnishing of services |
| Korea, Rep./RF | 1 January 1996 | 5 (23)/10 | 0 | 5 | 12 (may be extended up to 24 months upon agreement with the competent authorities) |
| Kuwait/RF | 1 January 2004 | 0 (24)/5 | 0 | 10 | 6 and an aggregated period of more than 3 months in any 12-month period for furnishing of services |
| Kyrgyzstan/RF | 1 January 2001 | 10 | 0/10 | 10 | 12 |
| Lebanon/RF | 1 January 2001 | 10 | 0/5 | 5 | 12 |
| Lithuania/RF | 1 January 2006 | 5 (25)/10 | 0/10 | 5 (26)/10 | 9 |
| Luxembourg/RF | 1 January 1998 | 10 (27)/15 | 0 | 0 | 12 |
| Macedonia/RF | 1 January 2001 | 10 | 10 | 10 | 12 |
| Malaysia/USSR | 1 January 1989 | 0/15 (28) | 0/15 | 10 (29)/15 (30) | 12 and more than 6-month period for installation or assembly projects |
| Mali/RF | 1 January 2000 | 10 (31)/15 | 0/15 | 0 | No special provisions in the relevant DTT; local tax legislation provisions should apply |
| Mexico/RF | 1 January 2009 | 10 | 0/10 | 10 | 6 |
| Moldova/RF | 1 January 1998 | 10 | 0 | 10 | 12 |
| Mongolia/RF | 1 January 1998 | 10 | 0/10 | rates in accordance with local legislation | 24 |
| Montenegro/RF | 1 January 1998 | 5 (32)/15 | 10 | 10 | 18 |
| Morocco/RF | 1 January 2000 | 5 (33)/10 | 0/10 | 10 | 8 |
| Namibia/RF | 1 January 2001 | 5 (34)/10 | 0/10 | 5 | 9 and more than 6-month period for furnishing of services and installation projects |
| Netherlands/RF | 1 January 1999 | 5 (35)/15 | 0 | 0 | 12 |

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| Recipient | Treaty benefits available from | Dividends (%) | Interest (%) (1) | Royalties (%) | Construction site duration before creation of PE (months) |
|---|---|---|---|---|---|
| New Zealand/RF | 1 January 2004 | 15 | 10 | 10 | 12 |
| Norway/RF | 1 January 2003 | 10 | 0/10 | 0 | 12 |
| Philippines/RF | 1 January 1998 | 15 | 0/15 | 15 | 183 days and an aggregate period of more than 183 days in any 12-month period for furnishing of services) |
| Poland/RF | 1 January 1994 | 10 | 0/10 | 10 | 12 (may be extended up to 24 months upon agreement with the competent authorities) |
| Portugal/RF | 1 January 2003 | 10 (36)/15 | 0/10 | 10 | 12 |
| Qatar/RF | 1 January 2001 | 5 | 0/5 | 0 | 6 |
| Romania/RF | 1 January 1996 | 15 | 0/15 | 10 | 12 |
| Saudi Arabia | 1 January 2011 | 0 (37) or 5 | 0/5 | 10 | 6 and an aggregated period of more than 6 months in any 12-month period for furnishing of services |
| Serbia/RF | 1 January 1998 | 5 (38)/15 | 10 | 10 | 18 |
| Singapore/RF | 1 January 2010 | 5 (39)/10 | 0/7.5 | 7.5 | 6 and an aggregated period of more than 3 months in any 12-month period for furnishing of services |
| Slovakia/RF | 1 January 1998 | 10 | 0 | 10 | 12 |
| Slovenia/RF | 1 January 1998 | 10 | 10 | 10 | 12 |
| South Africa/RF | 1 January 2001 | 10 (40)/15 | 0/10 | 0 | 12 |
| Spain/RF | 1 January 2001 | 5 (41)/10 (42) /15 | 0/5 | 5 | 12 |
| Sri Lanka/RF | 1 January 2003 | 10 (43)/15 | 0/10 | 10 | 6 and an aggregated period of more than 183 days in any 12-month period for furnishing of services |
| Sweden/RF | 1 January 1996 | 5 (44)/15 | 0 | 0 | 12 |
| Switzerland/RF | 1 January 1998 | 5 (45)/15 | 0 (46)/ 5 (47) /10 | 0 | 12 |
| Syria/RF | 1 January 2004 | 15 | 0/10 | 4.5 (48) /13.5 (49)/ 18 (50) | 6 |
| Tajikistan/RF | 1 January 2004 | 5 (51)/10 | 0/10 | 0 | 24 (may be extended on agreement with the competent authorities) |
| Thailand/RF | 1 January 2010 | 15 | 0/10 | 15 | 6 and an aggregated period of more than 3 months in any 12-month period for furnishing of services |
| Turkey/RF | 1 January 2000 | 10 | 0/10 | 10 | 18 |
| Turkmenistan/RF | 1 January 2000 | 10 | 5 | 5 | 12 |

| Recipient | Treaty benefits available from | Dividends (%) | Interest (%) (1) | Royalties (%) | Construction site duration before creation of PE (months) |
|---|---|---|---|---|---|
| Ukraine/RF | 1 January 2000 | 5 (52)/15 | 0/10 | 10 | 12 |
| United Kingdom/RF | 1 January 1998 | 10 | 0 | 0 | 12 |
| United States/RF | 1 January 1994 | 5 (53)/10 | 0 | 0 | 18 |
| Uzbekistan/RF | 1 January 1996 | 10 | 0/10 | 0 | 12 |
| Venezuela | 1 January 2010 | 10 (54)/15 | 0/5 (55) /10 | 10 (56)/15 | 9 |
| Vietnam/RF | 1 January 1997 | 10 (57)/15 | 10 | 15 | 6 and more than 12-month period for furnishing of services |

Notes

1. In general, a 0% tax rate applies to interest payments to the governments of contracting states and to payments guaranteed by the government.
2. If the resident of the other contracting state holds directly at least 25% of the capital of the company paying the dividends.
3. If the resident of the other contracting state contributed at least USD 40,000 (or an equivalent amount in the domestic currency of either of the contracting states) to the authorized capital of the enterprise paying the dividends.
4. If the following conditions are met:
   a. Dividends are paid to a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends.
   b. The resident of the other contracting state has invested a minimum of 700,000 Australian dollars, or an equivalent amount in Russian rubles, in the capital of that company.
   c. If the dividends are paid by a company that is resident in Russia, the dividends are exempt from Australian tax.
5. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends and the participation exceeds USD 100,000 or an equivalent amount in any other currency.
6. If the resident of the other contracting state holds directly at least 25% of the capital of the company paying the dividends.
7. If the beneficial owner of the dividends holds directly at least 20% of the total capital of the company paying the dividends.
8. If the beneficial owner of the dividends is a company which owns at least 10% of the voting stock (or in the case of Russia, if there is no voting stock, at least 10% of the statutory capital) of the company paying the dividends.
9. If the following conditions are met:
   a. In respect of the production or reproduction of any literary, dramatic, musical, or other artistic work (but not including royalties in respect of motion picture films nor royalties in respect of works on film or videotape or other means of reproduction for use in connection with television broadcasting).
   b. Royalties for the use of, or the right to use, computer software.
   c. Where the payer and the beneficial owner of the royalties are not related persons, royalties for the use of, or the right to use, any patent or any information concerning industrial, commercial, or scientific experience (but not including any such information provided under a rental or franchise agreement).
10. If the beneficial owner of the dividends is a company which holds directly at least 25% of the capital of the company paying the dividends (this share should be at least USD 100,000 or its equivalent in other currency).
11. If the beneficial owner of the dividends is a company (excluding partnerships) which holds directly at least 25% of the capital of the company paying the dividends.
12. The Protocol to the DTT between Russia and Cyprus was signed on 7 October 2010. However, it is not yet ratified by the Russian State Duma, which is expected to be finalised by the end of 2011. It should enter into force the next year after ratification. The Protocol does not change general WHT rates; however, it introduces changes to the information exchange clause and taxation of capital gains upon sale of shares in land-rich companies (becomes effective after four years from DTT entering into force), and other significant changes. As a result, Cyprus is likely to be removed from the Russian ‘Black List’.
13. If the beneficial owner of the dividends has directly invested in the capital of the company not less than the equivalent of USD 100,000 (EUR, when the signed Protocol will be ratified).
14. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 30% of the capital of the company paying the dividends, and the foreign capital invested exceeds USD 100,000 or its equivalent in the national currencies of the contracting states at the moment when the dividends become due and payable.

15. If the following conditions are met:
    a. Where the beneficial owner of the dividends has invested in the company paying the dividends, irrespective of the form or the nature of such investments, a total value of at least FF 500,000 or the equivalent in another currency; as the value of each investment is appreciated as of the date it is made.
    b. Where such beneficial owner is a company which is liable to tax on profits under the general tax laws of the contracting state of which it is a resident and which is exempt from such tax in respect of such dividends.
16. If only one of the conditions of 15 (a) or 15 (b) are met.
17. If the beneficial owner of the dividends is a company which holds directly at least 10% of the basic or common stock of the company paying the dividends and such capital share amounts to at least EUR 80,000 or the equivalent value in rubles.
18. If the beneficial owner of the dividends is a company (other than partnership) which holds directly at least 25% of the capital of the company paying the dividends.
19. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends and the foreign capital invested exceeds USD 100,000 or its equivalent in national currency of the first-mentioned contracting state.
20. If the recipient of the dividends is a company (excluding partnership) which holds directly at least 25% of the capital of the company paying the dividends.
21. If the beneficial owner of the dividends is a company which holds directly at least 10% of the capital of the company paying the dividends (this share should to be at least USD 100,000 or its equivalent in other currency).
22. Literary, artistic, or scientific work including cinematograph films and films or tapes for radio or television broadcasting.
23. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 30% of the capital of the company paying the dividends and invests not less than USD 100,000 or equivalent amount of local currencies to the company paying the dividends.
24. 0% rate applies to dividends paid to governmental agencies or financial institutions.
25. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends and the capital directly invested by this beneficial owner is not less than USD 100,000 or the equivalent amount in the national currency of a contracting state.
26. For the use of industrial, commercial, or scientific equipment.
27. If the beneficial owner of the dividends holds directly at least 30% of the capital of the company paying the dividends and of an acquisition price of at least ECU 75,000 or its equivalent in national currency.
28. 15% rate applies to profits received from joint-venture by resident of Malaysia.
29. Any patent, trademark, design or model, plan, secret formula or process, or any copyright of scientific work, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.
30. Cinematograph films, or tapes for radio or television broadcasting, any copyright of literary or artistic work.
31. If the invested amount equals or exceeds FRF 1 million.
32. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends and has invested in it at least USD 100,000 or equivalent amount in the national currencies of the contracting states.
33. If the beneficial owner of the dividends has invested in the capital of the company paying the dividends more than USD 500,000.
34. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the share capital of the company paying the dividends and have directly invested in the equity share capital of that company not less that the equivalent of USD 100,000.
35. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends and has invested in it at least ECU 75,000 or its equivalent in the national currencies.
36. If the beneficial owner of the dividends is a company that, for an uninterrupted period of two years prior to the payment of the dividends, owns directly at least 25% of the capital of the company paying the dividends.
37. 0% rate applies to dividends paid to governmental agencies or financial institutions.
38. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends and has invested in it at least USD 100,000 or equivalent amount in the national currencies of the contracting states.
39. If the beneficial owner of the dividends is the government of the other contracting state or if the beneficial owner of the dividends is a company which holds directly at least 15% of the capital of the company paying the dividends and has invested in it at least USD 100,000 or its equivalent in other currencies.
40. If residents of the other contracting state hold at least 30% of the capital of the company paying the dividends and have directly invested in the equity share capital (authorised fund) of that company an amount of not less than USD 100,000 or the equivalent thereof in the currency of the first-mentioned state.
41. If the following conditions are met:

   a. The beneficial owner of the dividends is a company (other than a partnership) which has invested at least ECU 100,000 ECU or the equivalent amount in any other currency in the capital of the company paying the dividends.
   b. Those dividends are exempt from tax in the other contracting state.
42. If only one of the conditions of 41 (a) or 41 (b) are met.
43. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends.
44. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly 100% of the capital of the company paying the dividends; or in the case of a joint venture not less than 30% of the capital of such joint venture; and in either case the foreign capital invested exceeds USD 100,000 or an equivalent amount in the national currencies of the contracting states at the moment of the actual distribution of the dividends.
45. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 20% of the capital of the company paying the dividends and the foreign capital invested exceeds 200,000 Swiss francs or its equivalent in any other currency at the moment when the dividends become due.
46. A 0% tax rate may be applied provided such interest is paid:
    a. in connection with the sale on credit of any industrial, commercial, or scientific equipment or
    b. in connection with the sale on credit of any merchandise by one enterprise to another.
47. In the case of any loan of whatever kind granted by a bank.
48. Cinematography films, programs, and recordings for radio or television broadcasting.
49. Any copyright of literary, artistic, or scientific work.
50. Any patent, trademark, design or model, plan, secret formula or process, any computer software program, or for information concerning industrial, commercial, or scientific experience.
51. If the beneficial owner of the dividends holds directly at least 25% of the capital of the company paying the dividends.
52. If a resident of the other contracting state has invested in its joint-stock capital (registered fund) at least USD 50,000 or an equivalent amount in the national currencies of the contracting states.
53. If the beneficial owner of the dividends is a company which owns at least 10%of the voting stock (or, in the case of Russia, if there is no voting stock, at least 10% of the statutory capital) of the company paying the dividends.
54. If the beneficial owner of the dividends is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends and has invested in this company not less than the equivalent of USD 100,000.
55. In the case of banks.
56. In the case of fees for technical assistance.
57. If the residents of the other contracting state have directly invested in the equity share capital of that company not less than USD 10 million.

## *Tax administration*

All taxpayers are required to obtain tax registration and be assigned a taxpayer identification number, irrespective of whether their activities are subject to Russian taxation.

### *Returns*

An annual profits tax return must be filed by 28 March of the year following the end of the reporting year.

### *Payments*

Companies pay advance profits tax payments on a monthly basis. The final payment for the year is due by 28 March of the following year.

# Saint Kitts and Nevis

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## Significant developments

On 24 August 2010, the Government of the Federation of Saint Kitts and Nevis (St. Kitts-Nevis) passed the Value Added Tax (VAT) Act and introduced VAT on 1 November 2010. The standard VAT rate is 17%, while hotel accommodation, tour operators, and restaurants carry a reduced rate of 10%.

The VAT replaced the Traders Tax, Consumption Tax, Hotel Accommodation and Restaurant Tax, Telecommunication Tax, Cable TV Tax, Vehicle Rental Levy, Parcels Tax, Export Duty, Public Entertainment and Lotteries Tax, and Gaming Machine Tax.

On 26 October 2010, the Excise Tax Act was passed by the Government, making provision for the taxation of certain imports and locally manufactured goods. The excise tax is not a new tax but has been reformed to support the implementation of VAT. The excise tax rate ranges between 5% and 25%.

## Taxes on corporate income

Companies incorporated in St. Kitts and Nevis pay corporate income tax (CIT) on their worldwide income with relief available under existing double taxation agreements (DTAs). Non-resident companies deriving income from St. Kitts and Nevis are liable for CIT and should be registered if they have a physical presence in St. Kitts and Nevis.

St. Kitts and Nevis imposes corporate income tax (CIT) at a flat rate of 35%.

Taxable income or assessable income is ascertained by deducting from income all expenses that are wholly and exclusively incurred during the year in the production of the income. Assessable income is normally arrived at by adjusting the net profit per the financial statements for non-taxable income, non-deductible expenses, and prior period losses up to 50% of chargeable income.

Where a person resident in St. Kitts and Nevis makes to another person not resident in St. Kitts and Nevis a payment *as noted in the Withholding taxes section*, then a withholding tax (WHT) at a rate of 10% must be deducted and remitted to the Inland Revenue within 15 days.

A company which carries on business exclusively with persons who are not resident in St. Kitts and Nevis is exempt from all income, capital gains, and withholding taxes.

Companies registered under the Condominium Act are governed by that act and are not required to pay CIT.

## Corporate residence

A corporation is deemed to be resident if it is incorporated in St. Kitts-Nevis or if it is registered as an external company doing business in St. Kitts-Nevis under the Companies Act.

### Permanent establishment (PE)

A permanent establishment (PE) is not defined in the Income Tax Act; however, any company which would meet the general definition of a PE must be registered.

## Other taxes

### Value-added tax (VAT)

On 24 August 2010, the Government passed the Value Added Tax Act and introduced VAT on 1 November 2010. The standard VAT rate is 17%, while hotel accommodation, tour operators, and restaurants carry a reduced rate of 10%.

The VAT replaced the Traders Tax, Consumption Tax, Hotel Accommodation and Restaurant Tax, Telecommunication Tax, Cable TV Tax, Vehicle Rental Levy, Parcels Tax, Export Duty, Public Entertainment and Lotteries Tax, and Gaming Machine Tax.

Persons who have made or are likely to make taxable supplies in excess of 96,000 East Caribbean dollars (XCD) for certain professional services and XCD 150,000 for other business activities in a continuous period of 12 calendar months are required to register for VAT.

### Excise tax

On 26 October 2010, the Excise Tax Act was passed by the Government making provision for the taxation of certain imports and locally manufactured goods. The excise tax is not a new tax but has been reformed to support the implementation of VAT and will apply to a small range of goods, such as alcoholic beverages, tobacco products, petroleum products, motor cycles, aerated beverages, and firearms. The excise tax rate ranges between 5% and 25%.

### Property tax

#### Saint Kitts

Property tax in Saint Kitts is levied at varied rates on the basis of the market value of the real property (including land and building as assessed by the Chief Valuation Officer) and its class.

Property classes and rates of tax are as follows:

- Residential use property: 0.2%
- Commercial use property: 0.3%

Annual allowances and tax rebates are available as follows:

- Residential use property and condominium allowance of XCD 80,000 from the taxable value.
- No property tax will be assessed on any buildings, condominiums, etc. that are under construction.
- New residential use property and condominiums are exempt from tax for one year from the date certified by the valuation officer.

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Note that residential use properties located in the South East Peninsula are assigned values based on fixed rates for land (XCD 20 per square ft) and building (XCD 300 per square ft). Property tax is then applied at a rate of 0.2%.

Where property situated in the South East Peninsula area is not developed within five years, a surcharge can be assessed at the rate of 1% of the assessed market value per annum, and increased annually at the rate of 1% thereafter until it reaches a maximum rate of 5% of the assessed market value while the property remains undeveloped. If property is less than one acre, undeveloped, and owned by a resident for the purpose of erecting a house, such property shall be exempt from the surcharge upon application in writing to the Comptroller of Inland Revenue.

Property tax is payable on or before 30 June of each year and is deemed to be in default if not paid within 30 days of becoming due. Interest is charged at a rate of 12% per annum on the unpaid taxes.

**Nevis**

Property tax in Nevis is levied at varied rates on the basis of the market value of the real property (including land and building as assessed by the Chief Valuation Officer) and its class.

Property class and rates are as follows:

| Property class | Building tax rate (%) | Land tax rate (%) |
|---|---|---|
| Residential | 0.156 | 0.075 |
| Commercial | 0.3 | 0.2 |
| Accommodation | 0.3 | 0.2 |
| Certified farming | 0 | 0.01 |
| Institutional | 0.2 | 0.15 |

Commercial use property is defined as property which does not include accommodation use property or property used for certified farming operations.

Accommodation use property is defined as property for short term accommodation and includes a guest house.

Annual allowances and tax rebates are available as follows:

- Residential use property and condominium allowance of XCD 80,000 from the taxable value.
- No property tax will be assessed on any buildings, condominiums, etc. that are under construction.

Property tax is payable on or before 30 June of each year and is deemed to be in default if not paid within 30 days of becoming due. Interest is charged at a rate of 12% per annum on the unpaid taxes.

### *Alien land holding licences*

To hold land as an owner, a non-citizen must first obtain an alien land holding license and pay 10% of the market value of property or XCD 750, whichever is greater.

A non-citizen is required to obtain a license to hold shares in a company which owns land, to vote at shareholders meetings of the company, and to be a director of the company. Each license costs XCD 250.

If a non-citizen purchases land in the Frigate Bay area, then there is no requirement to obtain a licence and only a minimal fee of XCD 50 is payable.

If a non-citizen wishes to purchase land in the South East Peninsula, the non-citizen is required to obtain a licence prior to purchasing the property; however, the payment of the 10% license fee will be waived.

### *Stamp duty*

Stamp duty applies to a very wide range of transactions (e.g. bill of sale, leases, mortgages, contract, bill of lading). Stamp duty on transfer of real property, transfer of shares, mortgages, and bank loans to aliens are specifically covered below.

#### Transfer of real property

Stamp duty is levied on the consideration for the sale or the value of property as assessed by the Chief Valuation Officer, whichever is higher.

The vendor is responsible for the payment of all stamp duty on property transfers on the following basis:

| Type of property transfer | | Rate |
|---|---|---|
| a | Transfer of property for consideration in money or value in kind of not less than the value of the property | 12% |
| b | Transfer of property for consideration in money or value in kind of less than the value of the property | 12% |
| c | Transfer of property without consideration in money or value in kind | 6% |
| d | Transfer of property in any Special Development Area other than the South East Peninsula | 14% |
| e | Transfer of property situated in the South East Peninsula | 18.5% |
| f | Transfer of property other than stock or debenture stock or funded debt or land | 2% |
| g | Transfer of property between husband and wife and between parents and children and vice versa | XCD 100 |
| h | Transfer of land by will or by similar instrument | XCD 100 |
| i | Transfer of registered condominium units | 5% |

Where a developer has obtained concessions in connection with a house or building constructed on the land being transferred, the developer is required to pay stamp duty on the same basis as noted in a, b, and c above.

Where a developer has obtained concessions in connection with a house or building to be constructed on the land being transferred, then the developer will be required to pay stamp duty initially on the land on the same basis as noted in a, b, and c above. However, when the house or building is subsequently constructed on the land with the aid of the concession, the owner of the building shall pay stamp duty on the house or building as provided in a, b, and c above as if the concessions or any part thereof had not been utilised.

Where a developer has not obtained concessions in connection with a house or building constructed on the land being transferred, the developer will be required to pay stamp duty on the same basis as noted in a, b, and c in respect of the land only.

**Transfer of shares**
Stamp duty is levied on the value of the consideration for the sale of shares or debentures issued by or on behalf of a company or at the value assessed by the Chief Valuation Officer, whichever is higher. The stamp duty is levied at a rate of 2%. If the company owns property and its value exceeds 50% of the value of the company's assets, then the stamp duty is calculated using the applicable rate on the transfer of real property *(see above)*.

**Mortgages**
Stamp duty is levied on the total amount secured and is applicable to both the registration and discharge of the mortgage. The standard rate is 1%. For amounts secured in relation to a Special Development Area, the rate is 2%.

**Bank loans to aliens**
Stamp duty is levied on the total amount of a bank loan to aliens. The standard rate is 2.5%. For loans to finance development in a Special Development Area, the rate is 5%.

### *Life insurance premium tax*
A premium tax of 5% is levied on the premium income of all life insurance companies, whether resident or non-resident. In addition, a registration fee of XCD 2 per XCD 1,000 of income or XCD 30, whichever is less, must be paid to the Comptroller of Inland Revenue.

### *General insurance premium tax*
A premium tax of 5% is levied on the premium income (net of agent's commission) of all general insurance companies, whether resident or non-resident.

## *Branch income*

Branch income is taxed on the same basis and at the same rate as the income of a corporation. A resident branch of a foreign company shall be regarded as a separate company and shall be taxed on the same basis as that of a locally registered corporation.

Recharges of expenses from head office to the branch will be subject to WHT at a rate of 10%; however, the recharges have to be justified and cannot be based on a percentage allocation.

## *Income determination*

### *Inventory valuation*
Inventories are generally stated at the lower of cost or net realisable value. The first in first out (FIFO) and average cost methods of valuation are generally used for book and tax purposes. However, the Comptroller of Inland Revenue will normally accept a method of valuation that conforms to standard accounting practice in the trade concerned. The last in first out (LIFO) method is not permitted for tax or book purposes.

### Capital gains
Capital gains tax will be imposed if an asset is sold within one year of the date of acquisition. The maximum rate of tax will be one half the CIT rate. Assets sold after one year will not attract capital gains tax.

### Dividend income
Dividends received by a company resident in St. Kitts-Nevis from another company resident in St. Kitts-Nevis are taxed at source at the CIT rate of 35%. Credit is given to the recipient for the tax on the dividend in computing the tax liability.

### Foreign income
A St. Kitts-Nevis corporation is taxed on foreign branch income when earned and on foreign dividends when received. Double taxation is avoided by means of foreign tax credits where active tax treaties exist and through deduction of foreign income taxes in other cases (the United Kingdom (UK) and the Caribbean Community (CARICOM)). There is also relief from Commonwealth taxes. *See Foreign tax credit in the Tax credits and incentives section for more information.*

## Deductions

### Depreciation
Depreciation allowed for tax purposes is computed by the diminishing-balance method at prescribed rates. An initial allowance of 20% is granted on industrial buildings or structures and in respect of capital expenditure incurred on plant and machinery by a person carrying on a trade or undertaking, as defined. In addition, an annual allowance of between 2% and 5% is allowed on all buildings constructed after 1 March 1994. Concrete buildings are depreciated at a rate of 2%, while the rate varies for other buildings depending on the type of material used in construction. Conformity between book and tax depreciation is not required.

Any gain on the sale of depreciated assets is taxable as ordinary income up to the amount of tax depreciation recaptured.

Initial allowances and annual allowances cannot reduce the tax that would have been otherwise payable by more than 50%. Any initial allowance or annual allowance not utilised may be carried forward indefinitely.

### Contributions to a pension fund
Contributions made by an employer to a pension fund (approved by the Comptroller) on behalf of its employees are deductible, up to a maximum of 5% of annual earnings of the employee or a maximum of XCD 2,000. Application should be made to the Ministry of Finance or to the Pension Fund Committee.

### Restriction on compensation expenses
Salaries, wages, leave pay, fee, commission, bonus, gratuity, or any other perquisite or such other payment which an employee of a company receives in the course of one's employment or the value of any benefit to such employee or to any member of an employee's family in excess of XCD 60,000 per annum will not be allowed as a deduction from chargeable profit.

### Restriction on bad debts
Specific bad or doubtful debts in excess of 5% of total trade receivables will not be allowed as a deduction.

### Net operating losses

Income tax losses may be carried forward for five years following the year in which the loss was incurred. However, the chargeable income of a company after deducting initial and annual capital allowances in any one income year may not be reduced by more than 50% by losses brought forward. No carryback of losses is permitted.

### Payments to foreign affiliates

A company incorporated in St. Kitts-Nevis may claim a deduction for royalties, management fees, and interest charges paid to foreign affiliates, provided the payments are equal to or less than what the corporation would pay to an unrelated entity. The deductibility of any payments to a foreign affiliate will be subject to an arm's-length test, and WHT will be payable at a rate of 10%.

## Group taxation

Group taxation is not permitted in St. Kitts-Nevis.

### Transfer pricing

There are no provisions for transfer pricing in the tax laws of St. Kitts-Nevis.

### Thin capitalisation

There are no provisions for thin capitalisation in the tax laws of St. Kitts-Nevis.

## Tax credits and incentives

Tax incentives are currently available under the following legislation.

### Income Tax Act, No. 17 of 1966

The Income Tax Act provides that if a company is licensed under the Hotel Aids Ordinance and constructs a hotel with more than 30 bedrooms, the hotel will receive an exemption from CIT for a period of ten years beginning on the day it is first open for business. If the hotel has less than 30 rooms, then it will be entitled to a five year tax holiday. During the tax holiday period, no initial deductions or annual capital allowance deductions shall be allowed. Thereafter, only the annual allowance will be allowed and will be computed on the total capital expenditure incurred during the holiday period less any assets sold. The net losses arising during the tax holiday period (i.e. the excess of accumulated tax losses over total profits) may be carried forward and reduced against profits following the expiration of the tax holiday in accordance with the normal rules for set-off of losses.

The Income Tax Act also provides that if a licence is granted to a pioneer manufacturer under the Pioneer Industries Act, the manufacturer is entitled to a five year tax holiday (or up to ten years, at the discretion of the government) as provided in the licence.

### Hotel Aids Act

The Hotel Aids Act provides that a licence may be granted to any person who desires to construct or extend an existing hotel to import building material and equipment free from import duties as specified in the licence for use in the construction of the hotel and to furnish and equip the hotel. The holder of a licence may not dispose of any hotel equipment within three years of being imported free of duties and taxes. Permission must be received from the Comptroller of Customs to dispose of any building material and hotel equipment within the three year period.

### *Fiscal Incentives Act*
The Fiscal Incentives Act provides that if a company is declared to be an approved enterprise to manufacture certain 'approved products', then the manufacturer is entitled to a tax holiday period of between ten and 15 years depending on the classification of the approved enterprise. The net losses arising during the tax holiday period (i.e. excess of all losses over all profits) may be carried forward and set off against profits of the approved enterprise for the five year period following the tax holiday period.

### *Small Business Development Act, 2009*
The Small Business Development Act provides the framework for the promotion of investment opportunities in St. Kitts-Nevis by introducing a system of registration of small businesses and a range of incentives which are available to locals. The available incentives and concessions to any small business that would be entitled for consideration are as follows:

- Concession on consumption tax applicable to professionals (e.g. engineers, doctors).
- Reduction on CIT for a minimum of three years to a maximum of five years.
- Relief on CIT by way of an allowable deduction on any monies borrowed from any financial institution including any bank, non-bank, or credit union.
- Export incentives.
- Rebate on CIT.
- Exemption from or reduction in customs duty on inputs imported for use in the small business.
- Exemption from or reduction in customs duty on any plant, machinery, equipment, or motor vehicle imported for use in the small business.
- Reduction of property tax of up to 75%.

A small business to which this Act applies must meet all of the following criteria:

- No more than 25 employees.
- Net assets or paid up capital does not exceed XCD 1 million.
- Annual sales that do not exceed XCD 2 million.
- Owned by citizens of St. Kitts and Nevis.
- Not more than 25% owned or controlled by a company whose annual turnover or net assets exceed the limits noted above or by a subsidiary of a larger company.
- The composition of the board of directors is not controlled by a company whose annual turnover exceeds the criteria above.
- Has no agreement for managerial or other services to persons who are not citizens of St. Kitts and Nevis or other CARICOM territories.



The registration fee for an approved small business status is XCD 100. Each approved small business must, within six months after the end of its financial year, submit to the Registrar (person designated by the Minister to perform the functions of Registrar of Small Businesses) audited financial statements of its accounts audited by an auditor in accordance with generally accepted international auditing standards.

### *Other incentives*
Approved manufacturing, agricultural, and tourist ventures are permitted to import building material and equipment free of customs duties.

A Memorandum of Understanding (MOU) between the government and small hotel operators provides for certain conditions under which small hotel operators will be eligible for duty free concessions on the refurbishment of their facilities every seven years, and on food and wine for their restaurant facilities where applicable. For the purposes of this new incentive package, a small hotel is defined as a hotel consisting of at least ten rooms and not exceeding 99 rooms.

### *Foreign tax credit*

Double taxation is avoided by means of foreign tax credits where active tax treaties exist and through deduction of foreign income taxes in other cases (the United Kingdom and CARICOM). A foreign tax credit is also available to persons in St. Kitts and Nevis who have paid or are liable to pay Commonwealth income tax.

#### Residents

The relief available from tax in St. Kitts and Nevis for a person resident in St. Kitts and Nevis from tax paid in St. Kitts and Nevis is the Commonwealth income tax rate if that rate does not exceed one-half the tax rate in St. Kitts and Nevis. If the Commonwealth income tax rate exceeds the St. Kitts and Nevis tax rate, then the relief will be limited to one-half the tax rate in St. Kitts and Nevis.

#### Non-resident

The relief available from tax in St. Kitts and Nevis for a person not resident in St. Kitts and Nevis from tax paid in St. Kitts and Nevis is one-half the Commonwealth income tax rate if that rate does not exceed the tax rate in St. Kitts and Nevis. In any other case, the relief will be limited to the amount by which the St. Kitts and Nevis tax rate exceeded one-half the rate of Commonwealth income tax.

## *Withholding taxes*

A WHT at the rate of 10% should be withheld from payments made to non-residents in respect of the following:

- Dividends.
- Interest, annuity, premium, and discount.
- Rent, lease, contract, and royalty payments.
- A natural resource payment.
- Commissions, remuneration, fees, and licences.
- Charges for the provision of personal services, commercial advice, and managerial skills.
- Administration, management, or head office expenses.
- Profit.
- Technical, professional, vocational, and any other service fees.
- Accounting, actuarial, legal, and audit expenses.
- Non-life insurance premiums.
- Any other annual or periodic payment or distribution.

### *Tax treaties*

There is a tax treaty with the United Kingdom and a DTA between member states of CARICOM.

## *Tax administration*

### *Returns*

Taxes are assessed on a fiscal-year basis. The taxpayer must file an information return on Form CIT–01 by the fifteenth day of the fourth month after the fiscal year end along with the financial statements. The authorities either accept the self-assessment or issue a revised assessment. If a return is not filed on a timely basis, the authorities have the power to issue estimated assessments. There is a 2.5% penalty for late filing (minimum of XCD 1).

The taxpayer can object to assessments raised within one month and ask the Comptroller of Inland Revenue to review and revise. In the event that the objection is unsuccessful, the taxpayer may appeal to the Commissioners of Income Tax.

### *Payment of tax*

Advance tax is payable in quarterly instalments on 15 March, 15 June, 15 September, and 15 December of each year and is ordinarily based on the tax chargeable and assessed in the previous fiscal year. The standard amount of each instalment is determined as one-fourth of the tax chargeable in the previous fiscal year. If the assessment for the prior year has not been finalised, the Comptroller of Inland Revenue can raise an assessment based on best judgment.

The balance of tax due after the final assessment is issued, as notified in the assessment, is payable on or before the fifteenth day of the fourth month after the fiscal year end. If the Comptroller of Inland Revenue revises the assessment, then payment of the balance of taxes due is due one month after the date of issue of the revised assessment.

Tax is deemed to be in default if not paid by the fifteenth day of the fourth month after the fiscal year end or within one month of the date of the notice of assessment, whichever is later. Interest of 1% per month or 12% per annum is charged on unpaid taxes in default.

### *Statute of limitations*

Assessments may be reviewed and revised by the Comptroller of Inland Revenue within the year of assessment or within six years of the expiration of the assessment year.

# Saint Lucia

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## Significant developments

Saint Lucia's 2011 Budget Address was delivered by the Prime Minister and Minister of Finance on 14 April 2011. No corporate taxation changes were announced; however, the following new tax measures were introduced:

- A National Security Levy of 1% of the cost, insurance, and freight (CIF) value of selected imported items into Saint Lucia. This is effective only for the fiscal year 2011.
- A 50% increase in the excise tax on cigarettes.
- Radio and television broadcast application license which will range from 25 East Caribbean dollars (XCD) to XCD 2,000 per license depending on the type of operation and the class of license. Further, there is an initial license fee from XCD 100 to XCD 2,000 per license.

Additionally, the following changes to income tax and property tax legislation began 14 March 2011:

- Any income accrued to a company on bonds is no longer exempt income; however, income earned on bonds issued by member governments of the Eastern Caribbean Central Bank and income accruing from bonds to any citizen or resident of any member state of the Organisation of Eastern Caribbean States or to any company incorporated in and registered in any member state of the Organisation of Eastern Caribbean States are tax exempt.
- The property tax rate for commercial property increased from 0.25% to 0.4% of the open market value.
- The property tax rate for residential property is now 0.25% of the open market value instead of 5% of the annual rental value.

## Taxes on corporate income

Resident companies are taxed on gains or profits accrued directly or indirectly from all sources, whether in and out of Saint Lucia, and are subject to tax at a flat rate of 30%. The 30% tax rate is only applicable to companies who prior to income year 2003 have no tax arrears and have complied with the requirements of any enactment administered by the Inland Revenue Department. The tax rate of 33.33% will still apply to those companies who have tax arrears and have not complied with the requirement.

Non-resident companies are taxed on Saint Lucia-source income. The gross amount of such income is liable to 25% withholding tax (WHT) while WHT of 15% applies to interest.

Associations of underwriters are taxed at 30% on 10% of the gross premium arising in Saint Lucia, and life insurance companies are taxed at 30% on 10% of the gross investment income arising in Saint Lucia.

## Corporate residence

Companies are regarded as resident if they are incorporated in Saint Lucia or managed and controlled through a permanent establishment (PE) in Saint Lucia.

### Permanent establishment (PE)

A PE is defined in Saint Lucia as a fixed place or premises through which the business is wholly or partly carried on.

## Other taxes

### Value-added tax (VAT)

VAT will be implemented in Saint Lucia in April 2012. VAT is designed to streamline the tax system in Saint Lucia. Upon implementation, the consumption tax will be replaced.

### Consumption tax

Consumption tax is levied on goods manufactured in Saint Lucia and on a wide range of imported goods. Rates range between 5% and 15%. For manufactured goods, the tax is charged on their open market value. For imported articles, consumption tax is charged as a percentage of the cost, insurance, and freight (CIF) value plus customs duty.

### Stamp tax

Stamp tax is charged on any document that evidences a legal or contractual relationship between two or more parties. Additionally, many types of commercial and legal documents must be stamped, denoting the payment of taxes, which may be either at a fixed rate or at an *ad valorem* rate, depending, for example, on the value of the property transferred.

The current rate of stamp tax under the stamp duty regulations for the conveyance or transfer on sale of the debenture, stock, debt, or shares of a company and the release, renunciation, or reassignment of any shares or interest in any shares of a company or corporation is the greatest of the following:

- 0.5% of the net value of the assets of the company or corporation.
- XCD 10.
- Provided that at least 75% of the open market value of the assets of the company or corporation is comprised of immovable property, the stamp duty (including vendor's tax) based on the stamp duty on the sale of immovable property that would be payable on a conveyance or transfer on sale of such immovable property, as indicated below:
  - Conveyance or transfer on sale of any immovable property such duty to be paid by the purchaser: 2% *ad valorem*.
  - Conveyance or transfer on sale of any immovable property such duty to be paid by the vendor:
    - where the vendor is not a citizen of Saint Lucia or is a foreign company: 10% *ad valorem*.

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- where the vendor is a citizen of Saint Lucia or is a local company: 2.5% *ad valorem* from XCD 50,000 to XCD 75,000; 3.5% *ad valorem* from XCD 75,001 to XCD 150,000; 5% *ad valorem* from XCD 150,001 and over.

### *Commercial property tax*
Commercial property tax is currently assessed annually at 0.4% of the open market value of the property. The owner is required to obtain a commercial valuation assessing the open market value of the property. All new commercial properties completed after 1 April 2001 can benefit from a three-year tax exemption from commercial property tax.

### *Residential property tax*
The property tax rate for residential property is now 0.25% of the open market value instead of 5% of the annual rental value.

### *Custom duties*
Customs duties are charged on a wide range of imported goods. Exemptions are granted for raw materials and plant and machinery used in manufacturing and for certain items imported by hotels under construction, extension, or refurbishing projects.

### *Excise tax*
Excise taxes are imposed on home-produced goods, mainly liquor, beer, and cigarettes. XCD 1.44 per litre of liquid applies to beer in glass bottles and XCD 3.50 per liquid gallon applies to beers in metal cans.

There is also an excise tax on fuel when fuel is imported by a wholesaler. Tax is included on the price of fuel paid at the gas pump. The tax rate formula is based on the current price provided by the supplier and regulated price at the gas pump.

## *Branch income*

The tax rate on branch income is the same as that on income earned by resident companies. No additional tax is withheld on transfers of profits to the head office.

## *Income determination*

### *Inventory valuation*
Stocks generally are valued at the lower of cost or market value. Obsolescence is permitted where it occurs, but there are no provisions to account for monetary inflation on inventory valuation.

### *Capital gains*
There is no tax on capital gains except in instances where such gains comprise a portion of the income-earning activities of the business. In such instances, the corporate tax rate applies.

### *Dividend income*
Inter-company dividends are not subject to tax in Saint Lucia.

### *Interest income*
The corporate tax rate applies to interest income. However, income earned on securities issued by member governments of the Eastern Caribbean Central Bank and income accruing from trading in securities under the Securities Act to any citizen or resident of

any member state of the Organisation of Eastern Caribbean States or to any company incorporated in and registered in any member state of the Organisation of Eastern Caribbean States is tax exempt.

Any expenditure incurred for the purpose of producing exempt income is not deductible.

### *Royalty and rental income*

The corporate tax rate applies to royalty and rental income. However, rental income from a residential accommodation shall be exempt from tax if certain requirements, as defined by regulations, are met.

### *Foreign exchange gains/losses*

Foreign exchange gains or losses arising from foreign exchange transactions on trading items are assessable or deductible as realised gains or losses, if settled within normal credit terms. Gains or losses on other instruments, including inter-company loans, are recognised only when actually realised.

Unrealised exchange gains/losses are not taxable/deductible.

### *Bribes, kickbacks, illegal payments*

Bribes, kickbacks, and illegal payments received by a company are includible in taxable income.

### *Foreign income*

Resident companies are taxed in Saint Lucia on income earned outside Saint Lucia. Reciprocal understandings exist with some countries for the avoidance of double taxation, and foreign tax is allowed as a credit against tax charged in Saint Lucia. Saint Lucia has no tax treaties with other countries, except for the member states that make up the Caribbean Community (CARICOM). There is an agreement among the governments of CARICOM for the avoidance of double taxation. Where no agreement exists, the foreign tax offset is the lesser of the foreign tax paid or the tax payable on that income in Saint Lucia.

Tax deferral is not permitted in Saint Lucia.

## *Deductions*



### *Depreciation*

The following capital allowances are available in Saint Lucia:

- An initial allowance of 20% is granted on the acquisition of industrial, agricultural, and commercial buildings (except for hotels and rental properties); on plant and machinery, including motor vehicles and furniture; and on fixtures and equipment.
- Thereafter, annual allowances for wear and tear, ranging from 10% to 33.33%, are granted on the reducing-balance method, except for industrial and agricultural buildings, which are allowed an annual rate of 5% and commercial buildings (except for hotels and rental properties), which are allowed an annual rate of 2.5%.

The Comptroller of Inland Revenue may also grant, on application, a higher rate for annual allowance for assets that have higher or abnormal wear and tear.

Gains on disposal are taxable as ordinary income to the extent of depreciation recovered, and any proceeds in excess of the cost of the asset are treated as a capital gain, which is not subject to tax. Where the proceeds on disposal are lower than the tax written-down value of the asset, a balancing allowance is granted for the shortfall.

### *Goodwill*
Neither the amortisation of impaired goodwill nor the related write-off of it is an allowable deduction.

### *Accrued expenses*
Accrued expenses are deductible as long as they are business related.

### *Contingent liabilities*
Contingent liabilities are deductible expenses once they are recognised in the book of accounts.

### *Interest expense*
Interest on any loan, including interest payable on debentures, is an allowable deduction to the extent that the amount of such loan was used for the purpose of producing assessable income.

### *Bad debt*
Bad debt expense is deductible provided it has been brought to account in generating the company's assessable income for any income year.

### *Charitable contributions*
Charitable contributions are an allowable deduction when the contributions are made under a deed of covenant for a period of not less than three years to any religious, charitable, medical, or educational institution; sporting body; or fund of a public character, approved by Cabinet, if such contributions are made to the Saint Lucia National Trust. However, the deduction with respect to such contributions shall not exceed 25% of the assessable income of the company for that income year.

### *Organisational and start-up expenses*
All expenditures incurred in connection with incorporation costs for the establishment of a new small business enterprise are allowable deductions. A small business enterprise is an enterprise incorporated during the year of income and

- is wholly owned by citizens of Saint Lucia who have not been owners of previously incorporated businesses in Saint Lucia
- employs not more than 50 persons
- has gross income that does not exceed XCD 1 million
- engages in an activity on the listing of preferred business activities as approved by the Minister of Finance, and
- satisfies the provision of any law in force with respect to micro or small scale business.

### *Pension expense*
Current annual contributions to an approved pension fund are deductible expenses. However, where a special payment is made to an approved pension fund, in relation to a period of service by an employee prior to the setting up of the approved pension fund, or to meet any actuarially ascertained insufficiency in the resources of the approved pension fund to meet its obligations to its employees, such amount shall be deductible as follows:

i. Where the special payment does not exceed the current annual contribution, such amount is wholly deductible.
ii. Where the special payment exceeds the current annual contribution, the special payment is an allowable deduction in such years of income, not exceeding five in number, as in the opinion of the Comptroller is reasonable in the circumstances.
iii. Where under (ii) above, annual deductions are allowable over a number of years of income, the first such deduction is allowable for the income year for which the special payment is made.

### *Taxes*
Consumption taxes paid on goods imported or purchased, and sold in the ordinary course of business, are deductible for tax purposes. Property taxes are deductible where the property is used in producing assessable income. Income taxes, penalties, and interest on tax in arrears are not deductible.

### *Other deductions*
Meals and entertainment, officer's compensation/life insurance, and payment to directors are deductible expenses, provided they are wholly and exclusively incurred by a company during that year of income for the purpose of producing its assessable income.

### *Net operating losses*
Net operating losses may be carried forward for up to six years if the losses have not been fully absorbed earlier. In carrying losses forward, the amount that can be claimed in any subsequent year is restricted to one-half of the assessable income of that year. Losses may not be carried back.

### *Payments to foreign affiliates*
There are no restrictions on the deductibility of interest paid to foreign affiliates if the transaction is carried out at arm's length and at commercial rates. However, deductions for management charges, allocations of head office expenses, royalties, and other charges that are subject to 25% WHT are restricted to the lesser of the aggregate of those charges or 10% of all allowable business deductions, excluding cost of sales and capital allowances.

## *Group taxation*



Group tax filing is not allowed in Saint Lucia; however, group tax relief is available under certain circumstances to allow the trading losses, excluding the current loss, of a resident company within a group to offset the profits of another resident company within the same group. A claim for group relief requires the consent of the Comptroller of the Inland Revenue Department and is only available to resident companies.

### *Transfer pricing*
Related party transactions are accepted if they are made on an arm's-length basis. The Inland Revenue has the power under the Income Tax Act to make any adjustment deemed necessary to place such transactions at arm's length.

### *Thin capitalisation*
No provision exists for thin capitalisation in Saint Lucia.

# Saint Lucia

## Tax credits and incentives

### Foreign taxes credit

Where income has accrued to a resident and has been taxed in a foreign country with which there is no double tax agreement (DTA), or is income to which a DTA, if there is one, does not relate, credit for tax on such income is allowed for the lesser of: the tax payable in the foreign country or the tax charged under Saint Lucia tax law.

### Tax holidays

Tax holidays are available for manufacturing companies. The incentives are aimed at increasing the manufacturing base of Saint Lucia, the level of exports, and the use of local materials and labour in production. An approved manufacturing enterprise will be granted a tax holiday up to a maximum of 15 years. In determining the length of the tax holiday, the extent of the local value added to approved products is taken into account.

### Investment incentives

Income tax incentives and other fiscal concessions are provided under the Fiscal Incentives Act, the Tourism Incentives Act, the Special Development Areas Act, and other concessions granted by the Cabinet of Ministers. The extent of the incentives and concessions granted are specific to the legislation or Cabinet conclusions and depend on the impact that the investment would have on local employment, exports, and the generation of foreign exchange earnings. The incentives granted include the following:

- Duty-free importation of raw materials, machinery, components, and spare parts and other inputs used in manufacturing, and the duty-free importation of construction materials, equipment, and other inputs used in the construction and operation of hotels and other hospitality products.
- Income tax waivers of up to 100% of the taxable income of companies engaged in manufacturing, tourism, and agriculture and other employment generating activities, for periods of up to 15 years.
- Whole or partial waivers of property tax, stamp duties, Alien Landholding License fees, WHT, and consumption taxes with respect to investments in specific areas, or in specific industries and activities.
- Guaranteed repatriation of capital and dividends. Remittance of profits and dividends are tax-free as they are not subject to WHT.
- Export allowances for goods manufactured in Saint Lucia and exported. Companies who engage in such activity are given tax exemption on the export of such goods up to a maximum of 10 to 15 years.

### Employment incentives

Employment incentives are available in the Income Tax Act for the following:

- Hiring university graduates: an additional deduction of 25% of salaries for a maximum period of three years.
- Hiring persons in the offshore financial services industry with skills not available in Saint Lucia. A special tax concession is given to such persons that allows a prescribed percentage of an employee's or contractor's salary or fees to be exempt from income tax.

### Other incentives

Complete or partial waivers of income tax are available on the taxable profits of companies engaged in providing services to the offshore financial services industry.

Special tax concessions are also available for capital construction in the hotel industry. Capital expenditures on the construction of a hotel may offset profits for up to 15 years.

## *Withholding taxes*

Resident corporations and persons that make certain payments of an income nature to residents or non-residents are required to withhold tax on these payments as follows:

| Recipient | WHT (%) |
|---|---|
| Resident corporations: | |
| Payments to contractors | 10 |
| Equipment hire | 10 |
| | |
| Non-resident corporations: | |
| Interest | 15 |
| Royalties | 25 |
| Management fees | 25 |
| Commissions or fees (not by way of employment) | 25 |
| Income of a trust | 25 |
| Premiums, including insurance premiums | 25 |
| Any other payment of an income nature | 25 |

## *Tax administration*

### *Returns*

Tax returns must be filed within three months of the company's fiscal year-end. An extension of the filing date may be obtained. Returns must cover a 12-month period, which may be changed only with the Comptroller's permission.

Financial statements must be submitted with the returns, together with a schedule reconciling taxable income with book income and various other schedules of additional information.

The system is one of self-assessment. Upon receipt of the returns, the Inland Revenue Department examines the information provided and issues a notice of assessment at any time, subject to the statute of limitations. The Revenue Department may also issue assessments in the absence of returns.

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### *Payment of tax*

Tax is payable in instalments on 25 March, 25 June, and 25 September in each year of income, based on the preceding year's income. Any remainder is payable within three months of the end of the financial year.

### *Appeals*

Within 30 days after the date of service of a notice of assessment or reassessment, the taxpayer may submit a written objection to the Revenue Department on any matters in such assessment or reassessment. If the Revenue Department confirms its assessment, the taxpayer may file an appeal with the Appeal Commission, which comprises seven persons appointed by the Minister of Finance. A decision by that body may be further appealed to the Saint Lucia High Court within 30 days. An appeal against an order from this Court may be made to the Court of Appeal.

### *Tax audits*

The Inland Revenue Department carries out audits of a selection of tax returns, usually at the taxpayer's place of business. Audits may be carried out at any time prior to the expiration of the statute of limitations, whether or not notices of assessment have been issued. The Revenue Department has wide powers in determining the information it requires for these audits.

### *Penalties and interest*

The following civil penalties and interest, which are non-deductible, are imposed:

- For late filing or for failure to file: 5% of the tax charge at filing date.
- For late payment: 10% of the unpaid tax at the due date.
- On tax and penalties unpaid: monthly interest at a rate of 1.04%.
- Tax knowingly evaded or sought to be evaded: 100% of the tax.

### *Statute of limitations*

Assessments are not final until six years after the end of the income year, within which period assessments may be made at any time. In cases of misrepresentation or failure to disclose any material fact, a reassessment can be made at any time.

# *Saudi Arabia*

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## *Significant developments*

### *Double taxation treaties (DTTs)*

Saudi Arabia has signed DTTs with more than 30 countries, most of which are in force in 2010 and 2011 while the others are still being finalised or awaiting ratification process. In addition, and to encourage foreign capital investments, there are plans for negotiations for DTTs with several other countries.

### *System automation*

The Department of Zakat and Income Tax (DZIT) is in the process of automating its systems, and tax payments can currently be made automatically through the SADAD system.

### *Double taxation of subsidiary income*

A significant change in the Saudi tax regulations took place in 2010 relating to the double taxation imposed on foreigners who are investing in a resident company that is investing in another resident company. This change could have a major impact on how investors structure investments in Saudi Arabia and included an amendment to the by-laws to avoid double taxation on foreign investors provided that the required conditions are met.

### *Application of DTTs with regard to withholding taxes (WHT)*

With a growing network of DTTs, combined with increasing cross-border trade, there has been a significant increase in the number of claims to reduce or eliminate WHTs under such treaties.

There had been no specific procedures to follow under the Income Tax Law where the terms of a DTT should be applied. This issue was addressed recently by the following procedures to be followed where a treaty protection is sought:



- The resident party should deduct WHT from payments in accordance with the domestic law.
- Where a relevant DTT provides for a reduced or 0% rate of WHT, the resident party should write a letter to the DZIT requesting them to refund the overpaid WHT.
- The letter should include the following documents:
  - A letter from the beneficiary who is a resident of the other contracting state claiming the overpaid WHT.
  - A certificate from that other contracting state's tax authority confirming that the beneficiary is a tax resident of that state, in accordance with the provisions of Article 4 of the relevant tax treaty, and that the amount paid is subject to tax in that contracting state.
  - A copy of the relevant submitted WHT form, and receipt of payment of the WHT, that evidences the amount being claimed.

- On receipt of the aforementioned documents, and on ensuring that the treaty conditions have been satisfied, the DZIT will refund the overpaid WHT in accordance with the procedures laid down for the refund process.

We understand that the above procedures are currently being evaluated by the tax authority, and certain changes may be made to the above.

## *Taxes on corporate income*

The rate of income tax is 20% of the net adjusted profits. Withholding tax (WHT) rates are between 5% and 20%. Zakat, an Islamic assessment, is charged on the company's Zakat base at 2.5%. Zakat base represents the net worth of the entity as calculated for Zakat purposes.

Only non-Saudi investors are liable for income tax in Saudi Arabia. In most cases, Saudi citizen investors (and citizens of the Gulf Cooperation Council (GCC) countries, who are considered to be Saudi citizens for Saudi tax purposes) are liable for Zakat. Where a company is owned by both Saudi and non-Saudi interests, the portion of taxable income attributable to the non-Saudi interest is subject to income tax, and the Saudi share goes into the basis on which Zakat is assessed.

According to the income tax law, the following persons are subject to income tax:

- A resident capital company to the extent of its non-Saudi shareholding.
- A resident non-Saudi natural person who carries on activities in Saudi Arabia.
- A non-resident person who carries out activities in Saudi Arabia through a permanent establishment (PE).
- A non-resident person who has other income subject to tax from sources within Saudi Arabia.
- A person engaged in natural gas investment fields.
- A person engaged in oil and other hydrocarbon production.

It should be noted that although the income tax rate is 20%, income from the following two activities is subject to different rates:

- Natural Gas Investment Tax (NGIT) shall be determined on the basis of the internal rate of return (IRR) on the cumulative annual cash flows of the taxpayer derived from natural gas investment activities. The rate applicable will be 30% if the IRR is 8% or less. The rate increases progressively up to 85% if the IRR equals or exceeds 20%.
- Income from oil and hydrocarbon production is subject to tax at the rate of 85%.

## *Corporate residence*

A company is considered a resident company if it is formed under the Saudi Arabian Regulations for Companies or if its central management is located in Saudi Arabia.

### *Permanent establishment (PE)*

According to the Saudi tax regulations, the following are the requirements for considering a non-resident party to have a PE:

- A PE of a non-resident in the Kingdom, unless otherwise provided below, consists of the permanent place of activity of the non-resident through which one carries out business, in full or in part, including business carried out through an agent.
- The following are considered a PE:
  - Construction sites, assembly facilities, and the exercise of its related supervisory activities.
  - Installations or sites used for surveying for natural resources, drilling equipment, or ships used for surveying for natural resources, and the exercise of its related supervisory activities.
  - A fixed location where a non-resident natural person carries out business.
  - A branch of a non-resident company which is licensed to carry out business in the Kingdom.
- A place is not considered a PE of a non-resident in the Kingdom if it is used in the Kingdom only to do the following:
  - Store, display, or deliver goods or products belonging to the non-resident.
  - Keep an inventory of goods or products belonging to the non-resident only for the purposes of processing by another person.
  - Purchase of goods or products only for the collection of information for the non-resident.
  - Perform any other activities that are preparatory or auxiliary in nature for the interests of the non-resident.
  - Prepare contracts relating to loans, supply of products or perform technical services for signature.
  - Executing any group of the activities mentioned above.
- A non-resident partner in a resident personal company is considered an owner to a PE in the Kingdom in the form of a share in a personal company.

Furthermore, the agent mentioned in the above article is identified as a dependent agent who has any of the following authorities:

- Negotiate on behalf of a non-resident.
- Conclude contracts on behalf of a non-resident.
- Has a stock of goods, owned by a non-resident, on hand in the Kingdom to supply the clients' demands regularly on behalf of the non-resident.

A place from which a non-resident carries out insurance and/or reinsurance activity in the Kingdom through an agent is considered a PE of the non-resident even though the agent is not authorised to negotiate and conclude contracts on behalf of the non-resident.



## Other taxes

### Value-added tax (VAT)
There is currently no VAT system in Saudi Arabia.

### Customs duties
Customs duties are imposed on imports according to tariffs rates that are effective on the payment date in accordance with the Saudi Customs regulations. Customs duties are imposed on the price of the imported goods. This price is assessed based on the actual cost paid or on the agreed upon cost denominated in the currency of the exporting country. The price consists of the price of the imported goods as packed for shipping from the port of export plus freight and insurance cost to the Saudi port which is converted to Saudi riyals at the exchange rates published by Saudi Arabian Monetary

Agency (SAMA) on the date of the declaration. In case this procedure is not achievable, the imported goods will be priced based on the most proximate comparable value that could be ascertained. Imported goods that are subject to customs duties based on weight are assessed based on the gross weight or the net weight as shown in the tariff schedules. The gross weight of the goods includes the goods weight including all internal and external packing materials. Net weight of the goods excludes all internal and external packing materials including the items used for separating and arranging the goods.

To encourage joint ventures in manufacturing, the government grants tariff protection from competing imports to locally produced, quality goods. Rates can be as high as 20%.

Penalties on smuggling goods vary from confiscation, to collections of customs duties and penalties, to imprisonment.

### *Social insurance tax*

Social insurance tax is paid monthly based on the monthly basic salary plus housing with an upper limit of 45,000 Saudi riyals (SAR), is computed at 2% for non-Saudi employees, and is paid by the employer. For Saudi employees, the rate is 20% and is paid by both the employee (9%) and the employer (11%).

### *Other taxes*

There is no form of stamp duty, transfer, excise, sales, turnover, production, real estate, or property taxation except in so far as they may fall within the scope of Zakat, which is applicable only to Saudi nationals.

## *Branch income*

Taxable income from a branch of a non-Saudi based corporation is taxed at 20%. Certain charges incurred by the headquarters are not deductible on the branch tax return.

## *Income determination*

### *Inventory valuation*

The weighted average-cost method is used for valuing inventory under Saudi tax law.

### *Capital gains*

Capital gains are subject to income tax or Zakat, as appropriate, at the normal income tax or Zakat rate. However, capital gains realised from the disposal of shares in Saudi stock companies listed in the Saudi market are tax exempt, subject to certain conditions.

### *Stock dividends*

Stock dividends distributed to non-resident recipient shareholders are subject to a 5% WHT.

### *Foreign income*

The gross income derived by a capital company resident in the Kingdom from its operations and of its branches inside and outside the kingdom is subject to tax in Saudi Arabia. However, in order to avoid double taxation on the same income, the following exceptions and clarifications are to be considered:

- With respect to the income realised from investments in other resident capital companies and in order to avoid double taxation, such income is to be excluded from being subject to tax under the following conditions:
  - That such income was subjected to tax in the Kingdom.
  - The percentage of ownership in the company invested in is not less than 10%.
  - The period of ownership of shares is not less than one year.
- With respect to the income realised from investments and operations outside the Kingdom, it will be subject to tax in the Kingdom unless an effective double tax treaty between the Kingdom and the country invested in stipulates different provisions.

### *Other significant items – imports and supply contracts*

Saudi tax law provides that no profit will be considered to arise from a contract for the supply of goods to Saudi Arabia, provided delivery of the goods is either free on board (FOB) or cost, insurance, and freight (CIF) to a Saudi port. However, should the contract provide for the delivery and/or installation of materials at a point inside Saudi Arabia, the supplier may be considered to be carrying on business within Saudi Arabia, and, as a consequence, the contract may be subject to Saudi income taxation as follows:

- If the material cost was identified in the supply contract separately from the cost of work performed in Saudi Arabia, then, in the absence of a PE, a WHT on the work that will be performed in Saudi Arabia may be assessed, based on the type of services. However, if the contract qualifies the supplier to have a PE in Saudi, then income tax will be applied according to the Saudi tax regulations as for a normal taxpayer.
- If the supply contract indicates a total cost without segregation in the value of supply and the value of the other activities in Saudi Arabia, then the work performed in Saudi Arabia will be assigned a value equal to 10% of the contract value for each type of activity.

## *Deductions*

All expenses that are necessary and normal to the business, paid or accrued, are allowable deductions, provided the expense meets the following conditions:

- It is an actual expense, supported by a verifiable document or other qualifying evidence.
- It is related to the generation of taxable income.
- It is related to the subject tax year.
- It is of a non-capital nature.

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### *Depreciation*

A depreciation deduction is allowed under the following limitations as stipulated by the law:

- The asset is not intended for resale and is to be used, in full or in part, for the entity's purposes.
- The asset is of a depreciable nature that loses value because of use or because of wear and tear and obsolescence and which has a value extending beyond the end of the taxable year.
- The asset is owned by the business, as per the ownership document for buildings and contracts and invoices for other assets.

- The asset depreciation is allowed even if the asset becomes inactive during the tax year.

Depreciation for tax purposes is calculated as follows, based on the following five categories of depreciable tangible or intangible assets, other than land:

| Asset category | Depreciation rate (%) |
|---|---|
| Fixed buildings | 5 |
| Industrial and agricultural movable buildings | 10 |
| Factories, machines and equipment, computer application programs, passenger cars, and cargo vehicles | 25 |
| Expenditures for geological surveying, drilling, exploration, and other preliminary work to exploit and develop natural resources and their fields | 20 |
| All other tangible or intangible assets not included in previous categories, such as furniture, planes, ships and trains, and goodwill | 10 |

The declining balance method of depreciation, according to the above rates, should be followed for tax purposes.

There are also rules for depreciation relating to assets either acquired or disposed. Essentially, 50% of the allowable acquisition price or disposal proceeds is added to or subtracted from the asset pool in the first year, and the remaining 50% in the following year.

Assets under build, own, and transfer (BOT) and build, own, operate, and transfer (BOOT) are allowed to be depreciated over the contract period. This presumes, although it is not clear, that assets under the BOT and BOOT schemes actually will have a separate grouping in addition to the above prescribed groups.

### *Loan charges (interest expenses)*

An interest deduction is limited to the lower of the loan charge incurred during the tax year, if related to income that is subject to tax, or the result of the following formula, whichever is less.

The taxpayer's total income from loan charges, plus 50% of (A minus B) as below:

A = income subject to tax other than income from loan charges.

B = expenses allowed under the law other than loan charge expenses.

Note that banks are not subject to this formula.

### *Bad debt*

Bad debts are deductable, provided they meet all of the following conditions:

- The bad debt was previously declared in the appropriate year's income.
- The debt resulted from sale of goods or services.
- The company holds a certificate from the taxpayer's certified public accountant certifying that the debt has been written off in the taxpayer's books and records, based on a decision by the taxpayer at the appropriate management level.

- Serious efforts have been exerted by the taxpayer to collect the debt with no success and the inability of the debtor to pay has been proved based on a judicial ruling or bankruptcy.
- The debt is not from a related party.
- There is a commitment by the taxpayer to reinstate, as income, any written-off debt whenever collected.

### *Allocations and reserves*
Allocations and reserves formed during the year are deductible as follows:

- Bank allocations to a reserve fund for doubtful debts are allowable deductions. However, a bank must submit a certificate from the Saudi Arabian Monetary Agency (SAMA) stating the amount of doubtful debts and the amount of doubtful debts collected during the year, which should be reinstated in the tax base of the year of collection.
- Insurance/reinsurance companies may deduct, based on industry standards, a reserve for unearned premiums and for unexpired risks, provided that it is reported in the tax base of the following year.

  A reserve for unearned premiums means a part of premium amounts collected or stated in books that covers risks related to the future tax year(s). A reserve for unexpired risks means the amount of compensation claimed or reported, but for which the payment process falls short of completion during the tax year.

- A taxpayer may reduce its book profit by the amount of reserves used during the year that had been readjusted when made, to increase income or decrease expenses in the year of formation. Examples of such reserves are end-of-service awards, doubtful debt, and drops in prices. Such amounts are deductible, provided the following conditions are met:
  - The used amount was paid or accrued during the year, and it is supported by documentation.
  - The reserve had been adjusted in the year of formation to increase the tax base.

### *School fees*
School fees paid by taxpayers for their employees' children are deductible expenses, provided they meet the following conditions:

- They are paid to a local licensed school.
- This benefit is stated in the employment contract.



### *Pension fund*
Employers' contributions to employees' pension funds or savings funds established under Saudi Arabia's rules and regulations are deductible, provided that such contribution, one payment or in aggregate, is not in excess of 25% of the employee's income before the employer's contributions and that the fund meets the following criteria:

- The fund is established according to special provisions that clearly stipulate conditions of subscription and rights of subscribers.
- Such obligation is stated in the employment contract or in the Articles of Association of the establishment.
- The fund has a character independent of the establishment and has separate accounts audited by an independent certified public accountant.

### *Research and development (R&D)*

A deduction is allowed for R&D expenditure incurred during the tax year in connection with the generation of income that is subject to tax. Such expenditure relates to technical, scientific, and engineering experiments; computer systems; or similar research. This provision does not apply to the acquisition of land and facilities, or to equipment used for research. Such facilities and equipment are subject to depreciation under the law.

### *Fines and penalties*

Fines and penalties related to income tax, paid or payable in Saudi Arabia or to other countries, are not deductible.

Financial fines or penalties paid or payable to any party in Saudi Arabia, such as traffic fines or fines for causing damage to public utilities are also not deductible.

Fines or penalties paid for breach of contractual obligations, such as fines on delayed or defaulted completion of contracts, are deductible, provided they are documented by the contracting party and the income from such penalties is reported in the year of recovery.

### *Non-deductible expenses*

The following expenses are non-deductible:

- Wages, salaries, and whatever is so deemed, in cash or in kind, paid to an owner, partner, or shareholder or to a member of their families, being a parent, spouse, sons/daughters, and siblings (this provision does not apply to stockholders in a stock company).
- Compensation in cash or in kind paid to a partner, shareholder, or to a family member including a parent, spouse, sons/daughters, and siblings for a property or service to the extent that the compensation is higher than the fair market value of such property or service at time of transaction.
- Entertainment expenses incurred for events such as parties, sports competitions, entertainment trips and activities, etc.
- Expenses of a natural person for personal consumption, such as personal withdrawals, dependents' cost of living, or education.
- Income tax.
- Any bribe or similar payment which is considered an illegal practice in Saudi Arabia, even if paid abroad.
- Insurance commission in excess of 3% of total premiums collected in Saudi Arabia through an agent or others and regardless of whether or not the agent is a partner.
- Employer contributions to their employees' legal pension fund, social insurance, or savings funds.

### *Net operating losses*

A taxpayer may carry forward operational losses as adjusted, to the years following the loss year until the cumulative loss is fully offset. The maximum profit percentage of any year that could be used to offset cumulative losses should not exceed 25% of the year's profit as reported in the taxpayer's return. Carryback of losses is not allowed.

### *Payments to foreign affiliates*

Payments made to headquarter offices located abroad by wholly owned local subsidiaries or branches are not deductible. Such payments include:

- royalties or commissions
- loan charges (interest expense) or any other financial fees, and
- indirect administrative and general expenses allocated on an estimated basis.

The value of goods or services delivered to the taxpayer by related parties is not deductible to the extent that it is in excess of an arm's-length value.

## *Group taxation*

A recent change took place in October 2010 with the intention of eliminating double taxation on the income of foreign investors realised from their investments in other resident companies. According to this recent change, such income is to be excluded from being subject to tax under the following conditions:

- That such income was subjected to tax in Saudi Arabia.
- The percentage of ownership in the company invested in is not less than 10%.
- The period of ownership of shares is not less than one year.

With respect to the income realised by a resident capital company from its investments and operations outside Saudi Arabia, it will be subject to tax in Saudi Arabia (unless an effective double tax treaty between Saudi Arabia and the country invested in stipulates different provisions).

However, for Zakat purposes, the concept of consolidation is acceptable and relief may be obtained for wholly owned subsidiaries by Saudi/Gulf Cooperation Council companies that are subject to Zakat.

Note that an entity operating in Saudi Arabia that has undertaken more than one project under the same commercial registration is required to consolidate the results of such projects into the financial statements of that entity and subject them to taxation as a single operation.

### *Transfer pricing*

There are no specific transfer pricing rules in Saudi Arabia that impose or deem a charge to arise where the DZIT have reason to believe that a transaction has taken place at a value other than on an arm's-length basis. However, there is a generic provision that allows the DZIT to re-characterise or re-allocate income or expenses arising from a transaction if it is undertaken for the purposes of avoiding or reducing a tax liability in Saudi Arabia.

### *Thin capitalisation*

There is no special legislation governing thin capitalisation for tax purposes. A Saudi company may deduct interest payments to affiliates, but not the head office, provided that the amount of debt and rate of interest are at arm's length and that interest deductibility formula is met. A Saudi company may be financed with minimum capital, and there is no limit to the amount of debt that may be used.

## *Tax credits and incentives*

### *Repatriation*

There are no restrictions on repatriation of profits, fees, capital, salaries, or other monies.

### *Incentives for investment in less-developed regions*
The government of Saudi Arabia has granted tax concessions to the following six less-developed regions in Saudi Arabia, with the intention of attracting more investment:

- Ha'il.
- Jazan.
- Najran.
- Al-Baha.
- Al-Jouf.
- Northern territory.

These tax privileges are granted for a period of ten years from the start of any project.

The qualifying investing company's annual tax bill may be reduced by:

- Half the annual training expenditure on Saudis.
- Half the annual salaries paid to Saudis.

More deductions are granted if investment capital for any project exceeds SAR 1 million and if more than five employees of Saudi nationality have jobs of a technical or administrative nature with contracts of at least one year.

### *Customs incentives*
An exemption from customs duties is available on machinery and raw materials that are required for approved projects, provided that they are not available in the local market. Such exemptions should be applied for prior to their importation and are subject to certain terms.

## *Withholding taxes*

Payments made from a resident party or a PE to a non-resident party for services performed are subject to WHT. The rates vary between 5%, 15%, and 20% based on the type of service and whether the beneficiary is a related party.

The WHT should be paid within the first ten days of the month following the month during which the payment was made.

The domestic rate for WHT is 5% on dividends, 15% on royalties, and 5% on interest.

### *Tax treaties*
Saudi Arabia has entered into tax treaties with several countries. Treaties currently or about to be in force are listed below. A number of other treaties are at various stages of negotiation.

DTTs have not yet been effectively tested in Saudi Arabia. However, they generally follow the Organisation for Economic Co-operation and Development (OECD) model treaty and may provide certain relief, including WHT on dividends, interest, and royalties.

The following are the treaty WHT rates for payments made from Saudi Arabia to treaty country recipients. Each tax treaty should be studied carefully because there could be exceptions to the general rules:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Non-treaty country | 5 | 5 | 15 |
| Treaty country: | | | |
| Austria | 5 | 5 | 10 |
| Belarus | 5/10 | 5 | 10 |
| China (P.R.C.) | 5 | 10 | 10 |
| France | 0 | 0 | 0 |
| Greece | 5 | 5 | 10 |
| India | 5 | 10 | 10 |
| Italy | 5/10 | 5 | 10 |
| Malaysia | 5 | 5 | 8 |
| Netherlands | 5/10 | 5 | 7 |
| Pakistan | 5/10 | 10 | 10 |
| Russia | 5 | 5 | 10 |
| South Africa | 5/10 | 5 | 10 |
| South Korea (R.O.K.) | 5/10 | 5 | 5/10 |
| Spain | 0/5 | 5 | 8 |
| Syria | 0 | 7.5 | 15 |
| Turkey | 5/10 | 10 | 10 |
| United Kingdom | 5/15 | 0 | 5/8 |
| Uzbakistan | 7 | 7 | 10 |
| Vietnam | 5/12.5 | 10 | 7.5/10 |

## *Tax administration*

### *Returns*

Tax filings are based on the company's fiscal-year. Returns are due to be filed with the DZIT, and tax due must be paid within 120 days after the taxpayer's year-end. The system is one of self-assessment.

### *Payment of tax*

Three equal advance tax payments are required to be made on the last day of the sixth, ninth, and 12th months for a current tax year, provided that the taxpayer has earned income during the year. Each advance payment is equal to 25% of the amount resulting from the taxpayer's tax liability based on the previous year return minus the withheld tax on reported income, if any. The taxpayer is not required to make advance tax payments if the result of the said formula is less than SAR 500,000. Late payment of an advance payment is subject to a delay penalty of 1% of the amount due for every 30 days of delay.

# Senegal

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## Significant developments

In 2011, the following two new special taxes to help financing the energy sector have been introduced:

- A Special Contribution for the Development of the Energy Sector amounting to 50,000 Communaute Financiere Africaine francs (XOF) per ton of diesel oil, high-octane petrol, fuel oil 380, naphtha, and light gasoline exported or re-exported.
- A Special Contribution of Support for the Energy Sector which amounts to XOF 15,000 per ton of diesel oil, fuel oil 180, as well as fuel oil 380 imported or sold in Senegal, unless those products are intended for the production of electricity, in which case they are exempt.

The 2% tax on telecommunication use and access that was introduced in 2009 has been increased to 5%. To offset the tax, the purchase of mobile telephones (and other types of telephones) remains exempt from value-added tax (VAT) and customs duty.

A reduction of the VAT rate for tourism activities from 18% to 10% became effective as of 1 January 2011.

## Taxes on corporate income

Branches and companies are liable for 25% corporate income tax (CIT).

A minimum CIT is due in case of lack of profits, and the amount depends on the annual turnover as follows:

- XOF 500,000 in case of an annual turnover up to XOF 250 million.
- XOF 750,000 if the annual turnover ranges from XOF 250 million to XOF 500 million.
- XOF 1 million in case of an annual turnover over XOF 500 million.

## Corporate residence

Companies are considered as Senegalese residents if they have a registered fixed establishment. Nonetheless, foreign companies that are not registered locally may be deemed to have a permanent establishment (PE) in Senegal in relation to their local activity, and will then be subject to tax liabilities.

### Permanent establishment (PE)

The criteria for a PE were derived from the General Tax Code and are close to the Organisation for Economic Co-operation and Development (OECD) standards. Double tax treaties (DTTs) can be applicable and can provide specific definitions. These DTTs are based on the OECD model in most cases.

Senegal has concluded such treaties with Belgium, Canada, France, Italy, Morocco, Mauritania, Norway, Qatar, Tunisia, and member states of the West African Economic and Monetary Union (UEMOA), including Benin, Burkina-Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, and Togo.

## Other taxes

### Value-added tax (VAT)

Subject to certain exclusions, most commercial operations are subject to an 18% VAT duty. A 17% special tax on banking operations is applicable instead of the VAT.

### Business licence tax

Business license tax is an annual duty consisting of a fixed annual payment (fixed duty) and a proportional duty calculated in most cases on the basis of the rental value of the premises used. The amounts and rates of these taxes are fixed according to the type and size of the activity carried out.

### Tax on built real estate (land with buildings and/or industrial equipment fixed thereon)

The tax on built real estate applies to owners of buildings, factories, industrial premises, or equipment fixed on the land. The tax rate is 5% for common buildings and 7.5% for factories and industrial premises. It is applied on the basis of the rental value of the lands, buildings, etc.

### Tax on non-built real estate

The tax on non-built real estate applies to owners of land without buildings, factories, industrial premises, or equipment fixed on the land. The tax rate is fixed at 5%. It is applied on the basis of the rental value of the land.

### Stamp/registration duties

There are many stamp and/or registration duties depending on the operations, such as the following:

- 1% registration duty applicable to the incorporation of a company and the increase in cash of the share capital.
- 1% registration duty applicable to transfer of stocks.
- 1% registration duty applicable to transfer of debts.
- 15% registration duty applicable to sale of business.
- 15% registration duty applicable to transfer of real estate.
- 5% registration duty applicable to rent agreements.

### Tax on vehicles

An owner of a motor vehicle (car, truck, or motorbike) must pay an annual registration tax ranging from XOF 18,000 to XOF 200,000 per vehicle, depending on its nature and horsepower.

### Company tax on vehicles

In addition to the tax on vehicles, companies owning or renting vehicles (more than 15 days a year) must pay a specific annual tax on them. Rates range from XOF 50,000 to XOF 200,000, depending on the type and horsepower of the vehicle.

## Branch income

In general, the tax on branch income is similar to that of corporate income. Nonetheless, a 10% duty is automatically applied to profits generated after corporate income tax. It corresponds to an automatic application of the 10% tax on payment on dividends applicable to a company.

## Income determination

### Inventory valuation

Inventory is generally stated at the lower of cost or market value. Last in first out (LIFO) and first in first out (FIFO) are permitted. Book and tax conformity is required.

### Capital gains

Regarding companies, capital gains derived from the transfer of assets are subject to the 25% corporate income tax. There is no basket system. The taxable base will be reduced to one-third if the transfer of assets arises due to a cessation of activity. However, if the transfer of assets is made less than five years after the start of the business, a one-half reduction of the taxable base will be applicable.

Sales of stocks by a non-resident are liable to the 25% corporate income tax, subject to the application of a DTT.

### Inter-company dividends

If a parent company domiciled in Senegal owns 20% of the subsidiary (main condition for the application of the parent-subsidiary corporation special taxation status), a 95% reduction on the dividends received is applicable for corporate income tax purposes.

### Stock dividends

Stock dividends are unusual in Senegal. However, this kind of distribution would be taxable at the general withholding tax (WHT) rate of 10% on the basis of its real value.

### Foreign income

In general, profits generated in Senegal are taxed under Senegal’s income tax law. Profits generated outside Senegal and constituting a PE in the relevant country are not taxed in Senegal. A DTT can provide different rules.

## Deductions

### Depreciation and depletion

The rates of depreciation are not provided by the law. The rate is determined on the normal and predictable duration of use of the asset by taking into account normal wear and tear. In practice, there are standard rates for common assets. Accelerated depreciation can be applicable, subject to conditions.

### Other significant items
Interest paid to shareholders may be deducted when it relates to loans with an amount lower or equal to the amount of the share capital and whose rate is lower or equal to the base rate of the Central Bank of West African States plus two points.

Provisions are deductible if they correspond to a risk or a probable cost that is more than possible and leads to a decrease in the assets. Provisions for paid holidays and retirement compensation are not deductible.

Payments made to specific chartered organisations are deductible at a rate of up to 0.2% of turnover.

Headquarter expenses, which are a proration of the worldwide office expenses, may be allocated to the Senegal branch. This proration is based upon a ratio of the local turnover of the branch and the worldwide turnover of the parent company. It applies to the total amount of headquarters' expenses incurred by the company. In addition, the deductibility of headquarters expenses is limited to 20% of the accounting profits before the deduction. This limitation does not apply to other types of services provided by headquarters such as technical assistance.

Fines, penalties, and foreign taxes are not deductible.

### Net operating losses
Tax losses may be carried forward to the next three years. The carryback of losses does not exist. Losses corresponding to the depreciation of assets can be forwarded indefinitely.

### Payments to foreign affiliates
Reasonable royalties, interest, and management service fees paid to foreign parent companies are tax-deductible. Supporting documents (e.g. invoices, contracts) will be necessary to prove that these expenses are justified. Transfer pricing issues are rare.

## Group taxation

Group taxation is not permitted in Senegal.

## Tax credits and incentives



### The Investment Code
The Investment Code applies to investments over XOF 100 million (mainly production, processing, industrial, tourism, agricultural, and complex trade). The benefits of the Investment Code include exemption from customs duties, suspension of VAT payment for three years, corporate income tax limitation, etc.

### The status of the free export company
Agriculture, industry, and telecommunications companies that have an exporting potential amounting to at least 80% of their turnover may qualify for the free export company status. There are several advantages for companies that qualify, including a corporate income tax rate of 15%, exemption from dividend tax, exemption from business license tax, exemption from taxes on real estate, and exemption from registration duty for incorporation or bylaws change purposes.

### Miscellaneous incentives
There are a wide range of investment laws for investments greater than XOF 250 billion (negotiation of a derogatory tax regime), including the mining code and the petroleum code, among others.

## Withholding taxes

Senegal has various WHTs. The primary ones are as follows:

- 20% WHT on remuneration paid for services rendered by a foreign individual or foreign company.
- 10% WHT on dividends distributed.
- 13% WHT on bond interest.
- 8% WHT on deposits or guaranteed interest on accounts with a bank.
- 16% WHT on other revenues, notably interest on loans.

These WHTs may be limited by DTTs.

## Tax administration

### Returns
Companies must file corporate income tax returns by 30 April of the year following the tax year (calendar year) for corporate income tax purposes.

VAT returns must be filed monthly.

Business license tax and taxes on real estate are due annually.

### Payment of tax
Corporate tax must be paid in two instalments (each equal to one-third of the previous year's tax) by 15 February and 30 April. The outstanding balance payment amount of the tax due must be paid by 15 June.

For the first financial year of a newly incorporated company, no instalment is due; the new company pays the whole corporate income tax before 15 June of the following year.

# Serbia

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## Significant developments

Amendments to the corporate income tax (CIT) law were enacted on 27 March 2010 and apply to determination of the CIT liability for fiscal years 2010 and 2011.

At the end of December 2010, the Ministry of Finance adopted new bylaws regulating methods of determining and declaring CIT liability.

A new customs law has been adopted and is effective as of 4 May 2010. This law represents a significant step forward in the process of aligning Serbian customs legislation with the European Union (EU) Community Customs Code.

## Taxes on corporate income

Residents are taxed on their income generated in Serbia, as well as on their worldwide income. Non-residents are taxed only on their income sourced through a permanent establishment (PE) in Serbian territory.

The CIT rate is 10%.

## Corporate residence

A legal entity is considered to be a resident of Serbia if it is established or has its place of effective management and control in Serbia.

### Permanent establishment (PE)

A PE is any permanent place of business through which a non-resident conducts its business.



## Other taxes

### Value-added tax (VAT)

The VAT was introduced on 1 January 2005 and generally follows the EU's Sixth Directive.

The standard VAT rate is 18% for most taxable supplies. A reduced VAT rate of 8% applies for basic food stuffs, daily newspapers, utilities, etc.

In addition to these tax rates, there is a 0% tax rate with the right of deduction of the input VAT which applies to the export of goods, transport and other services directly related to exports, international air transport, etc.

A 0% tax rate without the right of deduction of the input VAT applies to trading in shares and other securities, insurance and reinsurance, and the lease of apartments, business premises, etc.

A taxpayer for VAT purposes is a person who independently, and in the course of its business activities, undertakes the supply of goods and services or import of goods. Business activity is defined as the permanent activity of a manufacturer, salesperson, or service provider for the purpose of gaining income. A branch or other operating unit can be a taxpayer.

A non-resident without a head office or PE within Serbia cannot register for VAT purposes.

The VAT law requires taxpayers to file VAT returns and pay VAT within ten days of the end of each taxable period. The usual taxable period is a calendar month; however, if a taxpayer's total turnover (for the last 12 months) is less than 20 million Serbian dinara (RSD) or is forecast (for the next 12 months) to be so, the taxable period is three calendar months.

### *Customs duties*
Goods imported into Serbia are subject to customs duty rates provided in the Law on Customs Tariff. These rates are *ad valorem* (the only exception is related to the importation of other cigarettes containing tobacco, where a combined *ad valorem* and specific customs duty rate is prescribed) and applies to goods originating in countries which have a most favoured nation (MFN) status in trading with Serbia. Goods originating in other countries are subject to MFN duty rates increased by 70%.

At the moment, the only trading partner with Serbia that does not have MFN status is Taiwan.

Customs duty rates in Serbia range from 0% to 57.6%, with most being under 30%. At the moment, the 57.6% rate only applies to cigarettes containing tobacco.

### *Excise duties*
Excise duties are levied on producers and importers of the following goods:

- Oil derivatives.
- Tobacco products.
- Alcoholic beverages.
- Coffee (green, roasted, ground, and coffee extracts).

Excise duty in Serbia is specific (for oil derivatives, alcoholic beverages, cigars, and cigarillos), *ad valorem* (for coffee and pipe tobacco), and combined (specific + *ad valorem* on retail price for cigarettes).

Excise duties stated in Serbian currency are adjusted on a half-year basis according to variations of the consumer price index (CPI) declared by relevant government bodies in charge of statistics. For oil derivatives, the government can modify the specific excise duty amounts during the year according to changes in prices of crude oil on the market.

### *Property tax*
Property tax is payable annually in Serbia by all legal entities and individuals who own or have rights over real estate located in the Republic of Serbia, such as:

- Ownership rights.
- Right of occupancy.
- Tenancy rights over an apartment or a building for a period longer than one year or for an indefinite period.
- Urban land usage right (municipal, public, and other state-owned land) larger than ten acres in area.

Where the taxpayer keeps books, the property tax on real estate is levied at a flat rate which cannot exceed 0.40%.

## *Branch income*

Non-residents carrying on business in Serbia through a branch are taxed on their Serbian-sourced income at the CIT rate of 10%. A branch is considered to be a PE.

## *Income determination*

Taxable profit is determined by adjusting the accounting profit as stated in the profit and loss statement (determined in accordance with International Financial Reporting Standards (IFRS) and local accounting and audit legislation) and in accordance with the provisions of the CIT Law.

For taxpayers who, according to local legislation, are not obliged to apply IFRS, taxable profit is determined according to the special guidelines prescribed by the Ministry of Finance.

### *Inventory valuation*

Cost of materials and the purchase value of merchandise are tax-deductible up to an amount calculated by applying the average weighted cost method or the first in first out (FIFO) method. If another method is used, an adjustment for tax purposes should be made.

### *Capital gains*

Capital gains are generated by the sale or other transfer of real estate, rights related to industrial property, as well as shares, stocks, securities, certain bonds, and investment units. A capital gain is determined as the difference between the sale and purchase price of the asset concerned, determined in accordance with the provisions of the Law. If the amount is negative, a capital loss is realised.

Capital gains and operational profit are disclosed in the same tax return, but they are taxed separately. Consequently, capital gains/losses cannot be used to offset business losses/gains.

However, capital gains can be offset with capital losses occurring in the same period. A capital loss can be carried forward for five years.

The capital gains tax rate is 10%.

### *Dividend income*

Dividends received by a Serbian company from another Serbian company are not subject to CIT.

Dividends received from a non-resident will be treated as taxable income of a Serbian company and subject to 10% CIT. However, a Serbian entity will have the right to decrease its tax liability by taking tax credit for the withholding tax (WHT) and underlying CIT paid in a subsidiary's country *(see the Tax credits and incentives section for more information)*.

### *Interest income*
Interest income will be included in accounting profit determined in accordance with IFRS and will be taxable at the CIT rate of 10%. A Serbian resident has the right to decrease its CIT liability for WHT on interest paid abroad by its non-resident subsidiary.

### *Royalties*
Royalty income will be treated as business income and subject to the general CIT rate.

A resident taxpayer also has the right to decrease its CIT liability for WHT on royalties paid abroad by its non-resident subsidiary.

### *Unrealised currency exchange gains*
Unrealised currency exchange gains will be included in accounting profits under IFRS rules. Serbian legislation does not provide any exception of taxation of this income. CIT rate is 10%.

### *Foreign income*
Companies resident in Serbia are taxed on their worldwide income.

When profit generated in another country is taxed in the foreign country, a company has the right to decrease its tax liability by claiming a tax credit from the tax authorities in Serbia *(see the Tax credits and incentives section for more information)*.

There are no provisions which provide for the possibility that taxation of income earned abroad may be deferred.

## *Deductions*

The following expenses are not recognised for CIT purposes:

- Non-documented expenses.
- Provisions for receivables from entities that are creditors at the same time.
- Presents provided to political organisations.
- Presents provided to related parties.
- Penalty interest for late payment of taxes.
- Expenses related to forced collection of taxes and other liabilities.
- Fines and penalties (both commercial and the one charged by the authorities).
- Contractual fines and penalties.
- Non-business related expense.
- Calculated but unpaid redundancy payments (deductible when paid).
- Impairment of assets (deductible in tax period in which asset is disposed of or used).
- Direct write-off of receivables (under certain conditions).
- Long-term provisions (except those for renewal of natural resources, expenses within warranty period, and other mandatory long-term provisions).

The following expenses are recognised for CIT purposes only up to a certain limit:

- Depreciation, in the amount computed in accordance with the tax legislation.
- Advertising and promotional expenses, up to 5% of total revenues.
- Representation expenses, up to 0.5% of total revenues.
- Expenses for health care, scientific, educational, humanitarian, religious, ecological, cultural, and sport related purposes, up to 3.5% of total revenues.
- Membership fees paid to chambers of commerce and other associations (except political parties), up to 0.1% of gross revenue.

### *Depreciation*

Fixed and intangible assets are divided into five groups, with depreciation rates prescribed for each (Group I: 2.5%; II: 10%; III: 15%; IV: 20%; and V: 30%). A straight-line depreciation method is prescribed for the first group, which includes real estate, while a declining balance method is applicable for assets in the other groups.

Assets subject to tax depreciation are all tangible and intangible (except goodwill) assets with useful life longer than one year and acquisition value above the average monthly gross salary published in Serbia at the moment of acquisition.

### *Net operating losses*

The taxpayer has the right to carry forward and utilise tax losses incurred over the following five years.

Carryback rules do not exist in Serbia.

### *Payments to foreign affiliates*

Generally, there are no restrictions on the deductibility of royalties and service fees paid to foreign affiliates, provided they are at arm's length, appropriately documented (by agreements, contracts, calculation sheets, etc.), and incurred for business purpose only.

Payment of interest to foreign affiliates is restricted and regulated by thin capitalisation rules and transfer pricing rules *(see the Group taxation section)*.

## *Group taxation*

Tax grouping/consolidation is allowed to a group of companies where all members are Serbian residents and one company directly or indirectly controls at least 75% of the shares in another company. Each company files its own tax balance sheet, and the parent company files a consolidated tax balance sheet for the whole group.

In the consolidated tax balance sheet, losses of one or more companies are offset by the profits of other related companies. Each company is liable for the portion of tax attributable to its share of the group's taxable profit.

Once approved by the Ministry of Finance, tax grouping/consolidation applies for at least five years.

### *Transfer pricing*

A transfer price is the price of transactions between related parties. Related parties exist if there is a possibility of control or influence over business decisions between them. Ownership of 50% or more, or a majority of shares, is considered as potential control. Influence over business decisions exists when an associated party holds 50% or more, or individually holds the greatest portion, of votes in the taxpayer's management bodies. If the same persons participate in management or control of both companies, a connection between them will be deemed to exist.

A company should disclose transactions with related parties separately at transfer prices and at arm's length prices in its corporate tax calculation. Positive difference between these prices (adjustments of expenses) and negative difference (adjustments of revenues) is included in taxable profit.

### *Transfer pricing rules for intra-group loans*

Any interest incurred on related party loans exceeding the arm's-length interest rate is not tax deductible. Arm's-length interest is deemed to be the:

- weighted average key policy rate for the tax period, for loans denominated in dinars, and
- weighted average interest rate at which domestic banks borrowed from foreign lenders in related tax period, for foreign currency loans.

These indicators are determined by National Bank of Serbia and published by the Ministry of Finance.

Transfer pricing rules in this respect are applied up to the amount of tax deductible interest determined in accordance with the thin capitalisation threshold.

### *Thin capitalisation*

The interest and related costs will be fully deductible provided that the loans from related parties do not exceed four times the taxpayer's net equity (ten times for banks). The amount of a taxpayer's net equity for this purpose is calculated as the average of the total assets less total liabilities on the beginning and the end of the year, while the amount of loan from related parties is calculated as a daily average for the year.

In cases where the loans from related parties exceed the prescribed threshold, the amount of non-deductible interest will be calculated as proportional to the amount of loans exceeding the 4:1 (10:1) threshold.

## *Tax credits and incentives*

Profit earned on the basis of a concession is tax exempt for a period of five years.

### *Foreign tax credit*

A Serbian entity is entitled to a tax credit for the WHT paid on distributed dividends and underlying CIT paid abroad (by its non-resident subsidiary). The tax credit cannot exceed the amount of corporate tax that would have been paid in Serbia. Non-utilised tax credit can be carried forward by the parent company for five years. The parent company is required to own not less than 25% of a non-resident subsidiary for at least one year before filing the tax return.

A resident taxpayer also has the right to decrease its tax liability for WHT paid abroad by its non-resident subsidiary on interest and authorship fees up to Serbian CIT due. Carryforward of unused tax credit is not allowed.

### *Tax holidays*

A ten-year tax holiday is available for companies with a minimum investment in property, plant, and equipment (PPE) of RSD 800 million. To qualify for the credit, a taxpayer must employ at least 100 new workers for an indefinite period. The tax holiday is available for the ten-year period in proportion to the investment made. The number of employees employed in the tax period in which the taxpayer qualified for the tax holiday must be retained throughout the whole tax holiday period.

A five-year tax holiday is available for companies conducting business in undeveloped regions that invest at least RSD 8 million in fixed assets. In addition, the company is obliged to employ at least five new workers for an indefinite period. The tax holiday is available for the five year period in proportion to the investment made.

### *Other tax credits*

A tax credit of 20% (40% for small enterprises) is available for qualifying investments in fixed assets. The credit is limited to 50% (70% for small enterprises) of the assessed CIT liability in the current tax period. Unused tax credits can be carried forward for ten years.

Taxpayers generating profit in a newly established operating unit in an underdeveloped region may claim tax credits for a period of two years in an amount proportional to the profit generated by that unit.

Taxpayers classified into one of the following industries: agriculture, fishing, production of textile yarn and fabrics, garments, leather, base metals, standard metal products, machines, office machines, electrical machines, radio, TV and communication equipment, medical instruments, motor vehicles, recycling, and video production are entitled to receive a tax credit in the amount of 80% of investments made in fixed assets which were not previously in use in Serbia. Unused tax credits can be carried forward up to ten years.

## *Withholding taxes*

WHT is calculated and paid at the rate of 20% on payments such as dividends/share in profit, royalties (including neighbouring authorship rights, intellectual property rights, and related rights), interest income, and lease payments for real estate and other assets made to a non-resident, unless a double tax treaty (DTT) applies to provide a reduced rate.

WHT is also payable on a non-resident's income realised on the basis of performing entertaining, artistic, sports, and similar programs in Serbia, which is not taxed as income of an individual (performer, musician, sportsman etc.).

In order to benefit from application of a relevant DTT, non-residents (i.e. the income recipient) must provide a tax residency certificate on the form prescribed by the Serbian Ministry of Finance stamped by the relevant body from the non-resident's country of residence.

WHT rates envisaged by applicable DTTs are provided in the following table.

| Recipient | Dividends (%) (1) | Interest (%) | Royalties (%) (4) | Applicable from |
|---|---|---|---|---|
| Albania | 5/15 | 10 | 10 | 2006 |
| Austria | 5/15 | 10 | 5/10 | 2011 |
| Azerbaijan | 10 | 10 | 10 | 2011 |
| Belgium | 10/15 | 15 | 10 | 1982 |

# Serbia

| Recipient | Dividends (%) (1) | Interest (%) | Royalties (%) (4) | Applicable from |
|---|---|---|---|---|
| Belorussia | 5/15 | 8 | 10 | 1999 |
| Bosnia and Herzegovina | 5/10 | 10 | 10 | 2006 |
| Bulgaria | 5/15 | 10 | 10 | 2001 |
| China | 5 | 10 | 10 | 1998 |
| Croatia | 5/10 | 10 | 10 | 2005 |
| Cyprus | 10 | 10 | 10 | 1987 |
| Czech Republic | 10 | 10 | 5/10 | 2006 |
| North Korea | 10 | 10 | 10 | 2002 |
| Denmark (2) | 5/15 | 0/10 (6) | 10 | 1983 |
| Egypt | 5/15 | 15 | 15 | 2007 |
| Estonia | 5/10 | 0/10 (6) | 5/10 | 2011 |
| Finland | 5/15 | 0 | 10 | 1988 |
| France | 5/15 | 0 | 0 | 1976 |
| Ghana (3) | 5/15 | 10 | 10 | N/A |
| Germany | 15 | 0 | 10 | 1989 |
| Greece | 5/15 | 10 | 10 | 2011 |
| Hungary | 5/15 | 10 | 10 | 2003 |
| Italy | 10 | 10 | 10 | 1986 |
| Iran (3) | 10 | 10 | 10 | N/A |
| Ireland | 5/10 | 10 | 5/10 | 2011 |
| India | 5/15 | 10 | 10 | 2009 |
| Kuwait | 5/10 | 10 | 10 | 2004 |
| Latvia | 5/10 | 10 | 5/10 | 2007 |
| Libya | 5/10 | 10 | 10 | 2011 |
| Lithuania | 5/10 | 10 | 10 | 2010 |
| Macedonia | 5/15 | 10 | 10 | 1998 |
| Malaysia | 0 (5) | 10 | 10 | 1991 |
| Malta | 5/10 (7) | 10 | 5/10 | 2011 |
| Moldova | 5/15 | 10 | 10 | 2007 |
| Netherlands | 5/15 | 0 | 10 | 1983 |
| Norway | 15 | 0 | 10 | 1986 |
| Pakistan | 10 | 10 | 10 | 2011 |
| Poland | 5/15 | 10 | 10 | 1999 |
| Qatar | 5/10 | 10 | 10 | 2011 |
| Romania | 10 | 10 | 10 | 1998 |
| Russia | 5/15 | 10 | 10 | 1998 |
| Slovak Republic | 5/15 | 10 | 10 | 2002 |
| Slovenia | 5/10 | 10 | 5/10 | 2004 |
| Spain | 5/10 | 10 | 5/10 | 2011 |
| Sri Lanka | 12.5 | 10 | 10 | 1987 |
| Sweden | 5/15 | 0 | 0 | 1982 |
| Switzerland | 5/15 | 10 | 10 | 2007 |
| Turkey | 5/15 | 10 | 10 | 2008 |
| Ukraine | 5/10 | 0/10 (6) | 10 | 2002 |
| United Kingdom | 5/15 | 10 | 10 | 1983 |
| Zimbabwe (3) | 5/15 | 10 | 10 | N/A |

Notes

1. If the recipient company owns/controls at least 25% of the equity of the paying company, the lower of the two rates applies.
2. A new DTT was signed with Denmark in 2009, but it is not applicable jet. Meanwhile, the old treaty is still applicable.
3. The treaty has not been ratified by one of the parties.
4. A tax rate of 5% will be applicable to literary, scientific, and work of art; films and works created like films; or other source of reproduction tone or picture. A tax rate of 10% will be applicable to patents, petty patents, brands, models and samples, technical innovations, secret formulas, or technical procedures.
5. Only in cases when dividends are to be paid to Serbian residents. If paid to Malaysian residents, they are taxable at 20% in Serbia.
6. A 0% rate is applicable in cases when the income recipient is the government or government owned banks.
7. Withholding rate refers solely to dividends distributed from Serbia. In Malta, WHT cannot be higher than corporate tax on profit before dividend distribution.

### *Taxation of capital gains of non-residents*

Capital gains realised by non-residents from both residents or other non-residents are subject to 20% capital gain tax. Non-residents should appoint a fiscal representative in Serbia who should submit a tax return within 15 days from the realisation of capital gain. Based on the tax return, Tax Authorities will issue a decision assessing tax liability (if any).

In order to benefit from application of a relevant DTT, the same rules are applicable as for WHT. Non-residents (i.e. the income recipient) must provide a tax residency certificate on the form prescribed by the Serbian Ministry of Finance stamped by the relevant body from the non-resident's country of residence, and the income recipient must be the beneficial owner of income.

## *Tax administration*

### *Returns*

The tax period in Serbia is the calendar year. However, entities have a possibility to opt for a different tax period other than the calendar year (subject to the approval of the Ministry of Finance), but still 12 months long. Once approved, such tax period must be applied for at least five years.

CIT returns, together with all supporting documents (e.g. tax depreciation and tax credit forms), must be filed with the tax authorities by 10 March of the following year.

A newly established company needs to register with the tax authorities within 15 days of registration with the court.

### *Payment of tax*

CIT is payable monthly in advance installments by the 15th day of the following month for the prior calendar month. The amount of payable advances is determined on the basis of a company's CIT calculation for the previous year.

The due date for final settlement of CIT liability for the previous year is 10 March of the current year.

# Singapore

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## Significant developments

The 2011 Budget was announced on 18 February 2011. Corporate tax changes include the following:

- A one-off 20% corporate tax rebate (capped at 10,000 Singapore dollars (SGD)) or a cash grant of 5% of the taxpayer's revenue (capped at SGD 5,000), whichever is higher, for the year of assessment 2011 (i.e. income year 2010).
- Enhancements to the Productivity and Innovation Credit scheme.
- The introduction of a pooling system for foreign tax credits.
- Liberalisation of the deduction rules for pre-commencement expenses and expenses incurred in respect of equity-based remuneration schemes.
- Extension of the 250% deduction for qualifying donations.
- Changes to the incentives for the maritime sector, global trading companies, and the financial sector.

Indirect tax changes include the following:

- Goods and services tax (GST) relief for the biomedical, maritime, and logistics industries.
- Stamp duty relief for companies converting to a limited liability partnership structure.
- An increase in the foreign workers' levy.

For details of the 2011 Budget proposals, refer to our 2011 Budget Commentary at http://www.pwc.com/sg/en/budget-commentary/index.jhtml

## Taxes on corporate income

Companies (resident and non-resident) which carry on a business in Singapore are taxed on their Singapore-sourced income when it arises and on foreign-sourced income when it is remitted or deemed remitted to Singapore. Non-residents are subject to withholding tax (WHT) on certain types of income (e.g. interest, royalties, technical service fees, rental of movable property) where these are deemed to arise in Singapore *(for details, see the Withholding taxes section)*.

Tax on corporate income is imposed at a flat rate of 17% for the year of assessment 2011 (i.e. income year 2010). There is an exemption of up to SGD 152,500 out of the first SGD 300,000 of chargeable/taxable income.

For qualifying start-up companies, a three-year tax exemption on the first SGD 100,000 and a further exemption of up to SGD 100,000 on the next SGD 200,000 of chargeable/taxable income are available.

In addition, for the year of assessment 2011 (i.e. income year 2010), there is a one-off tax rebate of 20% of the corporate tax payable (capped at SGD 10,000) or a cash grant of 5% of the company's revenue (capped at SGD 5,000), whichever is higher. The cash grant is available only to companies who have made contributions to the Central Provident Fund in 2010, which means they must have had at least one Singaporean or permanent resident employee in that year.

Singapore adopts a one-tier taxation system, under which all dividends are tax exempt in the shareholder's hands.

## *Corporate residence*

In Singapore, the tax residence of a corporation is determined by the place where the central management and control of its business is exercised. This is taken generally to mean the place where the directors meet to exercise de facto control, although the Inland Revenue Authority of Singapore (IRAS) has recently set out further qualifying criteria.

## *Other taxes*

### *Goods and services tax (GST)*

GST is charged at 7% on the supply of goods and services made in Singapore by a taxable person in the course or furtherance of business.

The only exemptions from GST are prescribed financial services (including life insurance) and the sale or rental of residential properties. Zero-rating only applies to the export of goods and international services.

GST is also levied on imports of goods, at the time of importation. However, there are reliefs available to ease the cash-flow burden of import-export traders by suspending GST at the time of importation. GST is not currently charged on imports of services.

A taxable person is one who is, or is required to be, registered for GST. GST registration is required if one's taxable turnover exceeds SGD 1 million per year. Voluntary registration is permitted if the taxable turnover is below the registration limit, subject to conditions.



A supply of goods is made in Singapore if the goods are in Singapore at the time of supply, and a supply of services is made in Singapore if the supplier belongs in Singapore. Generally, a person belongs in Singapore if the business (including carrying on a business through a branch or agency) or fixed establishment is in Singapore.

A taxable person is allowed to offset the input GST paid on taxable purchases against the output GST chargeable on supplies made. However, certain purchases are specifically denied an input GST deduction. These include supplies of goods and services such as non-business expenses, club subscription fees, family benefits, car rental expenses, motor vehicle expenses, medical expenses, and transactions involving betting, sweepstakes, lotteries, fruit machines, or games of chance.

A non-resident is not entitled to GST refunds except by appointing a resident tax agent to act on one's behalf. The resident tax agent can then recover import GST paid on behalf of the non-resident business but will be required to account for output GST on any subsequent supply of the non-resident's goods in Singapore.

### *Customs and excise duties*

Singapore is essentially a free port with minimal import restrictions. Customs and excise duties are imposed on intoxicating liquors, tobacco products, motor vehicles, and petroleum products.

### *Foreign workers' levy*

A levy, not exceeding SGD 500 per month, is assessed for each foreign employee. It was announced in the 2010 Budget that levy rates will be gradually increased over the next three years. In the 2011 Budget, it was announced that the levy rates will be further increased for one more year beyond the initial three. Details of the increased rates have yet to be announced.

### *Property tax*

Property tax is levied annually at 10% on the annual value of houses, land, buildings, or tenements other than owner-occupied residential property.

### *Stamp duties*

Stamp duties are levied on written documents relating to stocks and shares at 0.2% and relating to immovable property in Singapore at graduated rates of up to 3%.

Leases with annual rents not exceeding SGD 1,000 are exempt from stamp duty.

Seller's stamp duty is levied on the sale of residential property (this excludes sales by property developers) if the sale takes place within four years of the purchase date. Stamp duty rates of 4% to 16% apply, depending on the holding period.

## *Branch income*

Tax rates on branch profits are the same as on corporate profits. There is no branch profits remittance tax on the repatriation of profits to the head office.

## *Income determination*

### *Inventory valuation*

There are no special rules as to which valuation basis should be adopted for inventories (stock-in-trade) in the case of a continuing business, as long as the basis is consistent from one year to another. However, the last in first out (LIFO) basis of valuation is not permitted for tax purposes. Generally, tax reporting conforms to book reporting.

### *Capital gains*

There is no tax on capital gains. Where there is a series of transactions or where the holding period of an asset is relatively short, the tax authorities may take the view that a business is being carried on and attempt to assess the gains as trading profits of the corporation. The UK Badges of Trade, which are used in judicial decisions to distinguish capital and revenue transactions, are generally applied in determining this issue. They include the existence of a profit seeking motive, the number of transactions, the nature of the asset, the existence of similar trading transactions or interests, changes to the asset, the way the sale was carried out, the source of finance, the interval of time between purchase and sale, and the method of acquisition.

### *Dividend income*
Singapore dividends are exempt in the hands of the recipient.

### *Stock dividends*
Stock dividends generally are not taxable. However, certain distributions could be treated as deemed dividends in certain circumstances.

### *Deemed dividends*
Certain distributions to shareholders under a capital-reduction scheme, a share buy-back, or a share redemption exercise may be treated as dividends paid by the company. Under the one-tier taxation system, this is not a significant issue unless the transaction is not correspondingly treated as a dividend in the hands of the shareholder. In which case, the gain may be taxable if it is in respect of a trade or business.

### *Foreign income*
A corporation, whether resident in Singapore or not, is taxed on foreign income when it is received in Singapore. Legislative provisions govern the basis of treating foreign income as received in Singapore. There are no special rules for taxing the undistributed income of foreign subsidiaries.

Where income is earned from treaty countries, double taxation is avoided by means of foreign tax credit granted under those treaties. For non-treaty countries, unilateral tax credit is given in respect of foreign tax on all foreign-sourced income, effective as of the year of assessment 2009 (i.e. income year 2008). These foreign tax credits may be pooled with effect from the year of assessment 2012 (i.e. income year 2011), subject to certain conditions.

Foreign dividends, foreign branch profits, and foreign service fee income remitted to Singapore are exempt from tax, subject to certain conditions. A temporary tax amnesty was introduced in the 2009 Budget for all foreign-sourced income, but this expired on 21 January 2010.

## *Deductions*



### *Depreciation and depletion*
Tax depreciation is allowable at specified rates on buildings used in qualifying industry sectors, subject to conditions. However, during the 2010 Budget, industrial building allowances were replaced by a Land Intensification Allowance. The latter provides for faster depreciation but is subject to approval as it is allowed as a tax incentive. Transitional provisions for industrial building allowances are available for taxpayers who committed to qualifying capital expenditure before 22 February 2010.

Tax depreciation is available on machinery and equipment on a straight-line basis over their specified working life for all types of business. In lieu of the straight-line basis, accelerated tax depreciation allowances can be claimed by all businesses on all machinery and equipment in equal instalments over three years.

For machinery and equipment purchased during the accounting periods that ended in 2009 and 2010 (i.e. years of assessment 2010 and 2011), tax depreciation could be claimed over two years instead of three, with 75% of the claim allowed in the first year of assessment and the remainder allowed in the second.

A 100% depreciation allowance is available on capital expenditure incurred on computers, robots, standby generators, pollution control and energy-efficient equipment, certain diesel-driven vehicles, and prescribed automation equipment.

Writing down allowances on a straight-line basis over five years is allowable on the cost of acquisition of intellectual property, subject to certain conditions, while a 100% writing down allowance is allowed for capital expenditure on approved research and development (R&D) cost-sharing arrangements entered into on or after 17 February 2006.

In addition, enhanced allowances may be available for the acquisition of automation equipment and intellectual *property (see Productivity and Innovation Credit in the Tax credits and incentives section)*.

Gains on tax depreciable property (i.e. the excess of proceeds over tax base) are taxed as ordinary income to the extent that tax depreciation has been allowed; that is, any clawback of tax depreciation on the disposal of the asset is taxed.

### *R&D expenses*
Expenses incurred in respect of R&D carried out in Singapore qualify for a tax deduction of 150% of the R&D expenses incurred. Enhanced deductions may also be available under the Productivity and Innovation Credit scheme *(see Productivity and Innovation Credit in the Tax credits and incentives section)*.

### *Charitable contributions*
Donations are deductible only if they are made in cash or another prescribed form and to an approved recipient. The deduction allowed for qualifying donations is generally 250% of the value of the donation.

### *Taxes*
Income taxes are generally not deductible in determining corporate income. However, irrecoverable GST is deductible under certain circumstances. The foreign workers' levy and property taxes are deductible to the extent they are incurred wholly and exclusively in the production of income.

### *Other significant items*
Private automobile expenses are not deductible.

The tax deduction for medical expenses is limited to 2% of total payroll if the employer implements certain portable medical insurance or benefit schemes. Otherwise, the amount deductible will be limited to 1% of total payroll. Where the company is exempt or taxed at a reduced rate, the expenses disallowed are taxed at the prevailing corporate rate.

A tax deduction for employee share-based remuneration (stock award or stock option schemes) is allowed only if treasury shares are purchased to fulfill such obligations. The deduction is restricted generally to the actual outlay incurred.

Borrowing costs incurred on capital employed in the production of income will be allowed as a tax deduction if the costs are incurred as a substitute for interest or to reduce interest costs.

### Net operating losses
Loss carryover, including unutilised tax depreciation allowance, is unlimited, provided shareholdings in the loss-making corporation have not changed beyond 50% of the issued and paid-up capital. Additionally, for tax depreciation allowances to be carried forward, the same trade needs to be continued. The tax authorities may exercise discretion to allow carryover of tax losses and unutilised tax depreciation even when there has been a change in shareholding beyond 50%, absent any tax avoidance motives. Losses of up to SGD 100,000 incurred by the company in the current year can be carried back for one year.

### Payments to foreign affiliates
Payments to non-residents, including foreign affiliates, are deductible, provided they are fair and reasonable, are revenue in nature, and can be seen to be relevant to earning the payer's income.

## Group taxation

A company is allowed to transfer excess current year trade losses, current year tax depreciation, and current year approved donations to another company within the same group if certain conditions are satisfied.

Broadly, to qualify for group relief, companies must be incorporated in Singapore, belong to the same '75%' group of companies such that there must be at least a 75% ownership relationship between claimant and transferor, and have the same accounting year-end. In addition, a group must comply with certain prescribed offset and apportionment rules.

### Transfer pricing
The Income Tax Act contains provisions that may be used in a transfer pricing context to effectively allow IRAS to challenge and revise inter-company transactions. Additionally, specific transfer pricing provisions were introduced in 2009 which define the arm's-length principle (ALP) and provide the IRAS with a right to make transfer pricing adjustments in cases where taxpayers do not comply with the ALP.

The IRAS has also issued transfer pricing guidelines to supplement the provisions in the Income Tax Act and the various treaties signed by Singapore. The guidelines cover the application of the ALP and documentation requirements relating to all related party transactions, including local related party transactions. The intention of the guidelines is to help taxpayers substantiate their transfer prices with their related entities by maintaining adequate documentation to mitigate the risk of tax adjustment by the IRAS and to safeguard them from potential economic double taxation. The IRAS has also provided guidance on matters relating to Mutual Agreement Procedures (MAP) and Advance Pricing Arrangements (APA).

In 2009, the IRAS also issued guidance on the application of the ALP to related party loans and services.

Although Singapore's income tax rates are traditionally lower than the majority of its trading partners, the IRAS is increasing its focus on transfer pricing issues.

### Thin capitalisation
There are no formal thin capitalisation rules in Singapore. However, general anti-avoidance and transfer pricing provisions may operate in cases of blatant abuse.

## Tax credits and incentives

There are various tax incentives available to taxpayers involved in specified activities or industries identified as being beneficial to Singapore's economic development.

### Pioneer tax incentive

Corporations manufacturing approved products with high technological content, providing qualifying services, or engaging in countertrade activities may apply for tax exemption for five to 15 years under the pioneer tax incentive. Corporations may apply for their post-pioneer profits to be taxed at a reduced rate under the Development and Expansion Incentive, as discussed below.

### Development and Expansion Incentive

Under the Development and Expansion Incentive, corporations engaging in new high-value-added projects, expanding or upgrading their operations, or undertaking incremental activities after their pioneer or post-pioneer period may apply for their profits to be taxed at a reduced rate of not less than 5% for an initial period of up to ten years. The total tax relief period is subject to a maximum of 20 years (inclusive of the post-pioneer relief period previously granted, if applicable).

### Investment allowance

Under the investment allowance, a tax exemption is granted on an amount of profits based on a specified percentage (of up to 100%) of the capital expenditure incurred for qualifying projects or activities within a period of up to five years (up to eight years for assets acquired on hire-purchase on or after 15 February 2007).

### Productivity and Innovation Credit (PIC)

The PIC scheme provides for an enhanced 400% deduction for qualifying expenditure incurred in respect of six qualifying activities during the accounting periods that end between 2010 and 2014 (i.e. years of assessment 2011 to 2015). The six qualifying activities are:

- The acquisition or leasing of prescribed automation equipment.
- Staff training.
- The acquisition of intellectual property.
- The registration of intellectual property rights.
- R&D.
- Design.

The enhanced deduction is available only on the first SGD 400,000 of qualifying expenditure incurred each year on each of the qualifying activities although this cap may be combined for certain years of assessment. Certain activities are subject to approval or minimum ownership requirements.

### Merger and acquisition allowance

The merger and acquisition allowance allows a write-off, over five years, of 5% of the value of qualifying merger or acquisition deals executed between 1 April 2010 and 31 March 2015, subject to a cap of SGD 5 million per year of assessment. This incentive is available only to companies that are incorporated, tax resident, and carrying on a business in Singapore.

### *Financial services incentives*

#### Financial sector incentive (FSI) scheme

The FSI scheme covers approved bond intermediaries, Asian currency units, approved derivative traders, approved fund managers, equity capital market intermediaries, operational headquarters, syndicated offshore credit and underwriting facilities, providers of high-value-added processing services supporting financial activities, futures members of the Singapore Exchange Limited, and members of the Singapore Commodity Exchange Limited.

High growth, high-value-added activities such as services and transactions relating to the bond market, derivatives market, equity market (i.e. futures, securities trading, which includes sale of stocks, shares, bonds and other securities, and extends to brokerage, nominee, and custodian services in relation to securities trading), credit facilities syndication, and Islamic finance will be exempt from tax or taxed at 5%, whilst other broader range financial activities will only qualify for a 12% tax rate. The tax incentive period may last for five, seven, or ten years, subject to certain conditions being met.

#### Finance and treasury centre (FTC)

Income derived by an FTC from approved finance and treasury centre activities is taxed at a reduced rate of 10%. Approved activities include regional and international treasury and fund management activities, corporate finance and advisory services, economic and investment research and analysis, and credit control and administration.

#### Debt securities incentives

A package of tax exemptions and reduced tax rates is available to various players in the Singapore bond market, including certain Islamic financing arrangements.

#### Offshore insurance incentives

Approved insurance companies engaged in the business of insuring and reinsuring offshore risks are taxed at a rate of 10% on qualifying income arising from offshore risks business and at a rate of 5% on qualifying income arising from writing offshore Islamic insurance (takaful) and reinsurance (retakaful) business. Tax exemption is available for qualifying income from the writing of both onshore and offshore marine hull and liability risk insurance and offshore specialised risk insurance and for qualifying income of approved offshore captive insurance companies. In addition, a concessionary tax rate of 10% is available to qualifying insurance and reinsurance brokers on income derived from the provision of insurance broking and advisory services to non-Singapore based clients.



#### Real Estate Investment Trusts (REITs)

Distributions made to foreign non-individual investors by a listed REIT out of rental from Singapore real estate are subject to a reduced tax rate of 10%, subject to certain conditions. Listed REITs investing in foreign properties can apply for tax exemption for certain foreign income received in Singapore. Distributions out of this income similarly are exempt. Stamp duty relief is available upon the transfer of immovable Singapore property to a REIT, and GST concessions are available with respect of overseas non-residential properties and special purpose vehicles or sub-trusts.

#### Islamic financing arrangements

The income tax, stamp duty, and GST treatment of (a) Islamic financing arrangements based on (i) the cost-plus (Murabaha) concept, (ii) the investment-partnership (Mudaraba) concept, (iii) the leasing-with-option-to-purchase (Ijara Wa Igtina) concept for mortgage financing; and (b) Islamic debt securities (Sukuk) are aligned with conventional financing contracts that they are economically equivalent to, subject to certain conditions. In addition, concessionary tax rates are available for certain activities relating to Islamic financing *(see FSI scheme and Offshore insurance incentives above)*.

**Infrastructure project finance incentives**
Tax exemption is available for interest income earned from qualifying investments in qualifying infrastructure projects/assets. FSI companies that provide project finance advisory services related to qualifying projects/assets pay tax at 5% on their qualifying income, and companies that provide management services to qualifying business trusts and funds pay tax at 10% on their qualifying income. Stamp duty relief is available also on the transfer of such projects/assets to listed companies.

**Sovereign wealth funds**
Tax exemption is available for income derived by a sovereign fund entity and an approved foreign government-owned entity from funds managed in Singapore.

***Headquarters (HQ) schemes***
Approved regional headquarters in Singapore are taxed at a concessionary rate of tax of 15% on qualifying overseas income. Approved international headquarters can negotiate for various tax incentives, including tax exemption or concessionary tax rates on qualifying income.

***Maritime Sector Incentive (MSI) scheme***
The MSI scheme consolidates all existing incentives for the maritime sector with effect from 1 June 2011. These include the tax exemption for shipping companies, the 10% concessionary tax rate for international freight and logistics operators, and the existing Maritime Finance Incentive (MFI) under which approved ship investment managers are taxed at 10% on their qualifying management-related income. It also includes approved ship investment vehicles which are tax exempt on their qualifying vessel lease income, approved container investment enterprises which are taxed at 5% or 10% on qualifying income from container-leasing, and approved container investment management companies which are taxed at 10% on qualifying management fees.

***Other incentives***
Incentives for not-for-profit organisations, international arbitration, investment holding companies, oil traders, international traders, general insurance companies, leasing companies, trust companies, cyber traders, and the provision of international legal services include tax exemptions or concessionary tax rates of 10% for qualifying income. The concessionary tax rate for liquefied natural gas (LNG) trading, aircraft leasing, qualifying oil traders, and international traders is further reduced to 5%.

## *Withholding taxes*

Domestic corporations paying certain types of income to non-residents are required to withhold tax.

Unless a lower treaty rate applies, interest on loans and rentals from movable property are subject to WHT at the rate of 15%. Royalty payments are subject to WHT at the rate of 10%. The tax withheld represents a final tax, and applies only to non-residents who are not carrying on any business in Singapore or who have no permanent establishment in Singapore. Technical assistance and management fees for services rendered in Singapore are taxed at the prevailing corporate rate. However, this is not a final tax.

Royalties, interest, rental of movable property, technical assistance, and management fees can be exempt from WHT in certain situations or subject to reduction in tax rates applicable, usually under fiscal incentives, or double taxation agreements.

Payments made to public entertainers and non-resident professionals who perform services in Singapore also are subject to a final tax of 15% on the gross income. For public entertainers, this appears to be a final tax unless they qualify to be taxed as Singapore tax residents. However, non-resident professionals may elect to be taxed at the prevailing tax rate for non-resident individuals of 20% on net income if this results in a lower tax cost. The WHT rate on payments to non-resident entertainers has been reduced to 10% from 22 February 2010 to 31 March 2015.

The WHT rates are shown in the following table.

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (2) |
|---|---|---|---|
| Resident individuals | 0 | 0 | o |
| Resident corporations | 0 | 0 | 0 |
| | | | |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 0 | 15 | 10 |
| | | | |
| Treaty: | | | |
| Australia | 0 | 10 | 10 (4a) |
| Austria | 0 | 5 (3b, d) | 5 |
| Bahrain | 0 | 5 (3b) | 5 |
| Bangladesh | 0 | 10 | 10 (4a) |
| Belgium | 0 | 5 (3b, d) | 3/5 (4b) |
| Brunei | 0 | 5/10 (3a, b) | 10 |
| Bulgaria | 0 | 5 (3b) | 5 |
| Canada | 0 | 15 (3e) | 10 |
| Chile (5b) | 0 | 15 | 10 |
| China, P.R. | 0 | 7/10 (3a, b) | 6/10 (4b) |
| Cyprus | 0 | 7/10 (3a, b) | 10 |
| Czech Republic | 0 | 0 | 10 |
| Denmark | 0 | 10 (3b) | 10 |
| Egypt | 0 | 15 (3b) | 10 |
| Estonia | 0 | 10 (3b) | 7.5 |
| Fiji Islands, Rep. of | 0 | 10 (3b) | 10 |
| Finland | 0 | 5 (3b) | 5 |
| France | 0 | 0/10 (3b, c) | 0 (4a) |
| Germany | 0 | 8 (3b) | 8 |
| Georgia (5d) | o | 0 | 0 |
| Hong Kong (5c) | 0 | 15 | 10 |
| Hungary | 0 | 5 (3b, d) | 5 |
| India | 0 | 10/15 (3a) | 10 |
| Indonesia | 0 | 10 (3b, e) | 10 |
| Ireland (5d) | 0 | 5 (3b) | 5 |
| Israel | 0 | 7 (3b) | 5 |

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# Singapore

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (2) |
|---|---|---|---|
| Italy | 0 | 12.5 (3b) | 10 |
| Japan | 0 | 10 (3b) | 10 |
| Kazakhstan | 0 | 10 (3b) | 10 |
| Korea, Rep. of | 0 | 10 (3b) | 10 |
| Kuwait | 0 | 7 (3b) | 10 |
| Latvia | o | 10 (3b) | 7.5 |
| Libya (5d) | 0 | 5 (3b) | 5 |
| Lithuania | 0 | 10 (3b) | 7.5 |
| Luxembourg | 0 | 10 (3b) | 10 |
| Malaysia | 0 | 10 (3b, f) | 8 |
| Malta | 0 | 7/10 (3a, b) | 10 |
| Mauritius | 0 | 0 | 0 |
| Mexico | 0 | 5/15 (3a, b) | 10 |
| Mongolia | 0 | 5/10 (3a, b) | 5 |
| Myanmar | 0 | 8/10 (3a, b) | 10 |
| Netherlands | 0 | 10 (3b) | 0 (4a) |
| New Zealand (5d) | 0 | 10 (3b) | 5 |
| Norway | 0 | 7 (3b) | 7 |
| Oman | 0 | 7 (3b) | 8 |
| Pakistan | 0 | 12.5 (3b) | 10 (4a) |
| Papua New Guinea | 0 | 10 | 10 |
| Philippines | 0 | 15 (3e) | 10 |
| Poland | 0 | 10 (3b) | 10 |
| Portugal | 0 | 10 (3b, f) | 10 |
| Qatar | 0 | 5 (3b) | 10 |
| Romania | 0 | 5 (3b) | 5 |
| Russian Federation | 0 | 7.5 (3b) | 7.5 |
| Saudi Arabia (5a) | 0 | 5 | 8 |
| Slovak Republic | 0 | 0 | 10 |
| Slovenia (5d) | 0 | 5 (3b) | 5 |
| South Africa | 0 | 0 | 5 |
| Sri Lanka | 0 | 10 (3a, b) | 10 (4a) |
| Sweden | 0 | 10/15 (3b, c) | 0 (4a) |
| Switzerland | 0 | 10 (3f) | 5 (4a, e) |
| Taiwan | 0 | 15 | 10 |
| Thailand | 0 | 10/15 (3a, b) | 10 |
| Turkey | 0 | 7.5/10 (3a, b) | 10 |
| Ukraine | 0 | 10 (3b) | 7.5 |
| United Arab Emirates | 0 | 7 (3b) | 5 |
| United Kingdom | 0 | 10 (3b) | 10 |
| United States (5c) | 0 | 15 | 10 |
| Uzbekistan | 0 | 5 | 8 |
| Vietnam | 0 | 10 (3b) | 5/10 (4c) |

Notes

1. Singapore has no WHT on dividends over and above the tax on the profits out of which the dividends are declared. However, some treaties provide for a maximum WHT on dividends should Singapore impose such a WHT in the future.
2. The non-treaty rates (a final tax) apply only to non-residents who do not carry on business in Singapore or have a PE in Singapore. This rate may be further reduced by tax incentives.
3. Interest:
   a. Lower rate or exemption if received by a financial institution.
   b. Exempt if paid to the government.
   c. Lower rate or exemption if paid by an approved industrial undertaking.
   d. Exempt if paid by a bank and received by a bank.
   e. Exempt if paid to a bank but linked to a government loan agreement or paid to specific financial institutions/banks.
   f. Exempt if paid in respect of an approved loan or indebtedness.
4. Royalties:
   a. Royalties on literary or artistic copyrights, including film royalties, are taxed at the non-treaty rate.
   b. Lower rate for payments in connection with industrial, commercial, or scientific equipment.
   c. Lower rate for payments in connection with patents, designs, secret formulas/processes, or industrial, commercial, or scientific equipment/experience.
   d. Exempt if paid to the government.
   e. Exempt for approved royalties.
5. Treaties:
   a. Comprehensive treaty with Saudi Arabia applies from 1 January 2012. Prior to that, the treaty covers only international air transport.
   b. Treaty with Chile covers only international ship operations.
   c. Treaties with Hong Kong and the United States cover only shipping and air transport activities.
   d. Treaty applies from 1 January 2011.

## *Tax administration*

### *Returns*

Tax is computed for each tax year based on the income earned in the preceding year (the tax basis period). The tax basis period is the calendar year; however, for business profits, the accounting year would be adopted generally. The corporation files a return of income by 30 November, and the tax is assessed by the Comptroller of Income Tax. There is no fixed date for the issue of assessments.

### *Payment of tax*

Assessed tax is payable within one month after the service of the notice of assessment, whether or not a notice of objection to the assessment has been lodged with the tax authorities. Application may be made to the Comptroller to pay estimated tax liabilities on a monthly basis. However, the Comptroller is under no obligation to grant such an application.

Late payment of tax will attract penalties up to a maximum of 17% of the outstanding tax.

## *Other issues*

### *Adoption of International Financial Reporting Standards (IFRS)*

Companies incorporated in Singapore and Singapore branches of foreign companies are required by the Companies Act to prepare and present financial statements that comply with the Singapore Financial Reporting Standards (SFRS). In Singapore, the Accounting Standards Council (ASC) has the statutory authority to issue SFRS for adoption.

The SFRS is principally based on and substantially similar to the International Financial Reporting Standards (IFRS) that are issued by the International Accounting Standards Board (IASB). The SFRS will converge with IFRS by 2012 for use by listed companies. For unlisted companies, the development of IFRS for small and medium-sized entities is being observed and evaluated.

Companies are required to submit financial statements as part of their tax return filing. The IRAS generally accepts financial statements prepared for statutory filing, although companies that have been allowed to prepare their financial statements using standards other than SFRS, such as IFRS or the Generally Accepted Accounting Principles (GAAP) adopted by the United States, may be required to explain and/or account for any differences and make the necessary tax adjustments, if any.

In relation to financial instruments, the Income Tax Act was amended to align the tax treatment with the accounting treatment prescribed by SFRS 39 (Financial Instruments: Recognition and Measurement).

### *Sample corporate tax calculation*

Accounting period ended 31 December 2010 (year of assessment 2011).

| | SGD | SGD |
|---|---|---|
| Net profit before tax per accounts | | 5,857,500 |
| | | |
| Less: | | |
| Singapore dividend (exempt) | 1,500 | |
| Foreign-sourced dividend (exempt) | 2,200 | |
| Foreign-sourced interest (exempt) | 1,600 | |
| Profit on sale of fixed assets | 34,000 | |
| Capital exchange gain | 6,750 | (46,050) |
| | | |
| | | 5,811,450 |
| | | |
| Add: | | |
| Depreciation | 650,485 | |
| Foreign pension contribution | 100,000 | |
| Medical expenses (non-deductible) | 500 | |
| Legal fees (capital in nature) | 15,500 | |
| Automobile expenses | 33,500 | |
| Donations | 9,000 | |
| Penalties and fines | 2,000 | 810,985 |
| | | |
| Adjusted profit before capital allowances | | 6,622,435 |
| | | |
| Less: | | |
| Unutilised capital allowances brought forward | 1,152,000 | |
| Capital allowances (current year) | 3,000,000 | |
| Balancing charge | (7,700) | (4,144,300) |
| | | |
| Adjusted profit after capital allowances | | 2,478,135 |

| | SGD | SGD |
|---|---|---|
| Less: Unutilised losses brought forward | | (67,500) |
| Adjusted profit after capital allowances and unutilised losses brought forward | | 2,410,635 |
| Less: Approved donations (250% deduction) | | (22,500) |
| Chargeable income before partial exemption | | 2,388,135 |
| Less: Partial exemption | | |
| 75% of first SGD 10,000 | 7,500 | |
| 50% of the next SGD 290,000 | 145,000 | (152,500) |
| Chargeable income after partial exemption | | 2,235,635 |
| Tax thereon at 17% | | 380,057.95 |
| YA 2011 20% tax rebate (capped at SGD 10,000) | | (10,000.00) |
| Tax payable after rebate | | 370,057.95 |

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# Sint Maarten

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## Significant developments

### Recent political developments

On 10 October 2010, the Netherlands Antilles dissolved, and St. Maarten became an autonomous country within the Kingdom of the Netherlands. Prior to dissolution, the Netherland Antilles consisted of five islands: St. Maarten, Curaçao, Bonaire, Saba, and St. Eustatius.

While each of the islands will remain within the Kingdom of the Netherlands structure, the ties between the islands will be loosened. Defence and foreign affairs will remain within the province of the government of the Kingdom of the Netherlands. Also, the judiciary system will remain an integral part of the Kingdom of the Netherlands.

### Compliance with sound international fiscal standards

In recent years, St. Maarten, as part of the former Netherlands Antilles, has complied with international standards as set forth by the Organisation for Economic Co-operation and Development (OECD) and the European Union (EU). There is, for example, no distinction in the fiscal treatment of offshore and onshore taxpayers. Well-known incentives such as a participation exemption comparable to that applied in the Netherlands and Luxemburg apply to all taxpayers, as well. St. Maarten does not have bank secrecy laws, and the tax information exchange agreements (TIEAs) that in recent years have been concluded with several countries remain applicable to St. Maarten.

### Tax treaties

St. Maarten currently has tax treaties in effect with the Netherlands (including the Caribbean Netherlands), Aruba, Curaçao, and Norway. A double tax agreement (DTA) has been negotiated with Jamaica but has not yet entered into force.

Furthermore, TIEAs have been signed with several countries, including Australia, Canada, Denmark, Mexico, Spain, Sweden, New Zealand, and the United States. As a result, St. Maarten, as part of the former Netherlands Antilles, has been moved to the white list of the OECD Global Forum.

### Transitional legislation

While the offshore tax regime was abolished in 2001, qualifying offshore companies incorporated before 1 January 2002 may continue to apply the old regime until 2019, provided that certain conditions are met under transitional legislation.

## Taxes on corporate income

Resident corporations are taxed on worldwide income. Non-resident companies are taxed on the following St. Maarten-source income:

- Income attributable to a permanent establishment (PE).
- Income from real property situated in St. Maarten.
- Interest on loans secured by a mortgage on property situated in St. Maarten.

Capital gains are not differentiated from operating income and are subject to the same applicable rates. Corporations are taxed on their income as reflected in their profit and loss account, less certain deductible items.

Companies are generally taxed at a flat rate of 34.5%. Special minimum rates apply to the taxable income of certain companies:

| Type of company | Rate (%) |
|---|---|
| New industries and hotels | 2 |
| Land development companies | 2 |

### *Shipping business*

Shipping companies are subject to the general profit tax rate of 34.5% but may apply for the tonnage regime. If applicable, their profit is calculated based on the rates in the table below. If a shipping company applies the tonnage regime, the actual profits or losses are not taken into account, regardless of whether they are regular profits or capital gains.

The calculated profit based on the table below is subject to the general tax rate of 34.5%.

| Over (tons) | Not over (tons) | Profit per net ton (ANG*) |
|---|---|---|
| 0 | 10,000 | 2.00 |
| 10,000 | 25,000 | 1.35 |
| 25,000 | | 0.60 |

* Antilles guilders

### *Exempt companies*

*Please see the Tax incentives section for more information on tax exempt companies.*

### *Companies under transitional offshore rules*

Transitional rules distinguish three types of offshore companies.

- Offshore companies which, on the last day of the financial year that ended before 1 January 2002, had all (or almost all) investments in or revenues from portfolio investments, royalties, holding companies, finance companies, or technical support subject to tax rates of 2.4% to 3% (while capital gains and losses were not taken into account) will be grandfathered through the last day of the financial year of the company that starts before 1 July 2019.
- Offshore companies which, on the last day of the financial year that ended before 1 January 2002, had all (or almost all) their profit subject to tax rates of 4.8% to 6% or, under certain circumstances, 2.4% to 3% and which had a valid ruling with the tax inspector (e.g. trading companies, banks, captives commissions, and fee-earning companies) on the aforementioned date or for which a request for (extension of) such a ruling had been filed on that date will be grandfathered through the last day of the financial year of the company that starts before 1 July 2019.

- Offshore companies that, on the last day of the financial year that ended before 1 January 2002, had invested all (or almost all) investments in or revenues from real estate property or rights connected thereto, located outside the Netherlands Antilles. These revenues were, under the old offshore regime, exempt from tax. For profit tax purposes, these companies will be grandfathered through the last day of the financial year of the company that starts before 1 July 2019.

Specific rules are applicable to companies that were incorporated after 30 June 1999 but before 31 December 2001. These companies may also qualify for the aforementioned transitional rules provided that these companies have been active in a meaningful way. In principle, a company will not be considered to have been active in a meaningful way if the assets of the companies consist predominantly of deposits or receivables on shareholders or affiliated parties.

The grandfathering period continues until 2019.

## Corporate residence

Corporate residence is, in principle, determined by the place of incorporation. However, other factors may also determine residence. For example, a foreign company with effective management in St. Maarten is considered to be a resident. A company that has been established in St. Maarten will always be considered a resident of St. Maarten.

Offshore entities in St. Maarten must have a local managing director. This function is easily provided by one of the many trust companies established in St. Maarten.

### Permanent establishment (PE)

The definition of a PE in St. Maarten is generally in line with the OECD model.

### Transfer of legal seat

Legislation has been enacted under which a St. Maarten company is allowed to transfer its legal seat to another jurisdiction (if permitted under the laws of the outside jurisdiction) and a foreign company is allowed to migrate to St. Maarten.

## Other taxes

### Turnover tax

A 5% turnover/sales tax is levied on the revenue derived from services and deliveries rendered by an entrepreneur or company in St. Maarten. Note that non-resident service providers are also subject to this tax as of 11 February 2011.

A limited number of services and deliveries are exempt, such as:

- Exports.
- Certain basic food and other products.
- Electricity and water.
- Medical services.
- Services at the airport or in the harbour regarding imported or exported goods or goods in transit.
- Advisory and management services provided to or by offshore companies and offshore banks.

An entrepreneur liable to turnover/sales tax must file a declaration, with the Tax Inspectorate before the 16th day of the month following the month concerned, at the Tax Collector's office.

### *Property taxes*
There is no property tax in St. Maarten.

### *Transfer tax*
The transfer of immovable property located in St. Maarten is subject to a 4% transfer duty.

## *Branch income*

### *Branches operating in St. Maarten*
Tax rates on the profits of PEs are the same as for resident corporations.

There are specific rules for the PE of an insurance company. In that case, the company may elect to declare profit based on a percentage of premiums received by the PE, as well as premiums the company has received from insured residents and from insured risks in St. Maarten. The insurance company may also elect to declare a profit that is in the same proportion to total profit of the company as the aforementioned premiums to total premiums.

No tax is withheld on transfers of profits to the head office.

### *Branches of St. Maarten-based companies*
St. Maarten has adopted a definition of a branch (permanent establishment/permanent representatives) that is in line with the definition in the OECD Model Double Taxation Convention on Income and Capital.

The profits of a PE on Aruba, Curaçao or the Netherlands, including the Caribbean Netherlands, are tax exempt in St. Maarten based on the tax arrangement with the Kingdom of the Netherlands. In the case of a PE outside the Kingdom of the Netherlands (i.e. the Netherlands, Aruba, Curaçao, and St. Maarten), the income realised through the PE, after deduction of foreign taxes, is tax exempt. In the case of a foreign loss, this is not deductible.

Foreign real estate is always deemed to be part of a permanent establishment and, as such, is fully tax exempt.



## *Income determination*

### *Inventory valuation*
Both the last in first out (LIFO) and first in first-out (FIFO) methods of inventory valuation are permitted, provided the chosen method conforms to sound commercial practice. Conformity of book and tax reporting is not required. However, occasions or situations for differences are very rare.

### *Capital gains*
Capital gains or losses are, in principle, considered ordinary income and subject to standard corporate rates. An exemption from profit tax is granted for advantages

(dividends and capital gains) from a qualifying participation *(see Dividend income below)*.

Under the transitional regime for offshore companies (investment, holding, finance, and patent holding companies), capital gains and losses are tax exempt.

### *Dividend income*

In general, a full participation exemption applies to all local as well as foreign participations for dividends as well as for capital gains. However, it is now required that dividends be derived from an active participation (non-portfolio investment) or a participation that is subject to tax.

Expenses incurred in connection with a qualifying participation (including capital losses) are not deductible, unless it can be demonstrated that these are indirectly incurred to realise profits that are subject to tax in St. Maarten.

#### Non-portfolio investment clause

A participation is deemed to be active if the gross income of that participation consists of not more than 50% of dividends, interest, or royalties received other than from an enterprise of that participation.

#### Subject-to-tax clause

A participation is deemed to be subject to tax if it is subject to a tax rate of at least 10%.

If at least one of these clauses has been met, the 100% participation exemption will apply. If none of these clauses are met, the participation exemption is limited to 70% of dividends. Consequently, the dividends would be subject to an effective tax rate of 10.35% (30% x 34.5% regular tax rate).

The 100% exemption also applies to income other than dividends, such as capital gains derived from qualifying participations.

#### Immovable property

The aforementioned clauses do not apply to dividends from a participation that (almost) exclusively (directly or indirectly) holds immovable property. The 100% participation exemption applies to these dividends.

#### Definition of dividend

A dividend is defined as a distribution of profits on shares or profit-sharing notes, paid from statutory profits or profit reserves. Dividends shall not be considered payments for the purchase of own shares or profit-sharing notes, distributions on shares upon liquidation, repayment of paid-up capital, or the distribution of bonus shares.

#### Minimum cost-price threshold for participations

The minimum cost-price threshold for shareholdings, profit-sharing notes, or voting rights of less than 5% is ANG 890,000.

### *Foreign income*

A St. Maarten corporation is taxed on foreign interest and other income as earned, and on foreign dividends when received. Undistributed income of foreign subsidiaries is not taxable.

The profit of a PE is tax exempt, and foreign losses are not deductible.

## Deductions

### Depreciation and amortisation
Depreciation of tangible fixed assets, excluding land, is taken over the estimated useful life of the asset. The depreciable base includes purchase price, customs duties, shipping costs, and installation costs, less residual value, if any. The straight-line method is customary, but the declining-balance method is also acceptable. In addition, an accelerated deduction of one-third of the assets' depreciable basis may be taken. The assets' remaining cost basis (two-thirds) is depreciated using one of the acceptable methods.

The cost basis of certain intangible assets, such as patents, trademarks, and copyrights, can be amortised over their expected useful lives. Goodwill and other intangibles resulting from the excess of purchase price over the cost basis of assets purchased are amortised over three to five years.

### Charitable donations
Charitable donations to qualifying entities within the Kingdom of the Netherlands may be deducted to the extent that they exceed 1% of net income and ANG 100 after utilisation of tax loss carryforwards. The maximum deduction is 3% of net income.

### Taxes
Taxes, other than the corporate tax itself, incurred in the course of doing business are deductible.

### Fines and penalties
Fines and penalties are not deductible in cases where they have been imposed by a criminal court in St. Maarten, or have been paid to avoid prosecution, and in cases of administrative fines imposed by a Government agency in St. Maarten.

### Bribes, kickbacks, and illegal payments
Expenses that are connected to a criminal offence for which a taxpayer has been convicted are not deductible. Bribes paid to public servants and politicians are not deductible.

### Net operating losses
Losses may be carried forward for a period of ten years. Start-up losses during the first four years for companies having tax holidays may be carried forward indefinitely. Carrybacks are not permitted.

### Payments to foreign affiliates
The Corporate Tax Act provides for specific limitations for deduction of interest in certain cases of restructuring and refinancing involving the creation of artificial flows of interest payments to persons who are tax exempt or subject to lower taxes in their jurisdiction.

## Group taxation

### Fiscal unity
The Corporate Tax Act provides for fiscal unity treatment for corporate profit tax purposes. Resident companies with wholly owned resident subsidiaries could qualify for this regime. The parent company is entitled to submit one consolidated income tax

return on behalf of the entire fiscal unity group. As a result, only the parent company is assessed.

Within certain limitations, losses of one company can be offset against the profits made by another company in the fiscal unity group. No profits need to be recognised on inter-company transactions, as these are disregarded for tax purposes. The fiscal unity applies for profit tax purposes only; the participating entities remain separate and identifiable under civil law.

Fiscal unity relief is confined to companies organised under the laws of St. Maarten, the Netherlands, Aruba, or Curaçao. The companies which invoke this relief must have their place of management in St. Maarten.

On the basis of the non-discrimination provision of a relevant tax treaty, entities established under the laws of a tax treaty party may also be admitted to the fiscal unity regime provided that they are resident in St. Maarten.

### *Transfer pricing*

There are no specific regulations with regard to transfer pricing. However, based on case law, businesses can be required to show that in case of intra-company transactions, these transactions have been made at arm’s length.

### *Thin capitalisation*

In cases where a company receives a loan from an associated exempt private limited liability company (Besloten Vennootschap or BV), and the amount of the loan is more than three times the net equity of the company, the interest on the loan is not deductible for the part that is more than three times the net equity.

## *Tax credits and incentives*

### *Foreign tax credit*

A tax credit applies to income from abroad that has been subject to tax at source or to another tax on income. The tax credit is allowed for the income tax levied abroad, but shall not exceed the St. Maarten profit tax that is attributable to that foreign income.

### *Inward investment and capital investment*

There are tax incentives or holidays for the establishment of new economic enterprises and hotels with a predetermined minimum employment and capital investment. Special provisions relate to the taxation of shipping and insurance companies.

### *Investment allowance*

For a minimum investment of ANG 5,000, an 8% investment allowance on acquisitions and improvements (for new buildings, 12%) is permitted as a deduction from taxable profit in the year of investment and in the subsequent year, for businesses operating in St. Maarten.

### *Accelerated depreciation and tax rollover reserve*

An accelerated deduction of one-third of the assets’ depreciable basis may be taken. If a profit results at the time of sale of capital assets with the intention to replace that asset, the profit may be placed in a tax rollover account.

### *Tax exempt company*
It is possible to elect tax-exempt status for a BV. To qualify for the exemption, a number of conditions must be met, including (but not limited to) the disclosure of beneficiaries, management, financials, and the activities (only investment and financing activities) of the company. Recently, the licensing of intellectual and industrial property rights and other comparable property and usage rights have been added to the list of allowed activities.

Another condition has been added that requires that no more than 5% of the revenues of the exempt company consist of dividends from subsidiaries that are not subject to a tax regime comparable to that of St. Maarten. A profit tax regime is comparable to that of St. Maarten if the foreign tax regime provides for a profit tax rate of at least 15% (50% of the old Netherlands Antillean rate, excluding island surcharges).

The subject-to-tax requirement is also met if the foreign tax regime appears on a list of comparable tax regimes. The list that has been issued includes all EU and OECD member states and all jurisdictions with which St. Maarten has a tax treaty. According to the list, the subject-to-tax requirement is also met in the case of a jurisdiction that is included in the white list issued by the OECD, provided that no special tax regime is applicable.

#### Independent expert
Currently, an independent expert is required to certify that the exempt company meets the requirements for exempt status. If more than 5% of the revenues of the exempt company consist of dividends from subsidiaries that are not subject to a tax comparable to that of St. Maarten, the independent expert must inform the Inspectorate of Taxes. The inspector notifies the company that it no longer meets the requirements for exempt status. The exempt status is then terminated starting the first day of the year following the year in which the notification becomes final.

### *Ocean shipping companies*
Ocean shipping companies are taxed on a fixed profit per net ton of ANG 0.60 up to ANG 2.00 (or per 10 net ton in case of management and control). International aviation companies may apply a reduced tax rate against 80% of their profit, as their profits are deemed to be gained outside of St. Maarten. As a result, the overall effective tax rate is 9.66%.

### *New industries and hotels*
New industries and hotels are granted partial exemption from profit tax and a minimum 2% tax rate for a period of five to 11 years. A minimum investment is required. Losses incurred during the first four years of operations may be used to offset taxable income for an indefinite period of time.

### *Land development companies*
Land development companies are granted a tax holiday. They are exempt from tax on profits realised on the sale of the developed land. A minimum investment of ANG 1 million is required. Activities should be expected to enhance the economic development of St. Maarten.

### *Private foundations*
Private foundations are exempt from St. Maarten profit tax, and their distributions are exempt from St. Maarten gift tax, as are contributions of assets to the foundation by a non-resident. Gift tax in the contributor's country may be applicable.

The ‘private’ foundation is a variant of the long-existing ‘common’ foundation. The most important difference is that the purposes of a common foundation may not include making distributions (other than distributions of an idealistic or social nature). This restriction does not apply to private foundations, whose purpose may include making distributions to the founders and others. A private foundation may not run a business or enterprise for profit. Acting as a holding company or investment company is not considered running a business. The private foundation is intended to be an alternative to the Anglo-Saxon trust, especially in civil law jurisdictions.

### Mergers, split-ups, and re-incorporations

In cases of a business merger, relief is granted under certain circumstances. Although there is no specific provision in the Corporate Tax Act with regard to legal mergers, legal split-ups, and re-incorporations, the Tax Inspectorate has announced that when certain conditions are met, a tax facility also applies in these cases.

## Withholding taxes

Although a dividend withholding tax (WHT) was approved in 1999, it has been decided that for the foreseeable future this tax will not enter into force. If it is decided that the tax will enter into force, there is a mandatory transitional period during which the tax will not be applicable to legal entities resident at that time in St. Maarten.

### Tax treaties

St. Maarten currently has tax treaties in effect with the Netherlands, Aruba, Curaçao, and Norway. A DTA has been negotiated with Jamaica, but this has not entered into force yet. Furthermore, TIEAs have been signed with several countries including Australia, Canada, Denmark, Mexico, Spain, Sweden, New Zealand, and the United States. As a result, St. Maarten, as part of the former Netherlands Antilles, has been moved to the white list of the OECD Global Forum.

### Tax arrangement for the Kingdom of the Netherlands (TAK)

As part of the Kingdom of the Netherlands (TAK), St. Maarten is party to a federal tax agreement with the Netherlands, Aruba, and St. Maarten. Subject to this treaty, dividends, interest, and royalties paid out to a St. Maarten company may qualify for reduced rates of WHT in the subject countries.

Dutch dividend WHT is 15% if the St. Maarten company owns less than 25% of the Dutch company. In St. Maarten, only 5% of these dividends are taxed, at a rate of 34.5%, which results in an effective profit tax rate of 1.725%.

If the St. Maarten company’s interest is 25% or more, Dutch WHT can be reduced to 8.3%. This tax is then paid, under a special procedure, to the St. Maarten tax authorities. These dividends are fully exempt from profit tax in St. Maarten.

Capital gains derived from shareholdings in Netherlands’ corporations are fully exempt from profit tax in St. Maarten, provided that the shareholding amounts to at least 25% interest in the corporation. If the shareholding amounts to less than 25%, the capital gain is tax exempt for 95%.

The WHT regime in the TAK also applies to the old St. Maarten offshore companies.

The TAK is to be revised.

## Tax administration

### Returns

Profit tax is levied by way of a self-assessment system. Returns are to be filed on a calendar-year basis. Non-resident corporations may file their returns based on a calendar year basis or on a different book-year. On request, this may also apply, for example, when a resident company is the subsidiary of a foreign parent company (i.e. only a local company must request for a different tax year end).

A provisional return must be filed within three months after the end of the book-year. A final return must be filed within six months after the end of the book-year.

### Payment of tax

Payment is to be made at the time of filing and in a lump sum on the basis of the self-assessment.

In general, at the time of filing the provisional return, an amount equal to the profit tax of the previous year must be paid; the remaining balance due for the year for which the return is filed must be paid at the time of filing the final return.

For example, if the tax due for the year 2009 was 100, then at the time of filing the provisional return for 2010, that same amount must be declared and paid. If there is reason to believe that the amount for the year 2010 will be lower than for 2009, the estimated lower amount may be paid at the time of filing the provisional return, upon request.

At the time of filing the final return for the year 2010, the balance due must be paid; or if the total amount is less than the amount already paid up, a repayment will follow.

### Statute of limitations

A reassessment can be imposed until five years after the tax year. In cases where the tax payer is considered to be in bad faith, a reassessment can be imposed until ten years after the tax year.

## Other issues

### Mergers

The Corporate Tax Act provides for a tax facility for business mergers. In a business merger, a company acquires all or a substantial part of the trade or business of another company with a view towards combining the business operations of the two companies into a permanent financial and economic organisation. If the business is transferred as part of a business merger, the gains realised by the transferor are not subject to profit tax if certain conditions are met.

Although there is no specific provision in the Corporate Tax Act with regard to legal mergers, legal split-ups, and re-incorporations, the Tax Inspectorate has announced that when certain conditions are met, a tax facility also applies in these cases.

### *Exchange controls*

In general, exchange control regulations are very liberal for offshore companies. Offshore companies established in St. Maarten can obtain non-resident status for exchange control purposes, which basically provides for total exemption from exchange controls. Onshore companies are subject to slightly stricter rules. These companies are subject to a licence fee of 1%.

# *Slovak Republic*

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## *Significant developments*

The tax legislation in the Slovak Republic (Slovakia) has not been significantly amended recently. Nevertheless, the legislation is subject to frequent amendments and new official interpretations. Therefore, it is advisable to contact PwC Bratislava for up-to-date information. The latest amendment recently approved by the Slovak Parliament is effective from 1 January 2011. Thus, the information included in this summary applies from 1 January 2011 unless otherwise stated.

## *Taxes on corporate income*

As a member state of the Organisation for Economic Cooperation and Development (OECD), the Slovak Republic's system of corporate taxation generally follows OECD guidelines and principles.

Slovakia has a flat corporate income tax (CIT) rate of 19%, and does not have local, state, or provincial CIT.

## *Corporate residence*

A company is a resident in the Slovak Republic if it has its registered seat or effective place of management in the Slovak Republic.

### *Permanent establishment (PE)*

A foreign company may create a PE if (i) its employees (or persons working for it) are present and providing services in the Slovak Republic on behalf of the foreign company where this activity is carried out through a permanent place of business, (ii) the employees conclude and negotiate agreements on the foreign entity's behalf, or (iii) the foreign entity establishes a building site within the territory of the Slovak Republic.



## *Other taxes*

### *Value-added tax (VAT)*

A basic VAT rate of 20% applies to all taxable supplies, with certain exceptions. Medical products and printed materials have a VAT rate of 10%. Exempt supplies without credit entitlement include postal services, financial and insurance services, education, public radio and TV broadcasting services, health and social services, the transfer and leasing of real estate (with exceptions), and lottery services. There are also other VAT-exempt transactions without credit entitlement, as well as exempt taxable supplies with credit entitlement.

VAT grouping is possible if certain conditions are met.

### *Stamp taxes*
There are no special stamp taxes in Slovakia.

### *Excise tax*
Excise tax is charged on the release to free tax circulation or import of tobacco products, wine, spirits, beer, and mineral oil. In addition, effective 1 July 2008, excise tax is also charged on electric energy, coal, and natural gas.

### *Immovable property tax*
Immovable property tax, which is divided into land tax, building tax, and tax on apartments, is governed by the Act on Local Taxes. Immovable property tax is calculated based on the area of the real estate, its location, and its type, as well as the tax rate of each self-governing region.

Real estate transfer tax was abolished effective 1 January 2005, and there are no stamp duties or similar taxes on share or other property transfers, although small administrative fees are payable to register such transactions.

### *Transfer taxes*
Transfer taxes are not applicable for Slovakia.

### *Turnover taxes*
Turnover taxes are not applicable for Slovakia.

### *Registration taxes*
Registration taxes are not applicable for Slovakia.

### *Customs duties*
- Goods imported from non-EU countries are subject to import customs clearance.
- Goods exported from the EU customs territory have to be declared for export customs clearance.
- The person responsible for paying the customs debt is the declarant.
- The declarant is the person making the customs declaration in his own name, or the person in whose name the customs declaration is made.
- The custom declaration should be made in the prescribed form and manner (in writing or by another action).
- Import or export duties are customs duties and other charges payable on the import or export of goods (import VAT, excise duties, and charges under the common agricultural policy).
- The customs authorities require declarants to provide a deposit to cover the customs debt in the event that a customs debt arises. Such a deposit may be in cash, or may be provided by a guarantor.

To communicate with the customs offices, each person must have an Economic Operator Registration and Identification Number (EORI), which is registered by the customs authorities on request. EORI registration is mandatory for customs clearance.

The European customs rate, customs nomenclature and customs tariffs are set by EU legislation.

### Motor vehicle tax
Vehicle tax applies to vehicles that are used for business purposes in the Slovak Republic, regardless of where they may be registered. The taxpayer is the entity that uses the vehicle for business purposes. The tax rate depends on engine capacity, vehicle size, and the decision of each self-governing region.

### Inheritance tax and gift tax
Inheritance tax and gift tax were abolished as of 1 January 2004.

## Branch income

A foreign company may trade through a Slovak branch, which must be registered in the Slovak Commercial Register. The taxable income of the branch may not be lower than that which an independent entity (e.g. a Slovak company) would achieve from carrying out similar activities under similar conditions. If the branch's taxable income cannot be assessed based on its income less costs, as adjusted for tax purposes, certain other methods may be used. A taxpayer may ask the tax authorities in writing to approve such a method. A Slovak tax resident entity is able to deduct from its tax base a tax loss made by its taxable PE (e.g. branch) outside Slovakia.

## Income determination

The tax base is generally the accounting result as determined under Slovak statutory accounting rules, adjusted for tax purposes. Under the transfer pricing rules, the tax base should be increased by the difference in prices charged between a Slovak entity and its foreign related parties compared with those that would be charged between independent parties. Slovak tax law generally reflects OECD rules with respect to transfer-pricing methods.

### Capital gains
Capital gains from the disposal of assets are included in the CIT base. The tax treatment of capital losses depends on the type of asset on which they arose.

### Dividend income
Dividends paid out of profits earned on or after 1 January 2004, and liquidation surpluses and settlement amounts to which shareholders became entitled on or after 1 January 2004, are not subject to tax. Income received by inheritance or donation, and income from acquiring new shares due to an increase in share capital from retained profits or mergers and demergers within Slovakia or the European Union (EU), is also not subject to tax.

### Interest and royalty income
Slovak-source interest income earned by taxpayers with limited as well as unlimited tax liability is subject to withholding at a flat tax rate of 19%, except where the recipient of the interest or the yield is an investment fund, supplementary pension fund, bank or the branch of a foreign bank, or the Slovak Export-Import Bank.

Royalty income is subject to the 19% corporate flat tax rate.

Interest and royalty income is also exempt if it is paid by a Slovak payer to a recipient who is a tax resident in the European Union and is a beneficial owner of this income, provided that for 24 months before the payment:

- the payer owns at least 25% direct shareholding of the recipient of the income
- the recipient owns at least 25% direct shareholding of the payer of the income, or
- a third entity resident in European Union owns at least 25% direct shareholding on both the payer and the recipient of the income.

### *Unrealised foreign exchange gains/losses*
The taxpayer may decide whether to include unrealised foreign exchange differences relating to unsettled payables and receivables in the tax base in the tax period when they are accounted for or in the tax period when they are realised. However, the decision to include these differences when they are realised must be made in writing to the Tax Office before the start of the tax period. Any subsequent decision to revert back to including these differences must be made before the end of the tax period concerned.

### *Foreign income*
Companies resident in the Slovak Republic are taxed on their worldwide income, including income of its foreign branches. Credit relief is available for foreign tax paid under most of Slovakia's double tax treaties (DTTs). Alternatively, exemption of foreign income taxed abroad from taxation in Slovakia may apply.

## *Deductions*

### *Depreciation and amortisation*
Tax depreciation is calculated on an asset-by-asset basis using a straight-line or reducing-balance method at statutory rates, and is generally available for expenditure incurred on tangible fixed assets. Some types of assets are excluded from depreciation (i.e. land, artwork, and national monuments).

Tangible fixed assets are classified into tax depreciation groups to which different depreciation periods apply, as follows:

| Depreciation group | Assets | Depreciation (years) |
|---|---|---|
| 1 | Motor vehicles, office machines and computers, and tools and implements | 4 |
| 2 | Engines, most production line equipment, furniture | 6 |
| 3 | Buildings made of metal, turbines, air-conditioning systems, and ships | 12 |
| 4 | Buildings of a permanent nature | 20 |

Taxpayers do not have to depreciate an asset every year. Tax depreciation may be interrupted in any year and continued in a later year without a loss of the total tax depreciation available.

A lessee can depreciate a tangible fixed asset held under a financial lease. For tax purposes, the depreciation period equals the leasing period, and the tax depreciation base equals the acquisition value of the leased asset without VAT and financing costs, plus expenses related to acquisition of the leased asset that the lessee incurred before the asset was put into use.

The value to be used as the basis for tax depreciation depends on how the asset is acquired and is usually based on one of the following:

- Acquisition costs (i.e. the price for which the asset was acquired).
- The taxpayer's own costs incurred, if the asset is acquired or produced internally.

Intangibles are amortised for tax purposes in line with their accounting amortisation (i.e. over the useful life of the intangible asset).

### *Goodwill*

Amortisation of purchase goodwill, including the goodwill on purchase of a business as a going concern, is tax deductible. Other goodwill is not tax deductible.

For goodwill created at the contribution of business as a going concern or goodwill created at a merger, the tax deductibility of the goodwill depends on the method of tax treatment of this reorganization. If the reorganization is performed for tax purposes in fair market values, the goodwill created will be tax effective. On the other hand, if the reorganizations are made in original values, the goodwill created is not tax effective.

### *Bad debt provisions*

Provisions for unsecured receivables from loans created by banks, and bad debts of regular commercial companies, are fully tax deductible (subject to certain conditions) once the debt has been overdue for more than 1,080 days (20% of the bad debt is tax deductible when it has been overdue for more than 360 days, and 50% after 720 days), provided certain conditions are met.

### *Charitable contributions*

Charitable contributions are treated as gifts which are not tax deductible.

### *Pension expenses*

Contributions to supplementary pension savings made by the Slovak employer on behalf of the employee, up to 6% of the gross salary of the employee participating in these plans, are tax deductible.

### *Start-up expenses*

Start-up expenses are tax deductible in the period when incurred.

### *Fines and penalties*

Contractual penalties and late payment interests are generally tax deductible on a cash basis.

### *Non-deductible expenses*

Expenses are generally tax deductible if incurred to generate, secure, and maintain the entity's taxable income. However, certain costs are specifically not tax deductible. These include entertainment costs, statutory penalties and fines, various provisions, and certain expenses in excess of statutory limits (e.g. employee travel expenses and meal allowances).

### *Net operating losses*

A company or branch may carry forward and utilise a tax loss for a period of up to five years following the year in which the loss arose, and for up to seven years for tax losses reported after 31 December 2009. Each year's tax loss should be considered separately, and can be utilised over its own five or seven-year period.

Carryback of losses is not available in Slovakia.

## Group taxation

There is no concept of group CIT in the Slovak Republic. Each company in a group is taxed individually.

### Treatment of inter-company items

Dividends are not treated as taxable costs if they are paid out of the profit after tax earned since 2004.

Royalties, commissions, and other payments paid to foreign related parties are tax-deductible, provided they would be taxable if paid to a third party and if the charges are in line with transfer pricing rules.

### Transfer pricing

Under the transfer pricing rules, prices in transactions between a Slovak company and its foreign-related parties should be at arm's length, which means the prices should be at rates similar to those that would be charged between unrelated parties for the same or similar transactions under comparable conditions. Although the OECD Transfer Pricing Guidelines were formally not implemented, these are usually followed for determination of arm's-length prices.

If transactions between the related parties are not made at arm's length, and this results in a reduction in the Slovak entity's corporate tax base, then the tax authorities can adjust the corporate tax base to that which it would have been achieved if arm's-length prices had been used.

#### Transfer pricing documentation

All Slovak taxpayers must keep sufficient transfer pricing documentation to justify prices charged by or to their foreign related parties. The Slovak Ministry of Finance has issued a guideline setting out detailed requirements for transfer pricing documentation (the Guideline) for entities which are obliged to prepare their financial statements under IFRS.

The EU code of conduct was formally not implemented. However, the Guideline requires maintaining transfer pricing documentation in a form generally in line with the EU standards.

Slovak tax inspectors may require transfer pricing documentation during a tax inspection. Without such documentation, transfer pricing adjustments (increased tax base) are much more likely to be imposed. In addition, entities reporting under IFRS may be specifically penalised for not keeping transfer pricing documentation or for non-compliance of their documentation within the Guideline requirements.

### Thin capitalisation rules

There are no thin capitalisation rules in the Slovak Republic.

### Controlled foreign company (CFC) regime

There is no CFC regime in place in the Slovak Republic.

## Tax credits and incentives

There are several types of investment incentives potentially available, including corporate tax credits, discounts on the price of publicly owned real estate, and financial support for creating jobs or for training employees. All of these are treated as state aid.

Various conditions must be met in order for a company to qualify for state aid. These include a minimum amount of investment in fixed assets, the amount depends mainly on the type of project and where it is located.

### Investment incentives

Investment incentives (including tax credits) are potentially available for projects in the following areas:

- Industry.
- Technology centres.
- Shared services centres.
- Tourism.

The granting of a tax relief is subject to approval of the Slovak authorities. If certain conditions are met, a taxpayer may apply tax relief in the five subsequent years following the tax period in which the relief was granted.

### Research and development (R&D) incentives

R&D incentives currently available under Slovak law are:

- Subsidies for research and development projects from the state budget.
- Income tax relief at the amount incurred for R&D.

Types of projects which can be granted investment incentives include:

- Fundamental research projects.
- Experimental development projects.
- Applied research projects.
- Feasibility studies.
- Protection of intellectual and industrial property.
- Staffing of research and development functions.



## Withholding taxes

Mainly, the following payments are subject to withholding tax (WHT) when made by Slovak companies to foreign parties. However, a DTT may reduce or eliminate the rate:

| Payments | WHT (%) |
|---|---|
| Management fees for services provided in the Slovak Republic | 19 |
| Royalties* | 19 |
| Interest on loans and deposits** | 19 |

* Royalties paid to related EU-resident companies are not subject to WHT if certain conditions are met.

** Interest paid to related EU-resident companies is not subject to WHT if certain conditions are met.

# Slovak Republic

Dividends paid out of profits arising in 2004 and later years are not subject to Slovak WHT.

WHT should be paid to the Tax Office no later than 15 days from the end of the calendar month following that in which the payment was made. The withholding obligation lies with the Slovak resident taxpayer. The taxpayer must also notify the tax administrator of the tax withheld and transferred. If the tax is not properly withheld, the unpaid tax becomes the Slovak tax resident's tax liability, and a penalty may be assessed.

### *Double tax treaties*

This table highlights countries with which Slovakia has entered into DTT.

| Recipient | Interest (%) | Royalties (%) |
|---|---|---|
| Australia | 10 | 10 |
| Austria | 0 | 0/5 (1) |
| Belarus | 0/10 (3) | 5/10 (1) |
| Belgium | 0/10 (2a) | 5 |
| Bosnia and Herzegovina | 0 | 10 |
| Brazil | 0/10/15 (2, 3) | 15/25 (1b) |
| Bulgaria | 0/10 (3) | 10 (6) |
| Canada | 0/10 (14) | 0/10 (1) |
| China, P.R. | 0/10 (4) | 10 |
| Croatia | 10 | 10 |
| Cyprus | 0/10 (3) | 0/5 (1) |
| Czech Republic | 0 | 0/10 (1) |
| Denmark | 0 | 0/5 (1) |
| Egypt (17) | N/A | N/A |
| Estonia | 0/10 (15) | 10 |
| Finland | 0 | 0/1/5/10 (8) |
| France | 0 | 0/5 (1) |
| Germany | 0 | 5 |
| Greece | 0/10 (3) | 0/10 (1) |
| Hungary | 0 | 10 |
| Iceland | 0 | 10 |
| India | 0/15 (4) | 30 |
| Indonesia | 0/10 (3) | 10/15 (5) |
| Ireland | 0 | 0/10 (1) |
| Israel | 2/5/10 (9) | 5 |
| Italy | 0 | 0/5 (1) |
| Japan | 0/10 (4) | 0/10 (1) |
| Kazakhstan | 0/10 (3) | 10 |
| Korea | 0/10 (4, 11) | 0/10 (1) |
| Latvia | 0/10 (4) | 10 |
| Libya (18) | 0/10 (3) | 0/5 |
| Lithuania | 0/10 (4) | 10 |
| Luxembourg | 0 | 0/10 (1) |
| Macedonia | 10 | 10 |
| Malta | 0 | 5 |

| Recipient | Interest (%) | Royalties (%) |
|---|---|---|
| Mexico | 0/10 (3) | 10 |
| Moldavia | 10 | 10 |
| Mongolia | 0 | 0 |
| Montenegro | 10 | 10 |
| Netherlands | 0 | 5 |
| Nigeria | 0/15 (3) | 10 |
| Norway | 0 | 0/5 (1) |
| Poland | 0/10 (4) | 5 |
| Portugal | 10 | 10 |
| Romania | 0/10 (4) | 10/15 (1a) |
| Russia | 0 | 10 |
| Serbia | 10 | 10 |
| Singapore | 0 | 10 |
| Slovenia | 10 | 10 |
| South Africa | 0 | 10 |
| Spain | 0 | 0/5 (13) |
| Sri Lanka | 0/10 (12) | 0/10 (1) |
| Sweden | 0 | 0/5 (13) |
| Switzerland | 0/10 (7, 11, 20) | 0/5/10 (1, 10, 20) |
| Syria | 0/10 (3) | 12 |
| Tunisia | 0/12 (3) | 5/15 (1) |
| Turkey | 0/10 (3) | 10 |
| Turkmenistan | 0/10 (3) | 10 |
| Ukraine | 10 | 10 |
| United Kingdom & North Ireland | 0 | 0/10 (1) |
| United States | 0 | 0/10 (1) |
| Uzbekistan | 10 | 10 |
| Vietnam | 0/10 (3) | 5/10/15 (16) |

Notes

1. The lower rate applies to cultural royalties.
   a. In the case of Romania, the rate of 10% applies to royalties in respect of the use of trademarks, patents, or know-how. The higher rate applies in any other cases.
   b. In the case of Brazil, the rate of 25% applies to royalties for the use of trademarks. The lower applies in other cases.
2. The lower rate applies to interest on loans and credits granted by a bank for at least ten years in connection with the sale of industrial equipment; with the study, installation, or furnishing of industrial or scientific units; or with public works.
   a. The zero-rate applies to interest on certain commercial debt-claims, loans guaranteed by public entities for export promotion, accounts/loans between banks/public institutions of the two states, and interest paid to another state or political subdivision of a local authority.
3. The zero-rate applies if the interest is received by the government/the central bank/other state institutions *(see the respective treaty for exact wording)*.
4. The zero-rate applies if the interest is received by the government or the central bank or other state institutions, or if the receivables on which the interest is paid are guaranteed/financed/indirectly financed by the government/governmental institutions *(see treaty for exact wording)*.
5. The rate of 10% applies to royalties for cinematography, TV broadcasting, and radio broadcasting, and to giving up rights related to royalties. The higher rate applies in other cases.
6. This rate also applies to payment for services.
7. Withholding tax is 0% on bank loans.
8. The zero-rate applies to copyrights, 1% applies to finance lease of equipment, 5% applies to equipment rental and royalties for software, cinematography, and TV and radio broadcasting, 10% applies to payments for the use of trademarks and know-how.

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9. The rate of 2% applies to state bonds, obligations, and loans insured or guaranteed by the National Bank of Slovakia/Israel, Slovak Society for Insurance of Foreign Credits and Loans, or Israel Society for Insurance of Foreign Trade; 5% applies if interest is received by a financial institution; and 10% applies in all other cases.
10. Slovakia can apply the rate of 5% to royalties for the use of trademarks, patents, or know-how paid from Switzerland to Slovakia, if Switzerland does not apply the 10% rate.
11. The zero-rate applies to interest on loans and credits in connection with the sale of industrial, business or scientific equipment, or the sale of goods.
12. The zero-rate applies if the interest received is related to loans (monetary or non-monetary) provided to the government of the other contracting state corporation or any other institution with state shareholding or to loans provided to a bank institution under a governmental approval.
13. The zero-rate applies to copyrights.
14. The zero-rate applies to interest received by a resident of one state in respect of indebtedness of the other state government or political subdivision/local authority, or in respect of a loan made/ guaranteed by the other state government in respect of imports/exports.
15. The zero-rate applies if the interest is received by the government, the central bank, or other state institutions, or if the receivables on which the interest is paid are guaranteed/financed/indirectly financed by the government/governmental institutions *(see treaty for exact wording).*
16. The rate of 5% applies to royalties for the use or the right to use of patent, draft or model, plan, confidential formula or procedure, for information related to industrial or scientific experience and for the use or the right to use of an industrial, business or scientific device. The rate of 10% applies to royalties for the use or the right to use of trademark or for information related to business experience. The rate of 15% applies to royalties, other than those stated above.
17. Slovakia is waiting for Egypt to announce its approval of DTT.
18. DTT between Slovakia and Libya is effective as of 21 June 2010.
19. Slovakia and Switzerland signed the Protocol to a DTT on 8 February 2011, which is not ratified yet. Based on this Protocol, the interest rate will be maximum 5%. Industrial royalties are subject to 10%, but the potential reduction of the rate is in case the royalties are paid within European Union, and entities are considered to be related companies with direct share exceeding 25% for more than 24 months, which is in accordance with the EU Directive on interest and royalty payments made between associated companies.

## *Tax administration*

### *Returns*

The standard fiscal year is a calendar year, but a Slovak entity may opt to change this to a different 12-month period. A corporate tax return must be filed together with the entity's financial statements within three months following the fiscal year-end. A three-month extension to the filing deadline may be used. Also, if part of the income to be reported in the tax return is from sources abroad, the taxpayer may extend the filing deadline by up to six months. To extend the filing deadline, the taxpayer has to notify the Tax Office before the normal filing deadline. After notification, the deadline is automatically extended.

### *Payment of taxes*

The balance of tax due for a fiscal year is payable by the filing deadline.

Advance payments of corporate tax must be paid monthly or quarterly during the current tax period. Installments are usually based on the last known tax liability of the entity. It is not necessary to pay tax advances if the last tax liability did not exceed 1,659.70 euros (EUR). When the tax return for the preceding tax period is filed, and the final tax liability is known, any outstanding tax is paid, and a new schedule for paying advances for the current year is made.

### *Statute of limitations*

A tax may not normally be assessed or additionally assessed more than five years (ten years when DTT treaty was applied, including transactions with foreign related parties) after the end of the year during which the obligation to file a tax return arose, or during which the taxpayer was obliged to pay the tax. If a tax inspection is undertaken within this five-year period, another five-year period commences from the end of the year in which the taxpayer was notified of this action.

If a taxpayer utilises a tax loss reported as of 2010, a tax or additional tax cannot be assessed more than seven years after the end of the year in which the obligation to file a tax return in which a taxpayer reported the tax loss arose.

However, tax may be assessed, or additionally assessed, no later than ten years after the end of the year during which the obligation to file a tax return arose, or during which the taxpayer was obliged to pay the tax.

## *Other issues*

### *Reserve fund*

When a joint-stock company is incorporated, it must create a reserve fund of at least 10% of its share capital. The statutory reserve fund must be increased annually by an amount set out in the company's Articles of Association, but not less than 10% of its net profit, up to a total of 20% of the share capital.

A limited liability company must create a reserve fund following the first year in which it reports a profit, at the latest. The minimum contribution is then 5% of the net profit each year (or more if specified in the company's Articles of Association) up to a total of at least 10% of the company's share capital.

A branch of a foreign company is not required to set up a reserve fund.

A reserve fund may be used to cover prior year losses of the company, and, in certain other limited situations, but it is not distributable.

### *Business combinations*

Two alternative tax treatments may be used for business combinations, including in-kind contributions to a company's share capital, mergers, and demergers.

Under the first alternative, the taxpayer should value assets for tax purposes using their current market values, and the revaluation difference must be reflected in the appropriate company's tax returns within seven years of the transaction.

Under the second alternative, the taxpayer should continue to use the original tax book values of the assets, and revaluation difference is not taxable/tax deductible.

When selling a business, the purchaser must include goodwill or negative goodwill, acquired as part of the purchase, in its tax base within seven tax periods.

### *International Financial Reporting Standards (IFRS) adoption*

Slovakia has adopted most of the principles of IFRS in its accounting law. However, there are still some differences between IFRS and Slovak accounting standards.

### *Obligation to prepare statutory financial statements according to IFRS*

Financial institutions (banks, insurance companies, etc.) must prepare their statutory financial statements according to IFRS. In addition, a company which fulfils two or more of the following conditions, in two consecutive accounting periods, must prepare its statutory financial statements according to IFRS:

- The total value of assets is more than EUR 165,969,594.
- Net turnover exceeds EUR 165,969,594.
- The average number of employees in the individual accounting period exceeds 2,000.

If the Slovak taxpayer is obliged to prepare its financial statements under IFRS, the tax base is derived from either:

- the profit before tax under IFRS, adjusted for tax purposes using the 'IFRS Tax Bridge' issued by the Slovak Ministry of Finance or
- the profit before tax under Slovak statutory accounting standards.

# Slovenia

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## Significant developments

### Amendments to corporate taxation

The Slovene Corporate Income Tax (CIT) Act, which became effective on 1 January 2007, was amended once during 2010.

The amendments, which are summarised below, aim to reduce the tax burden on businesses during the global economic downturn, to encourage employment of certain categories of people, and to facilitate investments in research and development (R&D).

**Tax relief for investments in the Pomurje region**

In 2010, a new decree came into effect that enables entities based in the Pomurje region of Slovenia to benefit from additional employment incentives and additional tax relief for investments. These extra benefits are available from 2010 to 2015. As a result, provided certain conditions are met, entities with their seat in Pomurje are entitled to a 70% tax allowance for investments in equipment and intangible assets as well as to certain employment allowances.

**Tax relief for employment of hard-to-place workers**

A taxpayer who employs a hard-to place worker may be able to benefit from a tax allowance for both corporate tax and tax on activity. A hard-to-place worker is a person younger than 26 or older than 55 who has been registered as unemployed for at least six months and who has not been employed by the taxpayer or a related party in the past 24 months. The tax allowance equates to 45% of the salary paid to the person during the first 24 months of their employment, up to the amount of the tax base.

**Increase in R&D allowances**

There have been changes with respect to the relief for investment in R&D. The relief has been doubled from 20% to 40% of the cost of investments into R&D. Correspondingly, additional regional tax reliefs were increased to 50% or 60%.

### Changes to double tax treaties (DTT)

Slovenia has recently ratified four new DTTs which will come into force after both contracting countries finalise all their internal procedures. These treaties are between Slovenia and

- Kuwait
- Egypt
- Qatar, and
- Singapore.

As of 1 January 2011, a new DTT between Slovenia and Italy entered into force.

## Taxes on corporate income

Slovenian tax residents are liable to pay corporate income tax (CIT) on their worldwide income. Slovenian tax non-residents are taxed only on income from sources in Slovenia, including income earned through permanent establishments (PE) in Slovenia.

The CIT rate for 2010 and subsequent years is a flat rate of 20%.

A special tax regime is granted for certain economic zones where additional tax allowances for investment and employment may be available *(see the Tax credits and incentives section)*.

Taxpayers, such as non-profit or charitable organisations, associations, foundations, etc., are exempt from CIT on their non-profit-making activities.

Investment funds as well as pension funds, pension insurance companies, and venture capital companies may be taxed at a rate of 0% if certain conditions are met.

There are no state or local taxes on income.

### Tonnage tax

A company may request to be subject to tonnage tax instead of CIT if it meets certain conditions (i.e. it operates in maritime transport in international shipping) and notifies the tax authorities in advance.

The tax base for tonnage tax is the sum of the tax bases for each of an entity's ships that are included in the tonnage tax regime. The tax base for a particular ship is calculated by multiplying the number of ship operating days by the daily tax base shown in the following table:

| Net tonnage (NT) | EUR*/day for 100 net tonnes |
|---|---|
| For the first 1,000 tonnes | 0.90 |
| For the next 1,001 to 10,000 tonnes | 0.67 |
| For the next 10,001 to 25,000 tonnes | 0.40 |
| Above 25,001 tonnes | 0.20 |

*Euros

## Corporate residence

A legal entity is considered to be a Slovenian tax resident if the entity has its statutory (registered) seat or place of effective management located in Slovenia. These conditions, however, do not exclude a society or any association of persons, including an association under civil or foreign law that does not have legal identity, from also being considered to be a Slovene tax resident.

### Permanent establishment (PE)

The Slovene definition of a PE is generally in line with the definition set out in the Organisation for Economic Co-operation and Development (OECD) model tax treaty. Thus, it is a place of business in Slovenia in or through which the non-resident's activities are conducted in whole or in part. The following, in particular, are considered to constitute a PE:

- An office, branch, factory, workshop, mine, quarry, or other place where natural resources are obtained or exploited.
- A building site, construction, assembly, or installation site, or the supervision thereof, if the duration of the activities concerned exceeds 12 months.

A place of business is not considered a non-resident's PE if the non-resident:

- only uses the premises in question for storage, display, or delivery of goods belonging to oneself
- only maintains inventories of goods belonging to oneself for the purpose of storage, display, or delivery
- only maintains inventories of goods belonging to oneself for the purpose of processing by third parties
- only maintains the place of business in question for the purpose of purchasing goods or collecting information for oneself
- only maintains the place of business for the purpose of engaging in any other preparatory or auxiliary activity for oneself, or
- only maintains the place of business in question for the purpose of any combination of activities referred to above, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

## Other taxes

### Value-added tax (VAT)

A basic VAT rate of 20% applies to all taxable supplies.

A lower VAT rate of 8.5% generally applies to foodstuffs, live animals, seeds, plants, water supplies, medicines, medical equipment, transport of passengers, books, admission fees, royalties for writers and performers, certain works of art, certain residential properties, hotel accommodation, use of sport facilities, burial and cremation services, public hygiene services, minor repairs of bicycles, shoes and clothing, domestic care services, and hairdressing services.

Exempt supplies without credit entitlement include financial and insurance/reinsurance services, rent and lease of immovable goods (with exceptions), tax and court stamps, lottery services, trade of land, health and social services, etc. There are also other VAT-exempt transactions without a credit entitlement as well as exempt taxable supplies with a credit entitlement.



VAT grouping is not possible within Slovenia.

### Excise tax

Excise tax is charged on the release into free tax circulation or import of tobacco products, alcohol and alcoholic drinks, fuel and mineral oils, and electricity.

### Real estate tax

Real estate tax of 2% is charged on real estate transfers and leases, unless VAT has been charged on the transaction.

### Customs duties

Goods imported from non-European Union (EU) countries are subject to import customs clearance, and goods being exported from the EU customs territory must be declared for export customs clearance. The person responsible for paying the customs debt is the declarant. The declarant is the person making the customs declaration in its own name, or the person in whose name the customs declaration is made. The customs declaration should be made in the prescribed form and manner (in writing or by another action specified by law). Import or export duties are customs duties and other charges payable on the import or export of goods (import VAT, excise duties, environmental tax, and motor vehicle tax).

For purposes of communication with the customs offices, each person has to be identified by an EORI number (Economic Operator Registration and Identification Number), which is registered by the customs authorities on request. EORI registration is mandatory for customs clearance.

### *Environmental tax*
Environmental tax is charged on carbon dioxide emissions, waste disposal, lubricating oils and fluids, and used motor vehicles.

### *Motor vehicle tax*
Motor vehicle tax applies to all vehicles that are registered for the first time in Slovenia. The taxpayer is the entity that imports the vehicle from EU or non-EU countries. The tax rate depends on fuel range and emission of $CO_2$ and ranges from 0.5% to 31%.

### *Insurance premium tax*
Insurance premium tax is levied on insurance premiums at the rate of 6.5% and paid by insurance companies.

### *Property tax*
Slovenia has not yet introduced property tax.

### *Stamp tax*
There is no stamp duty in Slovenia.

## *Branch income*

If a branch meets the conditions, as set out in the tax legislation and relevant DTT, to be treated as a PE, then it will be liable to pay tax in Slovenia on profits that are attributable to the PE.

The profit that is attributed to a PE is determined broadly in line with OECD principles. Generally, the attributable profit is the profit that would be expected to be earned by the PE if it were an independent taxpayer performing the same or similar activities and/or business.

A branch whose activities do not create a PE is not subject to CIT in Slovenia.

## *Income determination*

Taxable profits are assessed in accordance with Slovenian Accounting Standards 2006 or International Financial Reporting Standards (IFRS) and modified for certain revenues and certain expenses, which are partly or wholly tax non-deductible.

### *Inventory valuation*
Slovenian law allows the application of all the most commonly used inventory valuation methods, including the first in first out (FIFO), weighted average cost, and floating average prices methods.

### *Capital gains*
Under certain circumstances, the gains made by a Slovenian taxpayer on the disposal of an equity shareholding are effectively 47.5% exempt from taxation. Similarly, 50% of a loss arising on the disposal of such a shareholding would not be deductible for CIT. This treatment applies to the disposal of shareholdings of at least 8% that have been held for at least six months and where the taxpayer disposing of the holding employed at least one person during the six-month holding period.

The above treatment is not available for the disposal of a shareholding of a company which is resident in a country that:

- is outside the EU
- has a corporate tax rate less than 12.5%, and
- is included in a list published by the Ministry of Finance.

### *Dividend income*
Dividends and similar income received by a Slovenian taxpayer are generally 95% exempt from taxation as long as the distributor was subject to Slovenian CIT or to a comparable profits tax. The exceptions to this are where dividends represent untaxed reserves of the distributor or where the distributor is tax resident in a country that:

- is outside the EU
- has a corporate tax rate less than 12.5%, and
- is included in a list published by the Ministry of Finance.

### *Foreign income*
Foreign income, except dividends, received by a Slovenian entity from foreign sources is included in taxable income for CIT purposes unless a tax treaty provides for exemption.

## *Deductions*

In general, business expenses which are necessary to generate taxable revenues are fully tax-deductible. The following expenses are considered unnecessary for the generation of taxable revenues and are not deductible for tax purposes:

- Expenses which are not directly necessary for performing business activities or are not incurred as a consequence of a business activity.
- Expenses of a private character.
- Expenses which do not correspond to standard business practice.

Some of the most common non-deductible expenses include:

- Penalties and the cost of bribes.
- Input VAT that could have been reclaimed in accordance with the VAT act.
- Entertainment costs, which are only 50% tax-deductible.
- Costs relating to the supervisory board, which are only 50% tax-deductible.
- Legal and other costs of incorporation, which may be deductible for the parent company but not for the entity being incorporated.

### *Depreciation and amortisation*

Depreciation of tangible fixed assets, amortisation of intangible assets, and depreciation of investment property are recognised as expenditures in line with the accounting treatment, up to a maximum of the amount calculated using the straight-line depreciation method and the maximum tax depreciation rates listed below. Any accounting depreciation in excess of these rates is not tax-deductible in the period concerned, but may be deductible in subsequent tax periods, until the asset is fully depreciated or disposed of.

The maximum annual depreciation rates are as follows:

| Depreciation category | Types of assets | Annual depreciation rate (%) |
|---|---|---|
| 1 | Buildings, including investment property | 3 |
| 2 | Parts of buildings, including investment property | 6 |
| 3 | Equipment, vehicles, and machinery | 20 |
| 4 | Parts of equipment, and equipment for research activities | 33.3 |
| 5 | Computer equipment, hardware, and software | 50 |
| 6 | Crops lasting several years | 10 |
| 7 | Breeding animals | 20 |
| 8 | Other fixed assets | 10 |

### *Goodwill*

In general, if goodwill is impaired for accounting purposes, then the impairment cost may be treated as tax-deductible. The amount that may be treated as tax-deductible in any one tax period is limited to 20% of the initial value of the goodwill.

### *Provisions*

Certain provisions are only 50% tax-deductible when accrued, with the remaining 50% being treated as tax-deductible when the provision is utilised. The provisions which are subject to this treatment are provisions for warranties granted when selling products or providing services, reorganisations/redundancies, anticipated losses from onerous contracts, pensions, long-service bonuses, and severance payments on retirement.

### *Bad debt*

Bad debt provisions are only tax-deductible if the amount does not exceed the lower of:

- the arithmetic mean of the bad debts written-off in the past three tax periods, under certain conditions specified in the tax law, and
- the amount corresponding to 1% of taxable revenues of the tax period.

In order to take advantage of this deduction, a company must be able to calculate amounts for both tests and then take the lower of the two amounts so calculated. If the company is not able to determine the amount for either, the cost of the bad debt provision is not tax-deductible until the provision is utilised.

Costs of bad debts are tax-deductible when the debt is finally written-off, provided there is a finalised court procedure, the creditor can demonstrate that it would cost more to pursue the debtor than the debt is worth, or the creditor can demonstrate that it has done everything required by good business practice to try to recover the debt.

### *Related-party interest*
Companies may deduct interest expense on loans from their owners or other associated parties up to a maximum of the amount calculated by using the prescribed interest rate published by the Ministry of Finance. Taxpayers must increase taxable profits by the amount of any excess interest expense, unless they can prove that they could have received the loan on comparable terms from an unrelated party.

### *Compensation*
Salaries and other payments relating to employment (e.g. wage compensation, holiday allowances, employer's social security contributions, long-service awards, severance benefits paid upon retirement, solidarity assistance, and reimbursement of business related expenses) are generally fully tax-deductible.

The costs of benefits in kind are also tax-deductible if such benefits are taxed for the individual under the Personal Income Tax Act.

### *Pension allowances*
Under certain conditions, a tax-deductible allowance for voluntary supplementary pension insurance may apply, of up to 24% of compulsory contributions for pension and disability insurance for insured employees, but may not exceed EUR 2,390 annually per employee.

### *Charitable contributions*
A taxpayer may claim a reduction of its taxable profits for donations made for humanitarian, disabled, charitable, scientific, educational, medical, sports, cultural, ecological, and religious purposes to residents of Slovenia or of EU or European Economic Area (EEA) member states, up to 0.3% of the taxable person's taxable revenues. An additional allowance of 0.2% of the taxpayers' taxable revenues is available for payments made for cultural purposes and to voluntary organisations that work for the public interest to protect the public from natural and other disasters.

A taxpayer may decrease its taxable base for payments made to political parties and representative trade unions, up to an amount equal to three times the average monthly salary per employee of the taxpayer.

### *Net operating losses*
Tax losses may be carried forward to reduce taxable profits indefinitely, but loss carrybacks are not permitted. Loss relief may not exceed the amount of current taxable income. Generally, losses that are generated in multiple tax years are absorbed chronologically. The right to carry losses forward may be forfeited if the ownership of the capital or voting power of the taxpayer claiming the loss carry forward changes by more than 50% within the tax period and the taxpayer either has not performed business activities for two years prior to the change of ownership or substantially changes its business activity two years prior to or after the change in ownership.



Treatment of tax losses mentioned in the preceding paragraph does not apply for those losses that are generated in the year of the change of ownership or prior tax periods.

## *Group taxation*

Group tax returns were abolished with the introduction of the CIT Act on 1 January 2007. However, special transitional provisions allow a group of taxable persons to continue to file a group tax return, until the period for which approval was granted to file a group tax return expires.

### *Transfer pricing*
Prices between a Slovenian entity and its related parties must be set, for tax purposes, at fair market value using the arm's-length principle. Broadly speaking, taxpayers are related by direct, indirect, or common shareholdings of over 25%; through a participation in management; or by control through other means, including through contractual terms.

For transactions between two related Slovenian tax residents, provided neither is in an 'advantaged' position (advantaged usually means having unutilised tax losses), there is no actual requirement for the companies to adjust their tax returns to reflect an arm's-length price.

Taxable persons must prepare transfer pricing documentation. The Slovenian rules regarding such documentation follow the EU Code of Conduct on transfer pricing documentation for associated enterprises in the EU (EU TPD).

### *Thin capitalisation*
Interest payments on loans granted, or guaranteed, by a related party (a party which directly or indirectly owns at least 25% of the shares or voting rights in the taxpayer) are not tax-deductible to the extent that the loan amount exceeds the thin capitalisation threshold specified in law. This does not apply to loan recipients who are banks or insurance companies.

Generally speaking, the thin capitalisation threshold is exceeded if the debt-to-equity ratio exceeds 5:1. Note that the debt-to-equity threshold ratio will decrease to 4:1 in 2012.

## *Tax credits and incentives*

### *Investment allowances*
A tax allowance for investment in equipment and intangible assets is available for investments made after 1 January 2008. The tax allowance is limited to the lesser of 30% of the value of the assets acquired or EUR 30,000.

### *Research and development (R&D) allowances*
A 40% investment allowance is granted for investments in R&D within the tax period. Such an investment tax allowance may be obtained for expenditures on:

- internal R&D activities within the company and
- the purchase of R&D equipment from related or unrelated parties or from a private research institution.

In addition, the following higher investment allowances may be available for companies that are established in certain regions in Slovenia, which have lower gross domestic product (GDP) rates than the state average:

- 50% investment allowance for investments in locations where the average regional GDP rate ranges between the state average and 15% lower than the state average.
- 60% investment allowance for investments in locations where the average regional GDP rate is more than 15% below the state average.

### *Allowances for employing certain individuals*

A taxpayer that employs trainees or students to undertake practical work may reduce its taxable profits by an additional 20% of the average monthly payment paid to such persons, for every month the person carries out the work.

A taxpayer that employs disabled persons may decrease its taxable profits by an additional 50% of the salary paid to such persons (in addition to the deduction for their actual salary cost). A taxpayer that employs a severely disabled person or a person with a combination of total hearing loss and speech impairment may reduce its taxable base by an additional 70% of the salary paid to such a person (in addition to the deduction for their actual salary cost).

### *Tax relief for investments in the Pomurje region*

Entities based in the Pomurje region of Slovenia may claim additional employment incentives and additional tax relief for investments. These extra benefits are available from 2010 to 2015. As a result, provided certain conditions are met, entities with their seat in Pomurje are entitled to a 70% tax allowance for investments in equipment and intangible assets as well as to certain employment allowances.

### *Tax relief for employment of hard-to-place workers*

A taxpayer who employs a hard-to-place worker may be able to benefit from a tax allowance for both CIT and tax on activity. A hard-to-place worker is a person younger than 26 or older than 55 who has been registered as unemployed for at least six months and who has not been employed by the taxpayer or a related party in the past 24 months. The tax allowance equates to 45 % of the salary paid to the person during the first 24 months of their employment, up to the amount of the tax base.

## *Withholding taxes*

In Slovenia, tax must be calculated and withheld on the payments made by residents and non-residents on Slovenian-sourced income to recipients outside Slovenia.

Payments to which the withholding tax (WHT) rules apply include payments for dividends, interest, copyrights, patents, licenses, leases on real estate situated in Slovenia, services of performing artists, and services charged from low-tax jurisdictions. As of 1 January 2007, a rate of 15% of WHT applies.

If a DTT exists, the WHT rate may be reduced in line with the provisions of the treaty. Similarly for payments of interest, royalties, and dividends within Europe, the Interest and Royalties directive and the Parent Subsidiary directive, respectively, may also reduce this WHT rate to zero.

Furthermore, WHT is not deducted on dividends paid to a parent company in another EU member state if those dividends are subject to an exemption from tax in the hands of the recipient, provided certain conditions are met.

Since the 2010 amendment of the CIT Act, and subject to certain conditions, tax is no longer required to be withheld on interest on non-exchangeable debt securities issued outside Slovenia by a Slovenian tax resident corporation through a public placement on an international clearing system (i.e. Euroclear).

### *Treaties in force*

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) |
|---|---|---|---|
| Austria | 5/15 | 5 | 5 |
| Belgium | 5/15 | 10 | 5 |
| Bosnia and Herzegovina | 5/10 | 7 | 5 |
| Bulgaria | 5/10 | 5 | 5/10 (6) |
| Canada | 5/15 | 10 | 10 |
| Croatia | 5 | 5 | 5 |
| Cyprus | 10 | 10 | 10 |
| Czech Republic | 5/15 | 5 | 10 |
| Denmark | 5/15 | 5 | 5 |
| Estonia | 5/15 | 10 | 10 |
| Finland | 5/15 | 5 | 5 |
| France | 0/15 | 5 | 5 |
| Germany | 5/15 | 5 | 5 |
| Greece | 10 | 10 | 10 |
| Hungary | 5/15 | 5 | 5 |
| India | 5/15 | 10 | 10 |
| Ireland | 5/15 | 5 | 5 |
| Israel | 5/10/15 (5) | 5 | 5 |
| Italy (3) | 5/15 | 10 | 5 |
| Korea | 5/15 | 5 | 5 |
| Latvia | 5/15 | 10 | 10 |
| Lithuania | 5/15 | 10 | 10 |
| Luxembourg | 5/15 | 5 | 5 |
| Macedonia | 5/15 | 10 | 10 |
| Malta | 5/15 | 5 | 5 |
| Moldova | 5/10 | 5 | 5 |
| Netherlands | 5/15 | 5 | 5 |
| Norway | 0/15 | 5 | 5 |
| People's Republic of China | 5 | 10 | 10 |
| Poland | 5/15 | 10 | 10 |
| Portugal | 5/15 | 10 | 5 |
| Romania | 5 | 5 | 5 |
| Russian Federation | 10 | 10 | 10 |
| Serbia/Montenegro | 5/10 | 10 | 5/10 (7) |
| Slovakia | 5/15 | 10 | 10 |
| Spain | 5/15 | 5 | 5 |
| Sweden | 5/15 | 0 | 0 |
| Switzerland | 5/15 | 5 | 5 |
| Thailand | 10 | 10/15 | 10/15 (8) |
| Turkey | 10 | 10 | 10 |
| Ukraine | 5/15 | 5 | 5/10 (9) |
| United Kingdom and Northern Ireland | 0/15 | 5 | 5 |
| United States | 5/15 | 5 | 5 |

### *Treaties not yet in force (4)*

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) |
|---|---|---|---|
| Kuwait | 5 | 5 | 10 |
| Egypt | 8/13 | 13 | 15 |
| Qatar | 5 | 5 | 5 |
| Singapore | 5 | 5 | 5 |

Notes

1. Under certain treaties, the WHT rate depends on whether, and to what extent, the recipient participates in the capital of the distributor. Generally, if the recipient holds a participation of more than 25% in the distributing company, the dividends are subject to a lower 5% WHT rate. The higher WHT rate is, however, normally due when the participation is less than 25%.
2. Some DTTs include specific provisions whereby interest payments are subject to a 0% WHT rate, if certain conditions are met.
3. The rates shown apply from 1 January 2011, when the new treaty with Italy came into effect.
4. These treaties have yet to be ratified by both parties.
5. 5% rate if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividend; 10% rate if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends and the dividends are paid out of profits which by virtue of the law of the state in which the payer is a resident, are exempt from company tax or subject to company tax at a rate that is lower than the normal rate in that state; 15% rate applicable in all other cases.
6. 5% rate applicable to the gross amount of: (i) royalties paid for the use of, or the right to use, any copyright of literary, artistic, or scientific work (but not including cinematograph films) and (ii) royalties paid for the use of, or the right to use, industrial, commercial, or scientific equipment, 10% rate applicable in all other cases.
7. 5% rate applicable to royalties for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting; 10% rate applicable to royalties for the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.
8. 10% rate applicable to royalties for the use of, or the right to use, any copyright of literary or artistic work including motion pictures, live broadcasting, film, tape, or other means of the use or reproduction in connection with radio and television broadcasting, and for the use of, or the right to use industrial, commercial, or scientific equipment; 15% rate applicable to royalties in all other cases.
9. 5% rate applicable to royalties for the use of, or the right to use, any copyright of literary or artistic work (including cinematograph films, and films or tapes for radio or television broadcasting); 10% rate applicable to royalties for the use of, or the right to use, any copyright of scientific work, any patent, trade mark, design or model, plan, secret formula or process, or any industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.

## *Tax administration*

### *Returns*

The tax period should be the calendar year. However, a tax period may differ from the calendar year, but may not exceed a period of 12 months. In this case, the tax authorities must be informed about the chosen tax period, and the taxable entity will not be allowed to change its tax period for the following three years.

A tax return must be submitted to the tax authorities by the end of the third month following the end of the tax year.

### *Payment of tax*

Tax is paid in advance in monthly instalments (if the amount of prepayment exceeds EUR 400 per month) or in quarterly instalments (if the amount of prepayment is less than EUR 400 per month) determined on the basis of the previous year's assessment.

# South Africa

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## Significant developments

After the switch from the source-based taxation to the worldwide taxation of South African (SA) residents in 2000, and the introduction of capital gains tax in 2001, the SA tax system has not undergone fundamental changes. Smaller reforms, however, are ongoing. In 2010, the most significant changes emanating from the budget speech were:

- the introduction of a withholding tax (WHT) on interest (effective as of 1 January 2013)
- the introduction of a headquarter company regime
- a new dividend definition
- further refinements to the proposed dividend tax
- the introduction of rules governing Islamic financing products, and
- refinements to the transfer pricing and thin capitalisation rules.

Please note this information is current as of 1 June 2011. Typically, pending legislation is announced in June or July. Please visit the Worldwide Tax Summaries website at www.pwc.com/taxsummaries to see any significant corporate tax developments that occurred after 1 June 2011.

### Secondary tax on companies reform

The Secondary Tax on Companies (STC) is a tax borne by the company on any dividends declared and paid to shareholders. A reform of STC was launched in 2007 and will culminate with effect on 1 April 2012 with the introduction of a WHT on dividends. This tax will replace the current STC in an attempt to align the SA system of taxing corporate profits with worldwide practice.

### Administrative developments

A voluntary disclosure programme was introduced in November 2010 and will remain open until 31 October 2011. This provides individuals and/or corporate entities with a window of opportunity to disclose and regularise their tax affairs.

## Taxes on corporate income

An SA-resident company is subject to normal corporate income tax (CIT) on its worldwide income, irrespective of source. Non-residents are taxable on SA actual or deemed source income.

In South Africa, the normal CIT rate applicable for corporate income of companies for tax years ending between 1 April 2008 and 31 March 2012 is a flat 28%.

Close corporations, which are essentially a simplified form of company, are taxed at the same rate as companies and are subject to the same taxation rules.

Small business corporations (i.e. companies with only natural persons as members/owners and with gross income of not more than 14 million South African rand (ZAR)) are taxed at 0% on the first ZAR 59,750 of taxable income earned, 10% on the amount above ZAR 59,750 but not exceeding ZAR 300,000, and 28% on the amount exceeding ZAR 300,000.

A personal service provider company (i.e. a company that provides certain services that are performed by persons who have an interest in the company) is taxed at 33% of its taxable income. Similarly, a branch of a company with its effective place of management outside South Africa (i.e. a non-resident company) is taxed at 33%.

Special CIT rates apply in certain industries, such as mining and insurance *(see below)*.

### *Alternative turnover-based tax for very small companies*

To reduce the compliance costs for very small companies, a turnover-based presumptive tax is available. Companies with a turnover of less than ZAR 1 million per year can elect to pay this tax instead of normal CIT, at a rate ranging from 0% to 7%, depending on the turnover.

### *Secondary tax on companies (STC)*

STC is levied at a rate of 10% on the net dividends declared by SA-resident companies. The net dividend amount is calculated by deducting dividends accrued from dividends declared during the dividend cycle. The company declaring the dividend, not the recipient, is liable for payment of the tax. Branches of foreign companies are exempt from STC but subject to a higher statutory income tax rate.

STC is in the process of being replaced with a WHT on dividends, which will be charged at the rate of 10%. In the case of foreign shareholders, the rate may be reduced by an applicable double taxation agreement (DTA). The switch from STC to a WHT will become effective 0n 1 April 2012.

### *CIT for mining companies*

There are two formulae for determining CIT for mining companies: one for gold-mining companies that are subject to STC and the other for such companies that have elected to be exempt from STC. The formula for gold-mining companies subject to STC will, as of the 12-month period ending 31 March 2010, be Y = 34 – 170/x, and for those exempt from STC, Y = 43 – 215/x. For these formulae, the following applies.

x = the ratio, expressed as a percentage, is calculated as follows:

(Taxable income from gold mining) / (Total revenue (turnover) from gold mining)

Y = calculated percentage which represents the rate of tax to be levied

The maximum tax rate, which applies only to companies' income from specified oil and gas activities, is capped at 28%, and the companies are entitled to enter into so-called fiscal stabilisation agreements with the SA government to 'lock in' this rate. The agreement will not prevent the company from benefiting from any possible rate reduction in the future.

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The rate of STC for the companies engaged in SA oil and gas activities is 5%. Where, however, a company is engaged in oil and gas activities under the so-called OP 26 right (a right to mine oil and gas), it is completely exempt from STC. The normal STC rate of 10% will apply if the company is engaged in refining.

The branches of foreign companies engaged in SA oil and gas activities are taxed at a maximum rate of 31%.

### *CIT for long-term insurance companies*

Life insurance companies are obliged to follow the 'four-fund approach', with policies divided into four funds, depending on the nature of the beneficiary. Each fund is then allocated assets according to the risk carried by the fund. Funds are treated as separate taxpayers and taxed at four separate rates. These rates are 30% for individual policyholder funds, 0% for untaxed policyholder funds, 28% for company policyholder funds, and 28% for corporate funds.

## *Corporate residence*

A company is resident in South Africa if it is incorporated, established, or formed in South Africa or has its place of effective management in South Africa. However, a company that is deemed to be exclusively resident in another country by the terms of a DTA is excluded from SA residency.

The place of effective management is, in terms of an Interpretation Note issued by the South African Revenue Service (SARS), interpreted as the place where the strategic decisions of the directors are implemented. However, this approach has not yet been tested by the South African courts. Where international precedent applies a different meaning to the term, it is expected that the South African courts would interpret the term in accordance with international precedent for both domestic law and treaty purposes.

### *Permanent establishment (PE)*

South Africa does not, as a general rule, tax non-residents on the basis of having a PE in South Africa. Rather, non-residents are subject to income tax in South Africa on income derived or deemed to have been derived from a South African source. The primary exception to this rule is in relation to capital gains where non-residents are subject to tax on assets attributable to a PE in South Africa. A PE is defined by reference to the definition thereof in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is an indirect tax, which is largely directed at the domestic consumption of goods and services and at goods imported into South Africa. The tax is designed to be paid mainly by the ultimate consumer or purchaser in South Africa. It is levied at two rates, namely a standard 14% rate and a zero rate (0%).

Very few business transactions carried out in South Africa are not subject to VAT. The tax is collected by businesses which are registered as vendors with SARS on all taxable supplies throughout the production and distribution chain. Sales or supplies by non-vendors are not subject to VAT.

### VAT registration and administration
All suppliers of goods and services having an annual turnover currently exceeding ZAR 1 million are obliged to register as VAT vendors and to charge output VAT. Other vendors may elect to register as VAT vendors, provided their annual turnover exceeds ZAR 50,000. If they do not register, they are prohibited from charging VAT on goods or services they supply and claiming an input tax (rebate of VAT paid) on goods and services which they acquire.

Under the VAT system, vendors normally pay VAT on expenses (input tax) and charge VAT on supplies made (output tax). This mechanism, therefore, ensures that only the so-called 'added-value' is taxed. Due to VAT being a self-assessment system, the output tax collected may be reduced by input tax paid. Thereafter, the net amount is payable to, or refundable by, the SARS. The self-assessment returns are due regularly within prescribed periods (tax periods).

### Taxable supplies
Standard rated and zero-rated supplies are known as taxable supplies. Other supplies are known as exempt and non-supplies.

### Goods and services
For a liability for VAT to exist, there must be a supply or importation of goods or services. Goods are corporeal movable things, fixed property, and real rights in such things and property. The meaning of 'services' is very broad and includes the granting, assignment, cession, or surrender of any right or the making available of any facility or advantage.

### Imports
Services imported by a vendor and utilised or consumed by the vendor for the making of taxable supplies are not subject to VAT. In addition, the VAT Act has a schedule that lists goods that are exempt from VAT on importation, whether by a vendor or an unregistered person.

### Zero-rated supplies
The VAT Act contains a list of the supplies of goods or services that are taxed at the zero rate. Most of the items refer to exports and international transport, but other specified goods utilised for farming purposes, the sale of an enterprise as a going concern, fuel subject to the fuel levy, and deemed supplies by welfare organisations are also zero-rated.

A zero-rated supply made by a vendor is subject to VAT but at a rate of 0%. Under a zero-rated supply, a vendor does not charge VAT on the consideration for the supply and obtains a refund or credit for the VAT paid on taxable supplies utilised in the making of the zero-rated supplies.

### Exempt supplies
In addition to zero-rated supplies, the VAT Act contains a list of the supplies of goods or services that are exempt from VAT. While all fee-based financial services are subject to VAT, the charging of interest is exempt. Other exempt supplies include residential rentals, basic foodstuffs, non-international passenger transport by road or rail, and educational services.

Under exempt supplies by vendors, the vendors do not charge VAT on the supply, and they are not entitled to a deduction or credit for the VAT paid by them on goods and services supplied to them for the making of the exempt supply. Accordingly, vendors treat the VAT paid by them, and for which they do not obtain a deduction or credit, as another cost and recover it in the consideration they charge for the making of the exempt supply.

### *Skills Development Levy (SDL)*
SDL is a compulsory levy to fund the education and training as envisaged by the Skills Development Act. It is payable by an employer and cannot be deducted from the remuneration payable to an employee. Small employers with an annual payroll of less than ZAR 500,000 are exempt from the levy. SDL is levied at the rate of 1% of payroll. It is payable monthly, together with income tax that the employer has withheld on its employees' salaries.

### *Unemployment Insurance Fund (UIF) contributions*
Employers are required to contribute on behalf of their employees on a personalised basis to the UIF. The rate of contributions is 1% of gross remuneration payable to an employee; however, the monthly cap of ZAR 124.78 applies. Another 1%, subject to the same cap, is payable by the employee and withheld by the employer.

### *Compensation for Occupational Injuries and Diseases Act (COIDA) fund*
Employers are liable for making annual contributions to the COIDA fund. COIDA contributions are a payroll cost that cannot be deducted from the employee's salary. The rates vary depending on the employer's industry (e.g. a rate of 1.62% is applied to the salaries of employees involved in the manufacture of pottery up to a maximum salary band of ZAR 214,305 per annum).

### *Donations tax*
Disposals of assets below their market value are a donation and, at least theoretically, subject to donations tax. Donations tax is payable by resident companies at a flat rate of 20% on donations made. An annual exemption of ZAR 10,000 is available.

Public companies, comprised of mostly listed companies, are exempt from donations tax. An exemption is also available for donations made to certain charities and other non-profit organisations.

### *Securities transfer tax (STT)*
Stamp duty and uncertified securities tax were abolished on 1 July 2008 and replaced by STT, which applies to the transfer of listed and unlisted securities. The tax rate is 0.25%, which is applied to the taxable amount in respect of the transfer of a security. The taxable amount is usually the consideration for which the security is purchased or the market value of the security, if the consideration declared is less than the market value or if no consideration was paid. STT is payable by the company that issued the securities in question. However, the company can recover the tax from the person acquiring the shares. Slightly different rules apply in the case of listed securities.

### *Property taxes*
Local municipalities levy rates on land. These rates are based on a percentage of the municipal valuation of land and improvements and vary from municipality to municipality. Generally, a higher rate is levied on properties zoned for business use.

### *Transfer duty*
Transfer duty levied on the sale of immovable property has been revised in the 2011 budget. The revised rate structure applies to properties acquired under purchase agreements concluded on or after 23 February 2011. The duty is payable by the

person acquiring the property within six months from the date of acquisition at the following rates:

| Purchase price (ZAR) | Transfer duty rate (%) |
|---|---|
| Not exceeding 600,000 | 0 |
| 600,000 to 1 million | 3 |
| 1 million to 1.5 million | 5 |
| Exceeding 1.5 million | 8 |

Prior to 23 February 2011, the rate applicable to companies was 8% calculated on the higher of the purchase price or market value. Transfers of immovable property subject to VAT are exempt from transfer duty.

### *Customs duties*
Customs duties are charged on importation of goods into South Africa which range between 3% and 20%, excluding clothing and apparel which may be as high as 45%. The import duties may also include anti-dumping and countervailing duties of up to 150%. No customs duties are charged on trade between South Africa and Botswana, Lesotho, Namibia, and Swaziland, as these five countries constitute a Southern African Customs Union.

### *Excise duties*
Excise duty is levied on certain locally manufactured goods as well as their imported equivalents. A specific duty at a pre-determined amount is levied on tobacco (52% including excise & VAT ) and liquor (23% to 43%), and an *ad valorem* duty (calculated as a percentage of price) on monitors (7%) cosmetics, televisions, audio equipment, and luxury automobiles (marginal rate of 25%). Relief from excise duty is available for exported products and for certain products produced in the course of specified farming, forestry, and (limited) manufacturing activities.

### *Vehicle emissions tax*
An environmental levy is levied on new motor vehicles based on gram per kilometre of CO2 emissions of the vehicle over a stated level. The levy is currently ZAR 75 to ZAR 100 per gram per kilometre over the CO2 threshold level.

### *Fuel levy*
A fuel levy is charged on petroleum fuel sold. As of 6 April 2011, the levy is 177.5 cents per litre of petrol and 162.5 cents per litre of diesel.

### *Electricity levy*
To support energy efficiency, the government has implemented a levy on electricity generated from non-renewable sources at 2.5 cents/kWh (2 cents/kWh prior to 1 April 2011). The levy is collected at source by the electricity producer.

### *Air passenger tax*
As of 1 October 2011, passengers departing on international flights must pay air passenger tax at the rate of ZAR 100 on flights to Botswana, Lesotho, Namibia, and Swaziland, and ZAR 190 on other flights. The tax is added to the price of the ticket. Departure prior to 1 October 2011 is subject to air passenger tax at the rate of ZAR 80 and ZAR 150 respectively.

## Branch income

SA branches of foreign companies are not considered to be separate legal entities for tax purposes, and no tax is withheld on transfers of profits to the head office. Branches of foreign companies are taxed at a rate of 33% and exempted from STC.

Note that a branch must register as a taxpayer and submit tax returns. Separate financial statements must be drawn up for the SA-trading operations. For all practical purposes, the SARS will treat the branch as a separate entity. For example, inter-branch cost recoveries levied by the head office incurred in the production of SA income normally will be allowed as a deduction by the branch.

In terms of DTAs, the taxation of branches is limited to cases where the branch constitutes a PE.

## Income determination

### Inventory valuation

Inventories generally are stated at the lower of cost or net realisable value. Write-downs of inventory for slow-moving and obsolete items must be justified, and a general policy on a percentage basis is not permitted. Last in first out (LIFO) is not accepted for tax purposes.

### Capital gains

Although the capital gains tax forms part of income tax, the two taxes are not fully integrated. Gains realised by companies are taxed at the normal CIT rate; however, only 50% of gains are included in taxable income.

### Dividend income

Dividends, other than foreign dividends, are generally not subject to tax in the hands of companies, but the company declaring the dividend is liable for STC (as of 1 April 2012, the shareholders will be liable for WHT on dividends). Qualifying foreign dividends are also generally not subject to tax where they are received by resident shareholders holding in excess of 20% of the equity shares and voting rights of the company declaring the dividend. Dividends received by residents holding less than 20% of such shares will generally be taxable in South Africa, subject to a tax credit for foreign WHT payable by the recipient shareholder.

### Stock dividends

Stock dividends (capitalisation issues of shares) are not subject to tax or STC.

### Foreign income

Foreign income of an SA-resident company is subject to tax in South Africa on an earliest of receipt or accrual basis. However, income that may not be remitted to South Africa in terms of the laws of the country where the amount arose is deferred until the income can be remitted. Double taxation may be avoided under certain DTAs or by way of unilateral credit or deduction for foreign tax payable on foreign income *(see Foreign tax credit in the Tax credits and incentives section)*.

## Deductions

### Depreciation and depletion

A depreciation (wear and tear) allowance may be deducted on movable assets used for the purpose of trade. There are no statutory provisions relating to rates of wear and tear, but SARS has published a table of periods over which the assets may be written off, in the absence of evidence to support a different write off period. The rates of wear and tear, based on the cash cost, are calculated either according to the straight-line or diminishing balance method.

New and unused machinery used in the process of manufacture or in a similar process is depreciable at the rate of 40% in the first year of use and 20% in the three following years. If the machinery is not new and unused, an allowance of 20% per year over five years is available.

An accelerated depreciation schedule (50% in the first year of use, 30% in the second, and 20% in the third year) applies to the machinery and articles used in farming, production of biodiesel or bio-ethanol, and production of energy from renewable sources.

Buildings and other permanent structures may not be depreciated, apart from an annual allowance for each of the following:

- Buildings used in a process of manufacture or a process similar to a process of manufacture: For buildings erected before 1 January 1989, a 2% rate applies per year. For buildings erected after 1 January 1989, a 5% rate applies. However, buildings erected between 1 July 1996 and 30 September 1999 are subject to an accelerated depreciation rate of 10% per year.
- Hotel buildings: For buildings built prior to 4 June 1988, a 2% rate applies per year. For hotel buildings erected after 4 June 1988, a 5% rate applies. Improvements within the existing building framework that commenced on or after 17 March 1993 are depreciated at the rate of 20%.
- Agricultural cooperative storage buildings: For buildings built prior to 1 January 1989, a 2% rate applies per year. For buildings erected on or after 1 January 1989, a 5% rate applies.
- Housing projects of not less than five units: Housing projects of not less than five units of residential accommodation, which consist of more than one room and the erection of which commenced on or after 1 April 1982 and before 21 October 2008, are subject to a 2% rate of depreciation. After 21 October 2008, an allowance of 5% is available on this type of property. The 5% depreciation rate is available to the taxpayer provided that the unit is used by the taxpayer solely for trade purposes, the unit is situated in South Africa, and the taxpayer owns at least five units in South Africa used for the purposes of trade. An additional allowance is available for a low-cost residential unit. Additionally, from 21 October 2008, taxpayers are granted relief for the transfer of ownership on a contract for deed basis of employer provided low cost residential units to employees.
- Buildings in urban development zones: Improvements to an existing building in an urban development zone, here the existing structural or exterior framework is preserved and brought into before 31 March 2014, qualify for an accelerated allowance of 20% per year. Buildings that are erected, extended, or added to in an urban development zone on or after 21 October 2008 and which are not covered by the first mentioned allowance qualify for a 20% allowance in the first year and a 8% allowance in the following ten years. As of 21 October 2008, new and unused low-income residential units located in urban development zone demarcations

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are subject to an additional annual depreciation allowance. The rate is 25% in the first year, 13% in the succeeding five years, and 10% in the year following the last year. Improvements are subject to a depreciation allowance of 25% over a period of four years.
- Specific allowances are also provided for pipelines, transmission lines, railway lines, airport property, ships, mining operations, and other qualifying industrial assets.
- Buildings used and specifically equipped for certain research and development (R&D) activities can be depreciated 50% in the first year of use, 30% in the second, and 20% in the third year.
- Commercial buildings: The cost to the taxpayer of any new and unused building owned by the taxpayer, or any new and unused improvement to any building owned by the taxpayer, if that building or improvement wholly or mainly is used by the taxpayer for trade purposes, other than the provision of residential accommodation, is subject to a 5% rate of depreciation. This allowance is applicable to any building or improvement contracted for on or after 1 April 2007 and the construction of which commenced on or after 1 April 2007.

An allowance for assets disposed of or scrapped during a year of assessment is determined by reference to the cost less allowances already granted and the proceeds on disposal (if any). Recoupments of allowances granted are taxable where disposal proceeds exceed the tax basis at the time of sale. Such recoupments cannot exceed the cost of the asset. Proceeds above cost will be taxed as a capital gain.

Book depreciation does not need to be consistent with tax depreciation.

No cost or percentage depletion is available for natural resources.

### *Cost of inventory*
The cost of inventory is, in principle, deductible as soon as the inventory is acquired. However, at the end of each year, the cost of the inventory still on hand has to be added to the company's income. Then in the next year, it can be deducted again. This has the effect of timing the deduction of the cost of inventory to match the time of its realisation.

### *Assets acquired for shares issued*
When current assets are acquired by a company in return for the shares or debt instruments issued to the seller, the purchaser of the assets may deduct the lesser of the market value of the assets immediately after acquisition or the market value of the shares immediately after acquisition.

### *Taxes*
Payroll taxes are deductible from taxable income for the corporation.

### *Net operating losses*
Losses may be carried forward indefinitely, provided an active trade or business of a similar nature is carried on without interruption. There is no loss carryback in South Africa.

### *Payments to foreign affiliates*
Deductions may be claimed for royalties, managerial service fees, and interest charges paid to foreign affiliates, provided such amounts approximate those that would be paid to an unrelated entity in an arm's-length transaction.

Interest deductions may be limited where the paying company is thinly capitalised *(see Thin capitalisation rules in the Group taxation section)*.

Specific provisions apply for 'bullet interest' (i.e. a one-off, upfront lump sum payment of interest). Any interest expenditure must be spread over the life of the interest-bearing arrangement on the compounding accrual basis.

## Group taxation

Group taxation generally is not permitted in South Africa. However, relief is given for transactions between group companies to allow for reorganisations, provided certain requirements are met.

In general, the relief will only apply to transactions between companies within the same group. A group of companies is defined as a controlling company and one or more controlled companies in relation to that controlling company. A controlling company means a company holding directly or indirectly at least 70% of the equity of any other company. Foreign-incorporated companies do not form part of a group of companies for the purposes of this relief.

Corporate rollover relief is available for asset-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions, and transactions relating to liquidation, winding-up, and deregistration.

The relief may cover the capital gains tax arising from the disposal of capital assets, income tax arising from the disposal of a depreciable asset, income tax arising from the disposal of trading stock, donations tax arising from the disposal of an asset, STC, and transaction taxes.

### Transfer pricing

Transfer pricing legislation has been in SA law since 1995; however, it has only been in recent years that SARS has focused on this area of taxation. The rules require those liable to tax in South Africa to follow arm's-length principles in their dealings with inter alia connected persons that are not tax residents of South Africa.

Section 31 of the Income Tax Act combines transfer pricing and thin capitalisation (explained below) measures. Section 31(2) provides the commissioner with the power to adjust the consideration of a transaction to an arm's-length price for the purposes of computing the South African taxable income of a taxpayer. This rule applies to both goods and services as well as to direct and indirect financial assistance.



Section 31 is a discretionary section which means that whilst the taxpayer can place some comfort on the fact that the commissioner must have applied due care and reasonableness in raising a transfer pricing adjustment, the onus of proof for rebutting such adjustments rests squarely with the taxpayer.

### Thin capitalisation rules

The thin capitalisation rules may be applied by SARS where financial assistance, such as a loan, advance, or debt, or the provision of any security, is granted by a non-resident investor to a resident investee who is either a connected person or a corporate entity in which the investor has a direct or indirect interest entitling it to participate in not less than 25% of the dividends, profits, capital, or votes.

The thin capitalisation rules, when applied, disallow the deductibility of interest paid by the SA resident to the foreign lender, to the extent that such interest is considered to be excessive by the SARS.

In broad terms, the rules will not be applied if the debt-to-equity ratio falls within a safe haven ratio of 3:1. In other words, where the financial assistance granted by the non-resident investor does not exceed three times the fixed capital (being essentially share capital, share premium, and accumulated profits) of the resident investee and the interest rate does not exceed the weighted average of prime plus 2% for SA rand-denominated loans, or the relevant weighted average interbank rate plus 2% for loans denominated in other currencies.

These rules do not apply to financial assistance granted by a 'parent' company to its branch operating as an external company in South Africa.

### *Amendments to transfer pricing and thin capitalisation rules as of 1 October 2011*

In 2010, significant amendments were made to section 31, but these refinements are only effective as of 1 October 2011 (it should be noted that draft legislation published for comment postpones the refinement to 1 April 2012). The amendments serve to modernise the transfer pricing and thin capitalisation rules in line with the OECD and international tax principles; to remove structural problems caused by a literal translation which focuses on isolated transactions rather than the overall arrangements; and to narrow focus which leads to the application of artificial arguments supporting certain arrangements, rather than focusing on the true economic substance.

Section 31 will no longer separately address transfer pricing and thin capitalisation. Rather, thin capitalisation will be treated as simply a breach of the general arm's-length standard.

The previous section 31 departure points of resident and non-resident, and who are 'connected', are retained.

The most critical difference from the current rules is the broadening and generalisation of the application concepts. Specifically, the combination of:

- the rules apply if any of the parties derive a 'tax benefit'
- the transactional concepts of 'goods and services' in section 31(2) are removed and replaced with a much broader 'transaction, operation, scheme, agreement, or understanding'
- the use of 'directly or indirectly' in referring to the transactions (etc.) entered into between the taxpayer and any connected person, and
- the general 'arm's-length' standard.

Regarding 'financial assistance', the generalisation of the concepts discussed above make them broad enough to catch both excessive debt amounts as well as excessive interest rates. The current concept of 'financial assistance' will be retained, i.e. including the provision of any loan, advance or debt, or any security or guarantee.

Importantly, the discretion given to SARS to adjust the price is removed, as the taxpayer is obliged in terms of the ITA to apply the arm's-length standard, i.e. "… the taxable income must be calculated as if the transaction (etc) … had been entered into … had those persons been independent persons dealing at arm's length". This therefore removes uncertainty that taxpayers had in respect of performing self adjustments on the tax return.

The much broader concept of 'connected persons' that currently exists in section 31 (1A) in respect of intellectual property will be retained (new section 31(3)) but extended to apply in respect of financial assistance, in addition to intellectual property).

### *Controlled foreign company (CFC) regime*
If one or more residents together hold more than 50% of the voting or participation rights in a foreign company, then it is a CFC in relation to those residents. The income of a CFC is imputed to the controlling holders in proportion to their holdings, subject to certain exclusions and tax credits, where applicable.

## *Tax credits and incentives*

### *Foreign tax credit*
The South African Income Tax Act makes provision for a rebate against normal CIT tax in respect of foreign taxes paid on foreign sourced income or a deduction against income of foreign taxes paid on SA-sourced income. In both instances, the taxpayer must be an SA resident, the income must be included in taxable income and is not exempt, and that income was subject to a foreign tax which is not recoverable. The rebate is limited to the total normal tax payable calculated by applying the ratio of the total taxable income attributable to the foreign tax to the total taxable income. The deduction, however, may not exceed the income on which the foreign tax was levied.

### *Tax exempt grants*
Cash grants received within the terms of a Government Incentive Scheme by taxpayers with manufacturing operations or similar processes are exempt from CIT on such grants.

### *Research and development (R&D)*
To encourage innovation, the current costs related to certain R&D activities carried on in South Africa are 150% deductible. The cost of machinery and other capital assets acquired for the purposes of R&D may be depreciated 50% in the first year of use, 30% in the second, and 20% in the third year.

### *Headquarter company regime*
For years of assessment commencing on or after 1 January 2011, a 'headquarter company' regime is introduced to encourage the use of South Africa as a location for intermediate holding companies.



The benefits on offer to a headquarter company are:

- Exemption from South Africa's CFC rules.
- Exemptions on the headquarter company's dividend distributions.
- Exemption from South African's thin capitalisation and transfer pricing rules on back-to-back loans.
- Capital gains tax exemption upon the disposal of shares in the headquarter company.

The requirements for a headquarter company are as follows:

- The headquarter company must be SA resident.

- Each shareholder in the headquarter company must hold at least 20% of the headquarter company's equity shares and voting rights. This means that a headquarter company can never have more than five shareholders.
- At least 80% of the headquarter company's assets (measured on a 'cost' basis) must be comprised of certain assets related to the foreign companies in which the headquarter company holds at least 20% of the equity shares voting rights. Specifically, these assets must be:
  - the equity shares in those companies'
  - loans to those companies, and
  - intellectual property licensed to those companies.
- At least 80% of the headquarter company's receipts and accruals must be comprised of dividends, interest, royalties, or fees from its 20%-plus holdings, or proceeds from the disposal of the equity shares or intellectual property.

The requirements regarding the headquarter company's shareholders must be fulfilled from the incorporation of the headquarter company. The requirements regarding the headquarter company's assets and its receipts accruals are tested only at year-end but must, in the case of assets, be fulfilled every year over the lifetime of the headquarter company. If a company does not meet the receipts/accruals requirements in any year, it will not be a headquarter company for that year, but will not be permanently excluded on this ground.

### *Industrial policy projects*
In 2008, a ZAR 20 billion incentive package for investors in energy efficient projects was announced. The incentive is available for industrial projects participating in the manufacturing sector (other than alcohol or alcohol related products, tobacco or tobacco related products, arms and ammunition, and bio-fuels, which have a negative impact on food security). Companies are divided into those with a qualifying status and those with a preferred status. The status is determined in terms of a point system.

The proposed project must either be a 'brownfield project' (expansion or upgrade of an existing industrial project) or a 'greenfield project' (a wholly new industrial project, which uses new and unused manufacturing assets). Approved projects may be granted a tax allowance known as an additional investment allowance equal to 55% of the cost of any manufacturing asset used in an industrial policy project with preferred status or 35% of the cost of any manufacturing asset used in any other approved industrial policy project.

Note that the additional investment allowance may not exceed ZAR 900 million in the case of any greenfield project with a preferred status, ZAR 550 million in the case of any other greenfield project, ZAR 550 million in the case of any brownfield project with a preferred status, or ZAR 350 million in the case of any other brownfield project.

In addition to the above, a company may also claim a deduction known as an additional training allowance.

### *Venture capital companies*
In order to assist small and medium-sized businesses to raise capital to finance businesses, a tax incentive for investors in small and medium-sized enterprises through venture capital companies has been introduced. This incentive became effective on 1 July 2009 and will last for 12 years.

A deduction is allowed from the income of an individual or a listed company (or a controlled group company in relation to a listed company) in respect of expenditures actually incurred by that person in respect of shares issued to that person by a venture capital company. A company may deduct its entire expenditures in respect of shares, provided that the shares held by that company and other companies within the same group do not constitute more than 10% of the equity shares of the venture capital company. The deduction available to an individual is capped at ZAR 750,000. A venture capital company is essentially a holding company deriving its income from equity investments in small and medium companies that, in turn, derive their income from active trade within South Africa. A venture capital company has to be specifically approved by SARS.

## *Withholding taxes*

### *Payments to residents*

No WHT, other than payroll taxes, are currently levied on payments to resident corporations.

### *Royalties payable to non-residents*

Royalties and know-how payments made to non-residents for the use of or right to use intellectual property rights in South Africa are deemed to be from an SA source. The payer of the royalty or know-how payment is obliged to deduct a WHT of 12% of this payment, which is a final tax payable by the recipient of such income. The treaty rate is only the maximum allowable rate to be charged by the treaty countries; where this rate is higher than the domestic tax rate, the latter will apply. The 12% WHT may be reduced by the terms of the relevant tax treaty, as follows:

| Recipient | Royalty WHT (%) |
|---|---|
| Non-treaty | 12 |
| Algeria (1) | 10 |
| Australia (1, 2) | 5 |
| Austria | 0 |
| Belarus (1, 2, 6) | 10 |
| Belgium (1) | 0 |
| Botswana (1, 2) | 10 |
| Brazil (1, 2, 7) | 10 |
| Bulgaria (1, 2, 6, 8) | 10 |
| Canada (1,4) | 10, 6 |
| China, People's Republic of (5) | 10 |
| Croatia | 5 |
| Cyprus (1) | 0 |
| Czech Republic (1) | 10 |
| Denmark (1) | 0 |
| Egypt (1) | 15 |
| Ethiopia (1, 2) | 20 |
| Finland (1) | 0 |
| France (1, 2) | 0 |
| Germany (2) | 0 |
| Ghana (1, 2) | 10 |
| Greece (1, 2) | 5 |
| Hungary (1) | 0 |

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| Recipient | Royalty WHT (%) |
|---|---|
| India (1) | 10 |
| Indonesia (1) | 10 |
| Iran (1) | 10 |
| Ireland (1) | 0 |
| Israel (2, 3) | 0 |
| Italy (1) | 6 |
| Japan (1) | 10 |
| Korea, Republic of (1) | 10 |
| Kuwait (1, 2) | 10 |
| Lesotho (1) | 10 |
| Luxembourg (1) | 0 |
| Malawi (2) | 0 |
| Malaysia (1, 2) | 5 |
| Malta (1) | 10 |
| Mauritius (1) | 0 |
| Mexico (1, 2) | 10 |
| Mozambique (1, 2) | 5 |
| Namibia (1) | 10 |
| The Netherlands (1, 2) | 0 |
| New Zealand (1) | 10 |
| Nigeria (1, 2) | 7.5 |
| Norway (1) | 0 |
| Oman (1, 2) | 8 |
| Pakistan (1) | 10 |
| Poland (1) | 10 |
| Portugal (1, 2) | 10 |
| Romania (1) | 15 |
| Russia | 0 |
| Rwanda (1, 2) | 10 |
| Saudi Arabia (1, 2) | 10 |
| Seychelles (1, 2) | 0 |
| Singapore (1) | 5 |
| Slovak Republic (1) | 10 |
| Spain (1, 2) | 5 |
| Swaziland (2) | 0 |
| Sweden (1, 2) | 0 |
| Switzerland (1) | 0 |
| Taiwan (1) | 10 |
| Tanzania (1, 2) | 10 |
| Thailand (1) | 15 |
| Tunisia (1) | 10 |
| Turkey (1, 2) | 10 |
| Uganda (1) | 10 |
| Ukraine (1) | 10 |
| United Kingdom (2) | 0 |
| United States (1) | 0 |

| Recipient | Royalty WHT (%) |
|---|---|
| Zambia (2) | 0 |
| Zimbabwe (2) | 0 |

Notes

1. Recipient is the beneficial owner of the royalty.
2. Royalty is subject to tax in recipient country.
3. 15% is levied on royalties for cinematographic or television films.
4. The maximum rate for copyright royalties, royalties for use of computer software, and patents concerning industrial, commercial, and scientific experience is 6% of the royalties paid, otherwise 10%.
5. Maximum rate of 10% of the adjusted amount (being 70% of the gross royalties) for use of industrial, commercial, or scientific equipment.
6. The 5% rate applies to royalties for the use of a copyright. A 7% rate applies to royalties for the use of patents, trademarks, designs, models, etc.
7. In respect of right to use industrial, commercial, or scientific equipment and transport vehicles, a 10% rate applies.
8. Maximum rate of 15% on royalties arising from the use of, or the right to use, trademarks.

### *Non-resident entertainers and sportspersons*

A WHT at the rate of 15% applies to all payments made to non-resident entertainers and sports persons in respect of their activities exercised in South Africa.

### *Disposal of immovable property by non-residents*

Any person who pays an amount to a non-resident in respect of the sale of immovable property in South Africa must withhold from the amount payable an amount equal to:

- 5% if the non-resident seller is an individual
- 7.5% if the non-resident seller is a company, or
- 10% if the non-resident seller is a trust.

The amount so withheld is not a final tax for the non-resident seller. Instead, this amount is regarded as an advance payment of the non-resident seller's normal tax liability for the year of assessment during which the property is disposed of. The non-resident seller is still obliged to submit an income tax return for that year.

### *Dividends tax*

From 1 April 2012, a WHT at the rate of 10% will apply to any dividends paid by a resident company or non-resident company in respect of shares listed on a SA exchange. This WHT will replace STC.

### *Interest payable to non-residents*

As of 1 January 2013, a WHT at the rate of 10% will apply to any amount of interest (subject to certain exemptions) received by or accrued to a non-resident that is not a CFC.

### *WHT for gambling winnings*

A withholding tax on gambling winnings is proposed with effect from 1 April 2012, and all gambling winnings above ZAR 25,000, including National Lottery winnings, will be subject to a final 15% WHT.

## *Tax administration*

### *Returns*

The corporate fiscal year is the same as the company's financial year. It may be changed upon application showing reasonable cause. Annual income tax returns must be submitted within one year from the end of the company's fiscal year.

### *Payments*

Payments are made with provisional returns filed at six-month intervals from the fiscal year-end based on an estimate of taxable income for the year. Interest is charged on any underpayment outstanding for more than six months after the fiscal year-end except in the case of February year-ends, in which case it is seven months. Any balance (together with interest) is then paid following assessment.

### *Voluntary disclosure programme*

In a drive to encourage defaulting taxpayers to come forward and regularise their affairs, SARS has introduced a voluntary disclosure programme which became effective between 5 November 2010 and 31 October 2011. The voluntary disclosure programme does not result in the waiver of any tax payable, but rather SARS will:

- not pursue criminal prosecution
- waive 100% of penalties and additional tax, and
- waive either 100% or 50% of interest payable.

# Spain

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## Significant developments

Over the past 12 months, the following significant amendments have been made to Spanish law on direct taxation of companies.

Law on Sustainable Economy, passed on 4 March 2011 (Law 2/2011), increases the following tax credits for tax periods commencing on or after 6 March 2011:

- Tax credit for technological innovation is increased from 8% to 12%.
- Tax credit for environmental investments in installations is increased to 8%. No tax credit will be available for investments made in tax periods commencing between 1 January 2011 and 5 March 2011. For investments made in tax periods commencing between 1 January 2010 and 31 December 2010, the tax credit is 2%.
- The maximum limit for tax credit application in one tax year is also increased if certain requirements are met.

State Budget Bill, passed on 22 December 2010 (Law 39/2010) introduces, among others, the following tax reforms:

- Section 12.5 of the Spanish Corporate Income Tax Law is amended to eliminate the possibility of amortising financial goodwill arising from the acquisition of an interest in a company resident in another European Union (EU) member state carried out after 21 December 2007, for tax purposes. This amendment is made as a result of the European Commission's decision passed on 27 October 2009, which concludes that the Spanish regulations that allow amortisation of financial goodwill arising from acquisitions of interests in EU companies distorts competition and constitutes unlawful state aid. In addition, the European Commission's decision passed on 12 January 2011 in relation to the amortisation of financial goodwill arising from the acquisition of an interest in a company resident outside the European Union has recently been published in the Official Journal of the European Union. The decision considers this tax relief to be unlawful state aid, and its scope is similar to that of the European Commission's decision of 27 October 2009.
- The time period for the application of the tax credit for training (1%/2%) is extended exclusively for expenses incurred and investments made in 2011 to train staff in the use of new communication and information technologies which can only be used outside the workplace and working hours.

A Royal Decree-Law passed on 3 December 2010 (RDL 13/2010) approved certain measures to boost investments and employment. The measures laid down in this legislation include, most notably:

- Extension until 2015 of free depreciation for new tangible fixed assets and investments in real estate used for business activities. Free depreciation was first introduced by Law 4/2008 for tax years commencing in 2009 and 2010, and it was extended to tax years 2011 and 2012 by Royal Decree-Law 6/2010. In both cases, such tax relief is conditional on the maintenance of or increase in staff levels. RDL 13/2010 eliminated the requirement to maintain or increase staff levels for investments made in taxable years beginning on or after 1 January 2011 and extended the application period of this tax incentive to tax year 2015.

- Increase in the threshold for a company to be considered a small company. Until tax year 2010, a company was considered as small (and thus could be taxed under the special tax regime for small companies) when its turnover in the preceding tax year was under 8 million euros (EUR). For tax years commencing on or after 1 January 2011, this threshold is fixed at EUR 10 million.
- Tax relief which may be availed of by small and medium-sized companies may continue to be applied by these companies if they exceed the EUR 10 million threshold. In this case, the tax relief may be availed of during the three tax periods following the tax period when they exceed the EUR 10 million threshold, provided that they have met the requirements to be considered small or medium-sized companies in the tax period when they exceed the EUR 10 million threshold and in the two previous tax periods.
- Increase in the first tranche of the tax scale under which small companies are taxed.
  - For tax periods starting on or after 1 January 2011, the rates are the following:
    - Taxable income up to EUR 300,000 is taxed at a 25% tax rate.
    - The part of the taxable income which exceeds this threshold is taxed at the general rate of 30%.
  - Until tax year 2010, small companies were taxed at the following rates:
    - Taxable income up to EUR 120,202 was taxed at a 25% tax rate.
    - The part of the taxable income which exceeded this threshold was taxed at the general rate of 30%.
- Increase in the first tranche of the tax scale under which micro companies are taxed.
  - For tax periods commencing in 2011 (the last year in which this reduced rate is applicable), entities with a net turnover under EUR 5 million and a total maximum staff of 25 employees which maintain or increase their staff levels are taxed at the following rates:
    - Taxable income up to EUR 300,000 is taxed at a 20% tax rate.
    - The part of the taxable income which exceeds this threshold is taxed at the tax rate of 25%.
  - For tax periods commencing in 2009 and 2010, the applicable tax rates were the following:
    - Taxable income up to EUR 120,202 was taxed at a 20% tax rate.
    - The part of the taxable income which exceeded this threshold was taxed at the tax rate of 25%.

## *Taxes on corporate income*

The general corporate income tax (CIT) rate in Spain is currently 30%. Other tax rates (ranging from 25% to 35%) may apply depending on the type of company which is taxed and the type of business carried out.

Resident companies are taxed on their worldwide income.

For permanent establishments (PEs) in Spain of foreign companies, non-residents' income tax is chargeable on their Spain-source taxable income at a 30% tax rate.

Non-residents' income tax is also chargeable on non-established foreign companies/individuals which obtain income in Spain *(see the Withholding taxes section)*.

### *Small companies*
For tax years commencing on or after 1 January 2011, companies with a turnover under EUR 10 million in the preceding tax year are considered small companies for CIT purposes and are taxed at the following rates:

- Taxable income up to EUR 300,000 is taxed at a 25% tax rate.
- The part of the taxable income which exceeds this threshold is taxed at the general tax rate of 30%.

For tax years commencing prior to 1 January 2011, companies with a turnover under EUR 8 million in the preceding tax year were considered small companies for CIT purposes and were taxed at the following rates:

- Taxable income up to EUR 120,202 was taxed at a 25% tax rate.
- The part of the taxable income which exceeded this threshold was taxed at the general tax rate of 30%.

The tax rate levied on companies forming part of a group depends on the total amount of the group companies' turnovers. The general 30% tax rate is levied when the sum of the group companies' turnovers exceeds EUR 10 million (EUR 8 million for tax years commencing prior to 1 January 2011).

### *Micro companies*
A new regulation came into force in Spain in December 2009 which established lower tax rates for companies which maintain or increase their staff levels in tax years 2009, 2010, and 2011.

The rates for tax year 2011 are as follows:

- Taxable income up to EUR 300,000 is taxed at a 20% tax rate.
- The part of the taxable income which exceeds this threshold is taxed at the general tax rate of 25%.

The rates for tax years 2009 and 2010 are as follows:

- Taxable income up to Euros 120,202 was taxed at a 20% tax rate.
- The part of the taxable income which exceeded this threshold was taxed at the general tax rate of 25%.



These lower rates of 20% and 25% are applicable subject to compliance with, amongst others, the following requirements:

- The income generated by all of the company's business activities does not exceed EUR 5 million.
- The company's total staff does not exceed 25 employees.
- The company's average number of employees during the 12-month period following the commencement of the tax year in question is not less than one employee and not less than the company's average number of employees during the 12-month period prior to the commencement of the tax year in question.

### *Business and professional activities tax*
The business and professional activities tax is a local direct tax levied annually on the performance in Spain of business, professional, or artistic activities, regardless of whether or not they are carried out in a particular premises. The tax payable depends

on different factors such as the type of activity carried out and the location and size of the premises where the activity is carried out. As regards limits, it may not exceed 15% of the presumed average profits of the professional/economical activity.

CIT-payers and non-resident companies carrying on an activity in Spain through a PE are exempt from this tax if their net turnover for the tax year of the last corporate/non-residents' income tax return filed prior to the date of accrual of the local tax (1 January) was less than EUR 1 million.

## *Corporate residence*

A company is resident in Spain and subject to CIT on its worldwide income when:

- it has been incorporated in accordance with Spanish law
- its registered office is in Spain, and/or
- its 'effective' head office is in Spain.

Under Spanish law, a company's 'effective', head office is in Spain when its business activities are managed and controlled from Spain.

Companies established in a country or territory where no tax is levied or which is a tax haven are deemed to be tax resident in Spain in the following cases:

- When the company's main assets consist, directly or indirectly, of property located or rights fulfilled or exercised in Spain.
- When the company's core business activity is carried on in Spain.

This presumption may be refuted by the company if it can prove that it is effectively administered and managed in the country or territory in which it is established and that it was incorporated and operates for valid economic and business reasons and not merely for the purpose of managing securities or other assets.

### *Permanent establishment (PE)*
Taxpayers operating in Spain through a PE are subject to non-residents' income tax.

Most Spanish tax conventions for the avoidance of double taxation contain a definition of PE in line with Organisation for Economic Co-operation and Development (OECD) criteria.

In the absence of a tax convention, internal law states that an individual or company is considered to operate through a PE when, by any legal means, one has continuous or habitual work facilities in Spain or a place to do any kind of work where one performs all or part of one's activity, or when one acts in Spain through an agent with powers to enter into an agreement in the name and on behalf of the non-resident individual or company, provided said powers are exercised on a regular basis.

In particular, management offices, branches, offices, factories, workshops, warehouses, shops or other establishments; mines, oil or gas wells, quarries, farms, forestry facilities, livestock farms, or any other site where natural resources are collected; and construction, installation, or assembly sites whose duration lasts more than six months will be considered PE.

## Other taxes

### Value-added tax (VAT)

Spanish VAT is payable on supplies of goods and services carried out in Spanish VAT territory and on imports/intra-European Union acquisitions of goods and services. There are three rates for the different types of goods and services, which are as follows:

- Ordinary rate of 18%, applied on regular supplies of goods and services.
- Reduced rate of 8%, applied on basic necessities (e.g. food and agricultural products not included in the 'super reduced' 4% rate, dwellings, and other qualifying services).
- Super reduced rate of 4%, applied on basic necessities other than those classified under the reduced rate (e.g. bread, milk, books, medicine).

In the Canary Islands, a specific tax is applied in lieu of VAT, called the Canary Island General Indirect Tax (IGIC). The ordinary IGIC rate is 5%, and the other IGIC rates are 0%, 2%, 9%, and 13% (20% for tobacco). IGIC is similar to VAT but it has some significant differences, such as the exemption established for telecommunications services. Imports of tangible goods into the Canary Islands are subject to this tax. In Ceuta and Melilla, sales tax is applied instead of VAT.

### Customs duties

Many goods imported into Spain from outside the European Union are subject to customs duties. The rates of duty are provided by the EU's Common Customs Tariff and vary widely.

### Excise duties

Excise duties are chargeable on most hydrocarbon oil products, alcoholic drinks, and tobacco products imported into or produced in Spain. Purely as examples, most road fuels carry a duty of about EUR 0.31 per litre, cigarettes carry a duty of about EUR 12.7 per thousand (plus 57% of the maximum retail sale price), tobacco of about EUR 8 per thousand (plus 41.5% of the maximum retail sale price), most wines of EUR 0 per litre, and spirits of about EUR 8.3 per litre of pure alcohol included.

### Transfer tax

A transfer tax of 6% or, more frequently, 7%, depending upon the region, is generally levied on inter vivo transfers, including real estate transfers and real estate leases that are exempt from VAT.



Second and ulterior transfers of buildings are exempt from VAT and thus, they are in principle, subject to transfer tax.

Residential leases are exempt from VAT and therefore subject to transfer tax.

Transfers of quoted or unquoted (listed or unlisted) securities are, in principle, exempt from both transfer tax and VAT, except in the following cases:

- Transfers of securities of a company whose real estate assets in Spain represent more than 50% of its total assets or whose assets include securities in another company whose real estate assets in Spain represent at least 50% of its total assets are subject to and not exempt from transfer tax if the acquirer gains control of the real estate company as a result of the transfer.

- Transfers of securities received in exchange for real estate contributions carried out on the incorporation of a company or on the execution of a subsequent capital increase are also subject to and not exempt from transfer tax provided that not more than three years have elapsed between the date on which the contribution was made and the date on which the securities are transferred.

In addition, acquisitions of assets by new businesses in the Canary Islands are exempt from transfer tax, subject to compliance with certain requirements.

Restructuring transactions are exempt from transfer tax. For these purposes, mergers, spin-offs, exchanges of shares, and in kind contributions defined in section 83 comma 1, 2, 3, and 5 and section 94 of the Spanish Corporate Income Tax Law are considered to be restructuring transactions.

### *Capital duty*
As of 3 December 2010, incorporations of companies, capital increases, contributions by shareholders, and the transfer to Spain of the place of effective management or the registered office of a company where neither one nor the other were previously located in a member state of the European Union are exempt from capital duty.

Restructuring transactions are not subject to capital duty. For these purposes, mergers, spin-offs, exchanges of shares, and in kind contributions defined in section 83 comma 1, 2, 3 and 5 and section 94 of the Spanish Corporate Income Tax Law are considered to be restructuring transactions.

The transfer of the place of effective management or the registered office between EU member states is not subject to capital duty. 1% capital duty is levied on capital reductions and company dissolution, to be paid by the shareholders.

Capital duty is incompatible with transfer tax and stamp duty in certain cases, but it is compatible with VAT.

### *Stamp duty*
A stamp duty is mostly levied on notarial instruments and records documenting transactions which have an economic value and need to be registered in public registries (e.g. company, land, and industrial property registries). Stamp duty is incompatible with transfer tax and capital duty, but compatible with VAT. The general rate is between 0.75% and 2% depending on the region of Spain and the taxable event.

Stamp duty is also levied on certain commercial documents (e.g. bills of exchange, promissory notes), court, and administrative documents.

### *Tax on non-resident companies owning real estate in Spain*
Non-resident companies which own real estate or hold real property rights in Spain are subject to a special levy accrued on 31 December and declared and paid in January of the following year in the place and manner established by law. The tax is equal to 3% of the assessed value of the real estate. This special levy is not applicable to companies resident in a country which has signed a convention for the avoidance of double taxation with Spain, including an exchange-of-information provision, if the ultimate shareholders of such companies are individuals resident in Spain or individuals that may benefit from the application of a convention for the avoidance of double taxation.

In addition, some other exceptions are established for this levy.

### Other local taxes
In addition to the taxes stated above, the following other local taxes may be charged on companies:

- Real estate tax, levied annually by local authorities on the ownership of real estate.
- Local tax levied on the increase in the value of urban land, chargeable when urban real estate is sold.
- Motor vehicle tax, charged on the ownership of vehicles.
- Tax on constructions, installations, and building works, charged on the cost of certain works which require town planning licences.
- Waste collection fees.

## Branch income

### Branches of Spain-based companies
Income obtained by a company resident in Spain through a branch located outside Spain is treated as income generated by the head office and is taxed accordingly. A tax exemption regime is applicable in this case, subject to compliance with certain requirements.

### Branches operating in Spain
Income obtained by a branch in Spain of a non-resident company is taxed at the standard CIT rate of 30% and, in most cases, the regulations established by tax law for resident companies are applicable.

Payments made by a branch to its head office or a PE of its head office for royalties, interest, commissions, or technical assistance fees are not tax deductible. Management and general administrative expenses incurred by the foreign head office which can be allocated to the branch are tax deductible if the payments for these expenses are made following a criteria of continuity and rationality and provided that certain documentary requirements and other formalities are fulfilled.

Under Spanish law, income obtained by a branch which is repatriated to its head office is taxed at source at the general withholding tax (WHT) rate of 19%. This tax is not chargeable in the case of a PE of a company resident in the European Union (unless the company is resident in a tax haven). Most tax treaties signed by Spain do not establish any provisions on this matter, and, in such cases, no tax is chargeable on income repatriated by branches. Some tax treaties, such as the treaties with the US, Canada, and Indonesia, expressly establish a tax on income repatriated by branches. For example, US head offices are taxed at a 10% rate on the repatriated profits of a Spanish branch under the US/Spanish tax treaty.



## Income determination

The general rule for determining income for CIT purposes is that accounting rules must be followed unless tax law establishes otherwise. In order to maintain this consistency, CIT/PE Non-residents' income tax returns include pages in which the company's accounting/commercial balance sheet and profit and loss account figures must be entered.

In Spain, the tax authorities are authorised to modify accounting results exclusively for the purpose of determining tax results if they observe that a company's accounting results have not been calculated in accordance with Spanish Generally Accepted Accounting Principles (GAAP).

### *Inventory valuation*

Inventory is valued at acquisition price or production cost under the average and first in first out (FIFO) valuation methods (the replacement and base stock valuation methods may only be used in exceptional cases). Again, since there are no specific tax rules for determining taxable income, accounting rules are also applicable for calculating valuation and obsolescence provisions for inventory.

### *Capital gains*

Capital gains are taxable in the tax year in which they arise. They are treated as normal income and taxed at the standard CIT rate of 30% (in the case of gains from real estate after taking into consideration an increase in the cost base for tax indexation purposes). *Please see the Tax credits and incentives section for a description of a tax credit for reinvestment of capital gains.*

### *Dividend income*

The amount of dividends included in the calculation of taxable income must be the gross amount.

Upon meeting certain requirements, companies may be eligible for a tax credit for dividends equal to the tax rate applied by the company on the dividends received. This tax credit is generally allowed for the total dividends received from taxable domestic companies when the interest of the company receiving the dividend in the other company is 5% or more and such interest has been held for at least one year. This one-year holding period is deemed to be complied with if it is completed after the dividend is distributed.

This tax regime is to some extent the same as a tax exemption regime. When an interest in a company is less than 5% or is held for less than one year, the tax credit is 30% of half of the amount of the dividends received.

In addition, taxation on capital gains arising from the sale of shares by a company with at least a 5% interest in the subsidiary held for at least one year prior to the sale can be reduced by means of a tax credit at the tax rate applicable on the undistributed part of the subsidiary's profits generated during the company's holding period. The reason for this tax relief is that this capital gain is understood to be an underlying dividend.

### *Stock dividends*

CIT is not levied on bonus shares (i.e. shares partially or totally given to shareholders in a capital increase charged against distributable reserves), although they must be taken into account when calculating the average cost of shares held for the levying of tax when the shares are sold.

### *Foreign income*

Resident companies are taxed on their worldwide income. For foreign-source income, total or partial tax relief in the form of tax credits or exemptions is given if tax is levied on the income in both Spain and the foreign country where the income has been generated.

This tax relief may be available for the following:

- Economic double taxation, which is when the same income is taxed in the hands of two different taxpayers. For example, another government taxes a foreign company on the income earned in that country and a Spanish resident shareholder is taxed on the dividends that it receives from the foreign company or the capital gains from transfers of its shares.
- Juridical double taxation, which is when the same income is taxed in two countries in the hands of the same taxpayer. For example, the income is taxed (via a WHT) in the country where the income is generated and again in the other country where the recipient is resident.

The main characteristics of double tax relief are discussed below.

Dividends or profit-sharing income received by a Spanish company from a foreign company are tax exempt, subject to compliance with the following requirements:

- The Spanish company has at least a 5% interest in the foreign company during the entire tax year prior to the tax year in which the dividend is paid. This one-year holding period is deemed to be complied with if it is completed after the dividend is distributed.
- The foreign company is subject to a similar tax to Spanish CIT and is not resident in a tax haven. The foreign tax is deemed to be similar to Spanish CIT if the foreign company is resident in a country with which Spain has signed a tax treaty containing an exchange-of-information provision.
- The income out of which the dividend is paid is generated from the business activities of the foreign company carried out abroad stipulated in CIT law.

Capital gains arising from the sale of shares in foreign companies also qualify for a tax exemption provided that the requirements stated above are complied with during the holding period and the acquiring company is not resident in a tax haven. Tax exemption is limited in certain cases.

As an alternative to this 'tax exemption' regime and applicable to dividend distributions only, a tax credit based on imputation is established. This tax credit allows the crediting of the foreign tax paid abroad on the income from which the dividends are paid and the foreign WHT paid on the profit distribution, up to the limit of the tax that would have been paid on the gross amount in Spain. The only requirement for the application of this 'tax imputation' regime is that the Spanish company has at least a 5% interest in the foreign company during the 12 months prior to the date on which the dividend is due and payable. This one-year holding period is deemed to be complied with if it is completed after the dividend is distributed. This tax relief may be carried forward for up to ten years.



Spanish international legislation provides for CIT relief on 'juridical' double taxation by applying the 'tax imputation' regime. Under this regime, gross foreign income (including foreign WHT paid) is included for Spanish tax calculation purposes, and a tax credit for the foreign WHT paid is applicable up to the amount of the CIT that the company would have paid if such gross income had been obtained in Spain. The tax credit can be carried forward for up to ten years, but the rate will be the rate applicable at the moment when the tax credit is applied.

Under Spanish tax treaties and implemented EU tax directives, several methods have been established to avoid double taxation. The main one is the traditional deduction of a tax credit from tax effectively paid. However, some treaties establish a tax exemption or the exclusive right to tax. Also, a tax-sparing clause is included in some treaties which allows for the deduction of not only the tax actually paid but a higher amount of tax.

### Other significant items
The following items, amongst others, are excluded or deferred from taxable income:

- Distributed dividends corresponding to profits obtained by companies in tax years in which the flow-through tax regime (internal and international) has been applied.
- Assets written up in accordance with revaluation laws and tax-protected restructuring transactions involving accounting capital gains.

## Deductions

### Depreciation, amortisation, and depletion
All assets, except land, are depreciable for tax purposes. Guideline tables of tax depreciation rates are established which state maximum per annum rates and maximum years of useful life for each asset type, classified by business sector. Please see the table below as an example of the maximum per annum rates and maximum years of useful life of some assets that are typically depreciated:

| Asset | Maximum per annum depreciation rate (%) | Maximum useful life (years) |
|---|---|---|
| Industrial buildings and warehouses | 3 | 68 |
| Administrative and commercial buildings | 2 | 100 |
| Passenger cars | 16 | 14 |
| Furniture and office equipment (excluded computers) | 10 | 20 |
| Computers | 25 | 8 |
| Software | 33 | 6 |
| Tools | 30 | 8 |

The straight-line depreciation method is normally used, calculated over the asset's useful life and applied on the asset's cost or written-up value (if such a write-up is acceptable for tax purposes). Off-book adjustments must be included in tax assessments if accounting depreciation exceeds tax depreciation.

Qualifying assets with a useful life of more than one year can also be depreciated using one of the following declining-balance methods:

- By applying a constant percentage on the carrying amount of the asset multiplied by 1.5, 2, or 2.5 depending on the useful life of the asset (below five years, between five and eight years, and over eight years, respectively).
- By using the sum-of-digits method, whereby the asset's acquisition price is multiplied by the ratio between the number of the years in which it is depreciated in a descending order (e.g. in a three-year useful life, three for the first year, two for the second, and one for the third) and the total numbers for the years of the asset's useful life (1 + 2 + 3 = 6 for 3 years of useful life).

Buildings, furniture, and fittings cannot be depreciated using the declining-balance methods.

Special depreciation plans for new assets can be approved by the tax authorities upon request, when they are subject to wear-and-tear at a higher rate than the normal rate applicable.

Recorded depreciation is fully tax deductible, even when it is higher than the depreciation which would arise by applying any of the tax depreciation methods stated above, if the taxpayer is able to justify that the depreciation is real.

Mining assets and assets used for research and development (R&D), amongst others, but not including buildings, can be freely depreciated/amortised for tax purposes.

### Free depreciation

Unrestricted depreciation of investments in new tangible fixed assets and real estate used in business activities is regulated for investments made by taxpayers in tax periods commencing in 2011, 2012, 2013, 2014, and 2015.

Unrestricted depreciation tax relief was also available for tax periods commencing in 2009 and 2010, but it could only be availed of if the requirement that the taxpayer's staff levels are maintained or increased was met. This requirement is eliminated for the application of the tax relief for tax periods commencing in 2011, 2012, 2013, 2014, and 2015. However, taxpayers that applied accelerated depreciation for their investments in 2009 and 2010 will have to meet the staff maintenance or increase requirement established for such tax periods.

In both cases, depreciation is fully tax deductible in this case, even if it is not recorded in the company's profit and loss account.

Provided that certain requirements are met and that the call option is exercised, free depreciation relief is also applicable to investments carried out in tax years 2009 to 2015 in new tangible fixed assets and property investments used for business activities which are carried out through leasing agreements. As explained above, for tax years 2009 and 2010 such tax relief is conditional on the maintenance of or increase in staff levels.

### Amortisation of intangibles

A 50% reduction may be applied for income obtained from licensing certain intangible assets, subject to compliance with certain requirements (the effective tax on this income would be 15%).



Goodwill cannot be amortised under Spanish GAAP. However, it can be amortised for tax purposes at an annual rate of 5%, subject to compliance with certain requirements (e.g. it is acquired for consideration from an unrelated party in accordance with the provisions of Section 42 of the Spanish Commercial Code and an obligatory non-distributable reserve is established).

Intangible assets with a specific useful life may be amortised and such amortisation is tax deductible even if it is not recorded in the company's profit and loss account, when the company complies with the following requirements:

- The assets are acquired for consideration.
- The company does not form part of a group as defined in Section 42 of the Spanish Commercial Code. The tax deduction of the amortisation is up to 10% per annum, unless a lower useful life can be evidenced.

If the two requirements stated above are complied with, amortisation on intangible assets which do not have a specific useful life is also tax deductible up to the 10% annual limit, regardless of whether they are amortised under Spanish GAAP or not.

**Depletion**
Depletion is allowed for mining companies and companies involved in exploring/ investigating natural oil resources as established in applicable legislation.

### *Taxes*
Taxes, other than CIT, that are recorded as an expense due to their nature (e.g. business and professional activities tax, but not withholdings) are tax deductible expenses. In some cases, indirect taxes such as non-deductible VAT or transfer tax could be added to the value of assets for depreciation purposes.

### *Fines and penalties*
Penalties imposed due to the failure to pay taxes and surcharges for late filing/payment or for other tax infringements are not tax deductible.

Late-payment interest recorded as an expense is, in principle, tax deductible.

### *Net operation losses*
Tax losses may be carried forward for 15 years, but they cannot be carried back. There are no tax loss 'baskets' (operating/capital) under Spanish law.

Complex rules may limit the use of tax losses of a company dissolved as a result of a restructuring operation and, in certain circumstances, when it has a change of shareholders.

### *Payments to foreign affiliates*
Supplies of goods or services by a company not established in Spain to a Spanish group company must be valued at arm's length. If recorded expenses for such goods/ services exceed arm's-length price, the tax deductibility of the excess amounts could be challenged in a tax inspection. The tax deductibility of expense charges received from tax havens is fully disallowed unless proper evidence of an actual service valued at arm's length can be provided.

Management services received from outside Spain and recorded as distributions of costs of a group centre do not have to be documented in a written agreement entered into before the commencement of the services to ensure the tax deductibility of the expenses (as previously was the case), although it would be recommendable to have such an agreement. For any other types of services, an agreement recorded before a notary public is not obligatory under Spanish law, but it is advisable.

As regards the taxation in Spain of the foreign company which supplies the services, the WHT rate to be applied on the gross income obtained by the company is 24%. Dividends, interest, and capital gains generated as a result of a transfer of assets are taxed at a 19% WHT rate. If management services, technical assistance, or the performance of studies are solely used outside Spain and are linked to business carried on abroad, then no WHT is applicable. In addition, under most tax treaties signed by Spain, 'business profits' obtained in Spain by non-residents are exempt from WHT. However, 'business profits' is a miscellaneous residual category. For instance, if the amount obtained qualifies as a royalty payment, WHT is applicable at the reduced tax treaty rates if the foreign company can obtain a document from the tax authorities of its country of residence certifying its tax residence. If no tax treaty applies, then the above 24% WHT rate is applicable *(see the Withholding taxes section for more information)*.

## Group taxation

### Tax groupings for CIT purposes

Under Spanish tax law, companies can form a group and apply a special tax consolidation regime for CIT purposes. Companies forming a tax group must formally pass a resolution agreeing to do so before the beginning of the first tax year in which the tax consolidation regime will be applied.

To apply the tax consolidation regime, the controlling company of the tax group must hold a 75% or higher interest, either directly or indirectly, in the companies forming the tax group at the beginning of the first tax year in which the tax consolidation regime is applied, and this interest must be maintained during the year unless the dependent company is dissolved. For tax years commencing after 1 January 2010, the interest requirement is 70% for companies listed on the Stock Exchange.

The main characteristics of the tax consolidation regime are as follows:

- The taxable income of the tax group is the sum of the taxable incomes of each of the companies forming the group.
- The tax losses of any of the companies forming the group can be offset against the tax profits of any of the other group companies.
- For the calculation of consolidated taxable income, the tax profits (losses) generated from transactions carried out between group companies are eliminated and only included in consolidated taxable income when:
  - they are carried out with third parties
  - a group company participating in the internal operation ceases to form part of the tax group, and
  - the tax consolidation regime is no longer applied by the group for whatever reason.
- Specific limitations apply regarding the offsetting of tax losses or the application of tax credits generated by the group companies before they formed part of the tax group. Such tax losses/credits may be offset (applied) by the tax group up to the limit of the tax profits/tax liability of the company which generated the losses/credits.
- No WHT is chargeable on payments made between companies of the tax group (e.g. interest, dividends).

### Tax groupings for VAT purposes

Groups of companies may also choose to be taxed under a special tax consolidation regime for VAT purposes. This special regime is optional, but once it has been opted for, it must be applied for a minimum of three years which is extendible unless it is expressly waived by the companies.

The VAT consolidation regime may only be applied by groups resident in Spanish VAT territory which do not form part of any other VAT grouping.

The controlling company of the group must be a legal entity or PE which is not dependent on any other entity established in Spanish VAT territory, and it must hold at least a 50% interest in the subsidiary companies of the group for the entire calendar year.

With the application of the VAT consolidation regime, there are two different options for taxation:

- The aggregation system, where the balances of the VAT returns of the individual companies of the group are totalled. The right to a tax deduction is exercised by the individual companies.
- The consolidation system, where an individual company can opt to reduce VAT taxable income for inter-company operations which is limited to the 'external' cost.

### *Transfer pricing*

All related-party transactions must be valued at market price, following the arm's-length standard (e.g. the value which in normal market conditions would have been established between unrelated parties).

For this purposes, related persons or entities shall be:

- A company and its shareholders or members.
- A company and its board members or directors.
- A company and the spouses of or persons related to its shareholders or members, board members, or directors, either in a direct line or collaterally, by consanguinity or affinity up to the third degree.
- Two companies of a group.
- A company and the shareholders or members of another company, when both companies form part of a group.
- A company and the board members or directors of another company, when both companies form part of a group.
- A company and the spouses of or persons related to the shareholders or members of another company, either in a direct line or collaterally, by consanguinity or affinity up to the third degree, when both companies form part of a group.
- A company and another company in which the former company has at least a 25% holding, held indirectly, in its share capital or shareholders' equity.
- Two companies in which the same shareholders or members or their spouses, or persons related to them either in a direct line or collaterally, by consanguinity or affinity up to the third degree, have at least a 25% holding, whether directly or indirectly, in their share capital or shareholders' equity.
- A company resident in Spanish territory and its PEs abroad.
- A company not resident in Spanish territory and its PEs in Spanish territory.
- Two companies forming part of a group taxed under the tax regime for groups of cooperative companies.

For cases where association exists as a result of a shareholder/member-company relationship, the shareholding must be 5% or more, or 1% if the shares are quoted on a regulated stock exchange. The reference to directors shall include *de facto* and *de jure* directors.

The determination of the market value by taxpayers must be done through the application of one of the following transfer pricing methodologies, in order of preference as follows: Comparable Uncontrolled Price (CUP) method, Cost Plus (CP) method, or Resale Price Method (RPM), usually referred to as traditional transaction methods.

If the application of any of the above methods is not possible, the Profit Split Method (PSM) or Transactional Net Margin Method (TNMM) could be applied, usually referred to as transactional profit methods.

Documentation is also a requirement, with taxpayers required to produce group-level and taxpayer-specific documentation for each tax year. Related persons or entities must keep such documentation available for the tax authorities as from the end of the voluntary return or assessment period in question. Exceptionally, no documentation requirements will be applied in the following cases, among others:

- With some exceptions, transactions carried out within a tax period with one related person or entity will not be subject to documentation requirements when the sum of the considerations of all these transactions does not exceed EUR 250,000.
- Transactions carried out within a group of companies taxed under the Spanish special tax consolidation regime.
- Transactions carried out by economic interest groups and temporary business associations.
- Transactions involving the purchase or sale of publicly traded shares.

Documentation is always required for transactions with entities, whether related parties or otherwise, which are resident in tax havens.

Please note that specific penalties may be imposed in the event of the absence of documentation or where data are omitted, inaccurate, or false.

### *Thin capitalisation rules*

When the net remunerated direct or indirect borrowing of an entity from other individuals or entities which are not resident in Spanish territory, excluding banking institutions, to which it is related exceeds the result of applying the coefficient of 3 to the entity's fiscal capital (equity), the interest accrued on the excess will be treated as a dividend for tax purposes.

Taxpayers may submit to the Tax Administration a proposal for the application of a different coefficient based on the arm's-length borrowings that the taxpayer would have been able to obtain from unrelated individuals or entities, provided that the transaction is not carried out with individuals or entities resident for tax purposes in territories listed as tax havens by tax regulations.

Thin capitalisation rules will not apply when the related entity which is not resident in Spain for tax purposes is resident in another EU member state, unless it is resident in a territory listed as a tax haven by tax regulations.

Please note that thin capitalisation rules are additional to, and not a substitute for, the transfer pricing requirement that related-party finance be at arm's length.



### *Controlled foreign company (CFC) regime*

Spanish CFC rules seek to avoid the effects produced when Spanish tax resident entities or individuals place their capital in low-taxed foreign entities to avoid including passive income generated by such capital in their taxable bases.

Under this regime, Spanish tax resident entities are subject to Spanish CIT on certain kinds of positive passive income obtained by entities which are not resident in the European Union for tax purposes in which they own, individually or together with tax related entities or persons, more than 50% of the share capital, equity, profits, or voting rights, provided that the CIT due by the non-resident entity is below 75% of the tax that would have been due in Spain.

The types of passive income to which CFC rules apply are as follows: (i) income from immovable property not used for business activities; (ii) income derived from equity in other entities or from capital assigned to third parties (interest and dividends); (iii) transfer of the above mentioned immovable property and financial assets; and (iv) income arising from credit, financial, insurance, and service activities carried out directly or indirectly with related Spanish tax resident entities in which a tax deductible expense is generated.

Passive income mentioned in numbers (i) to (iii) above obtained by the non-resident entity will not be considered taxable income of the Spanish tax resident entity when it arises from entities in which the latter holds a direct or indirect interest of over 5%, provided that the non-resident entity controls and manages the interest using the relevant human and material resources and provided at least 85% of the income obtained from such participated entities comes from business activities.

Moreover, the passive income mentioned in numbers (i) to (iii) above will not be included in the Spanish entity's taxable base when it amounts in total to less than 15% of the total profits obtained by the CFC or less than 4% of its total turnover.

## *Tax credits and incentives*

### *CIT relief*

No specific tax relief is established in Spanish law for foreign investors. Relief may be availed of by Spanish and foreign-owned companies alike. The tax relief available under CIT law in Spain is as follows:

Current tax credits for promoting certain investments must be reduced and finally eliminated. However, the largest tax credits are maintained (tax credit to prevent internal and international double taxation, tax credit for the reinvestment of extraordinary profits, and tax credit for R&D).

### Tax relief for business activity/place of business activity

- 50% tax credit on CIT levied on income obtained in Ceuta and Melilla through companies established and carrying on activities during a full business cycle in these enclaves.
- 99% tax credit on the CIT levied on income obtained from the supply of local public services, except when the state company in question is owned, partially or wholly, by a quoted/non-quoted company or individual.
- 38% tax credit (50% prior to 2011) on the CIT levied on income obtained from exports of films, books, and similar cultural items if profits are reinvested in the acquisition of assets used for such activities. This tax credit will be gradually reduced over the coming years and eliminated in 2014.

### R&D credits

A 25% tax credit can be availed of for expenses incurred from R&D activities. If the expenses are higher than the average R&D expenses incurred by the company during the previous two years, the tax credit is 42% for the excess amount.

An additional tax credit of 17% can be availed of for staff expenses incurred for staff exclusively carrying out and qualified to carry out R&D activities.

An 8% tax credit can be availed of for investments made in tangible fixed assets (excluding buildings) and intangible assets which are exclusively assigned to R&D activities.

### Technological innovation credits

An 8% tax credit can be availed of for technological innovation activities. For tax periods commencing on or after 6 March 2011, such tax credit is increased to 12%.

### Tax credit for environmental investments

Tax credit for environmental investments in installations is increased for tax periods commencing on or after 6 March 2011. Depending on when the investment is made, the tax credit for these investments is as follows:

- For investments made in tax periods commencing between 1 January 2010 and 31 December 2010, the tax credit is 2%.
- No tax credit may be availed of for investments made in tax periods commencing between 1 January 2011 and 5 March 2011.
- For investments made in tax periods commencing on or after 6 March 2011, the tax credit is 8%.

Finally, the tax credit for environmental investments in vehicles and the tax credit for environmental investments in assets to promote the exploitation of renewable energies are eliminated for tax periods commencing on or after 1 January 2011.

### Reinvestment of extraordinary income

A 12% tax credit can be availed of for sales of assets which are used for the company's business activities when the amount obtained from the sale is reinvested in similar types of assets during a four-year period (as from one year prior to the sale up to three years after the sale). This tax credit therefore reduces the effective tax levied on sales of certain assets to 18%.

In the case of a sale of company shares, to be eligible for this tax credit, the interest in the company must be a minimum of 5% and must have been held for more than one year prior to the sale.

The asset in which the reinvestment is made must be maintained for five years (three in the case of moveable assets) unless its useful life is shorter.

### The following tax credits have been eliminated for tax periods commencing on or after 1 January 2011

- Tax credit for the promotion of information and communications technologies: 3%.
- Tax credit for investments in vehicle navigation and tracking systems, adaptation of vehicles for the disabled, and nursery school fees for staff's children: 2%.
- Tax credit for contributions made by employers to certain staff pension schemes: 2%.
- Tax credit for export activities: 3%

The 18% tax credit for film productions will be eliminated in 2012.

The tax credit for investments in heritage assets (8% in 2010 and 6% in 2011) and book publishing (3% in 2010 and 2% in 2011) will be eliminated in 2014.

A tax credit of 1% to 2% may be obtained on expenses incurred in, or related to, financing ongoing staff education programmes. This tax credit can also be availed of for expenses incurred by companies to familiarise staff in the use of new technologies.

These expenses are not a benefit in kind for the staff. The tax credit related to education programmes will be eliminated in 2011, but the tax credit related to expenses incurred to familiarise staff in the use of new technologies will not be eliminated until 2012.

### Other tax relief

A tax credit can be applied for increases in the number of disabled workers contracted per year on a permanent and full-time basis (EUR 6,000 per worker contracted). This increase is calculated by taking the average number of company workers meeting these requirements in the tax year in question and comparing it with the company's average number of staff in the previous tax year.

## *Special tax regimes*

Special tax regimes are applicable, among others, in the following cases:

### Spanish and European Economic Interest Groupings and Temporary Consortia of Entities

- Spanish Economic Interest Groupings (SEIGs) that meet certain requirements will not be subject to Spanish CIT on the part of the taxable income which corresponds to members resident in Spain for tax purposes. Such part of the positive or negative taxable income shall be deemed to be the profits/losses of the SEIG members. The proportional part of tax credits and payments in advance will also be assigned to the Spanish tax resident members of the SEIG where they are subject to corporate or personal income tax. Dividends distributed to SEIG members that have been subject to imputation will not be taxed under corporate or personal income tax on distributions. Dividends distributed to Spanish non-resident SEIG members will be taxed in accordance with the Spanish Non-Resident Income Tax Act and Conventions for the Avoidance of Double Taxation.
- European Economic Interest Groupings (EEIGs) will be taxed under the above-mentioned regime with the following exception: EEIG will not be subject to Spanish CIT.

  If the EEIG is not resident in Spain for tax purposes, Spanish tax resident members will include the corresponding part of the profits or losses determined for the grouping, corrected by applying the rules for determining taxable income for corporate or personal income tax purposes, as applicable. When the activity carried out by the members through the grouping determines the existence of a PE abroad, the rules provided for in this Law or in the respective treaty for the avoidance of double international taxation will be applicable.

  Non-Spanish tax resident members will only be subject to Spanish Non-Resident Income Tax when the activity they perform through the grouping determines the existence of a PE in Spanish territory.

  Dividends distributed to non-Spanish tax resident members that have been subject to imputation will not be taxed in Spain on the distribution.

- Temporary Consortia of Entities (TCEs) are taxed under the SEIG regime. As an exception, members of a TCE that operates abroad may benefit from exemptions for income obtained abroad.

### Restructuring transactions

For restructuring transactions, the special tax regime is a tax neutrality regime implemented under EU Directive 90/434. As a general rule, under this regime, asset transfers carried out through such transactions do not have any tax implications (either from a direct, indirect, or other Spanish tax perspective) for the parties involved (transferor, beneficiary, and shareholder), until a subsequent transfer takes place which is not protected by this regime.

The transactions which can be taxed under this regime are mergers, global transfers, spin-offs of business units/majority interests, splits, share-to-share transactions, contributions of business units, and contributions of assets (this last transaction is not fully tax-protected). Each of them must comply with a series of requirements for the application of the regime.

The tax credit position of a company dissolved as a result of a tax-protected restructuring transaction is 'acquired' in full by the beneficiary company in the case of universal succession.

The 'acquired' tax credits only include tax credits which are obtained in relation to assets transferred in transactions where the transferor is not dissolved or the succession is not a full succession for Spanish commercial purposes.

Regarding tax losses, the Spanish tax authorities hold the view that tax losses may not be transferred when the transferring company is not dissolved. When the transferring company is dissolved, the tax losses may be applied by the beneficiary company up to certain limits and subject to certain restrictions.

Financial goodwill arising in a merger transaction is amortised for tax purposes at a maximum annual rate of 5% at the level of the Spanish beneficiary company of the merger, if the seller of the shares giving rise to the 'merger' goodwill has been actually taxed for the equivalent capital gain in Spain or in any other EU country (excluding tax havens), and provided that certain requirements are met. Amortisation of financial goodwill does not have to be recorded in the profit and loss account for it to be tax deductible, although an annual amount must be charged to a non-distributable reserve (either from annual profits or from freely-distributable reserves), which must be at least the tax deductible amount.

This tax regime cannot be applied if the transaction is carried out for the purpose of tax fraud or evasion (anti-abuse clause). An additional anti-abuse clause in line with the clause established by the EU directive is established in Spanish law to ensure that the tax regime cannot be applied if the transaction is not carried out for valid economic reasons, such as the streamlining of activities or group restructuring to gain efficiency, but to obtain a tax benefit.



The tax authorities must be notified of the application of this tax regime.

### Tax transparency

Tax transparency (international controlled foreign company (CFC) rules) is not applicable for companies resident in the European Union. *See CFC regime in the Group taxation section for more information.*

### Venture capital companies and funds

Venture capital companies (VCCs) and funds (VCFs) may benefit from the following tax regime if certain requirements are met:

- Dividends from target companies may benefit from a 100% tax credit for the avoidance of double taxation or tax exemption.

- Capital gains arising from the transfer of shares in target companies may be 99% exempted from CIT, provided that such shares have been held for a period between 2 and 15 years.
- Profit distributions to VCC and VCF shareholders may benefit from a 100% tax credit for the avoidance of double taxation if the shareholders are Spanish tax residents or have a PE in Spain. Income from profit distributions to non-Spanish tax resident shareholders without a PE in Spain is not subject to taxation in Spain unless it is obtained through a tax haven. The same regime applies to the transfer of shares in VCCs and VCFs.

### Collective Investment Institutions (CIIs)
CIIs are subject to CIT at a reduced rate of 1%. They are not entitled to apply any tax credits. Dividends distributed by these institutions are subject to the general WHT regime. Shareholders are taxed on dividends received from the CII and on capital gains obtained for the transfer of the CII without being entitled to the application of a tax credit for the avoidance of double taxation.

### Lease transactions
Financial leasing contracts with a purchase option that may be exercised at the end of the lease period may benefit from a special tax regime if they meet certain requirements. According to this regime, the lessee may deduct the following expenses from its taxable income:

- The part of the lease instalments corresponding to the financial charge (interest) paid to the lessor.
- The part of the lease instalments paid which corresponds to the recovery of the cost of the good. Tax deductibility for this amount may not exceed the result of applying twice the straight-line depreciation rate which corresponds to the good in question in accordance with the officially-approved depreciation tables.

### Spanish holding companies of foreign companies (Entidad de Tenencia de Valores Extranjeros or ETVE) regime
Spanish resident companies whose corporate purpose includes the holding and management of foreign companies' shares are granted some tax benefits subject to compliance with certain requirements.

The tax authorities must be notified of the application of this tax regime.

Companies taxed under this tax regime are granted a tax exemption on dividends and capital gains when they have a 5% direct interest or, if their interest is less than 5%, when the acquisition value of their interest is at least EUR 6 million.

In addition, the distribution of profits by the holding company to non-resident companies or individual shareholders is not taxable in Spain (unless the profits are distributed to a tax haven). Resident company shareholders are now entitled to an internal tax credit on dividends under Spanish law.

### Small and medium-sized companies
Small and medium-sized companies are eligible for tax relief such as accelerated depreciation/amortisation, or more favourable bad debt provision treatment. Accelerated depreciation/amortisation can be applied for assets acquired using amounts obtained from sales of trading assets. To be eligible for this relief, turnover in the previous tax year must not exceed EUR 10 million (EUR 8 million for tax

years starting prior to 1 January 2011). In the case of a group, the turnover of all the companies must be considered for this purpose.

A reduced CIT rate of 25% is levied on the first EUR 300,000 of annual tax profits (EUR 120,202 for tax years starting prior to 1 January 2011).

Small and medium-sized businesses are eligible for a tax credit of 3% of investments made and expenses incurred to improve their capabilities in internet access and business information management to improve the efficiency of their internal processes. This tax credit may be carried forward for a period of 15 years and will be eliminated in 2011.

### *Special economic and tax regime of the Canary Islands*

Due to the distance to and isolation of the Canary Islands, they have traditionally enjoyed a special economic and tax regime with specific economic and tax measures different to those established for the rest of Spain.

Regarding direct taxes, the Canary Island economic and tax regime establishes the following tax benefits for companies and businesses domiciled in the Canary Islands or with a PE in the Canary Islands:

- Up to 90% of annual undistributed accounting profits can be allocated to a special investment reserve and not taxed providing that they are invested within a four-year period (including the period during which the profits are obtained) in qualifying assets in the Canary Islands, or in certain public debt securities or shares in other companies operating in the Canary Islands which invest in qualifying assets.
- Most Spanish CIT relief is 80% higher for companies and businesses located in the Canary Islands.
- A 25% tax credit can be availed of for investments in new tangible fixed assets and, subject to compliance with certain requirements, second-hand assets.
- A tax credit of 50% of the CIT liability is granted for taxable income generated from the production of tangible goods while carrying on agricultural, farming, industrial, and fishing activities.
- A tax credit of 90% of the CIT liability is granted for profits of shipping companies generated from ships registered in the Canary Islands Special Ships and Shipping Companies Register. For sailors of such ships, a 50% tax exemption can be applied to personal income tax levied on their employment income and a 90% reduction to the part of their Social Security contributions paid by their employers.



Regarding indirect taxes, in addition to lower taxation through the Canary Island general indirect tax (IGIC at the general rate of 5%) compared to VAT and specific IGIC exemptions, the following should be noted:

- Companies domiciled in the Canary Islands which are CIT-payers and which are newly incorporated, start new activities or improve their existing activities may benefit from the following tax relief:
  - Exemption from IGIC on supplies and imports of capital goods if the company has a deduction percentage that is not 100%.
  - Shipping companies qualify for an exemption from transfer tax for any contracts related to ships registered in the Canary Islands Special Ships and Shipping Companies Register.

- Custom Free areas are available. Upon EU demand, there are restrictions on the application of certain tax relief (special investment reserve, tax credits for production, and new business indirect tax relief) for the following industrial sectors: shipbuilding, synthetic fibres, automobile, iron and steel, and coal.

### *Canary Islands Special Zone tax regime*

In January 2000, a special Canary Island Special Zone tax regime was approved by the European Union. The main regulations of this regime, established by the Spanish government, are as follows:

- New companies may qualify for the application of this tax regime and, on the approval of the tax authorities, may be registered up to 31 December 2013 (applying the tax regime up to 31 December 2019). This may be extended by the European Union.
- To qualify for this tax regime, the company must:
  - covenant to make an investment in fixed assets of at least EUR 100,000 in Gran Canaria or Tenerife, or EUR 50,000 in Fuerteventura, Lanzarote, La Palma, El Hierro, or La Gomera, within the first two years of their business activity
  - covenant to create at least five new jobs in Gran Canaria or Tenerife, or three in the other islands
  - provide a description of the business activities to be carried out which support the company's solvency, viability, international competitiveness, and contribution to the economic and social development of the Canary Islands
  - establish its registered office and place of effective management in the Special Area
  - have at least one company director who resides in the Canary Islands, and
  - carry out one of the qualifying business activities.
- The territory where this tax regime can be applied includes all the Canary Islands, except for companies which intend to carry out industrial or commercial activities involving tangible goods, which must be located in specific controlled areas.
- Companies applying the tax regime may operate outside the Canary Islands through branches if separate accounting books are kept, but the tax regime will not be applicable to such branches' activities.
- Activities for which the tax regime can be applied include a wide range of industrial and commercial activities, most services and holdings. Credit and insurance entities are excluded, and no stock exchanges are allowed.
- Companies applying the tax regime are subject to CIT in Spain at a 4% rate for companies authorised from 1 January 2007 onwards and at a variable rate of between 1% and 5% for companies authorised before this date. The special 4% rate shall be levied on a maximum amount of the taxable income which will depend on the number of jobs created and the type of activity carried out by the company. The general CIT regime establishes a 30% tax rate for Spanish companies applicable as from 2008. For small companies, the tax rate is 25% for the first EUR 300,000 of profits (EUR 120,202 for tax years starting prior to 1 January 2010) and 30% for remaining profits.
- Under this tax regime, companies can avail themselves of large tax exemptions for IGIC, transfer tax, and stamp duty, and large reductions and simplified regulations for local taxes.
- Interest and some other returns from moveable goods paid by companies under this tax regime are exempt from Spanish Non-Residents' Income Tax, except when paid to residents in tax havens.
- Benefits established in the EU Parent-Subsidiary Directive are extended to non-EU residents. These benefits are not applicable when the income is paid to residents in tax havens.

- A fee of EUR 732.51 is payable to be registered as a company which applies this tax regime, and an annual fee of EUR 1,098.76 is payable to continue to be registered as qualifying for the tax regime.

Finally, the Spanish Parliament has recently proposed some amendments to the law regulating the Canary Island Special Zone tax regime, including, among other tax benefits, a reduction in the special CIT rate for companies which apply the regime to 1% for the first tax base segment.

### Foreign tax credit

*See Foreign income in the Income determination section for a description of double tax relief.*

## Withholding taxes

Ordinarily, WHT is the mechanism by which the Spanish tax authorities collect the final tax levied on non-residents. In the case of resident beneficiaries, however, it is simply an advance payment of a tax that is then normally self-assessed by the resident taxpayer in the final annual tax return.

The advance payment system of WHT for resident beneficiaries referred to above also applies if non-resident companies/individuals not established in Spain sell their title to Spanish real estate. In this case, the acquirer of the real estate must levy a 3% WHT on the selling price on account of the 19% tax chargeable to the seller on its capital gain. Other capital gains (for instance, from a sale by a non-resident of a substantial interest in a Spanish company where neither a tax treaty nor internal rules establish a tax exemption) are taxed in the hands of the non-resident transferor, but the mechanics of levying the tax are not those of a WHT. In this case, the non-resident's tax is paid directly, through its representative or by the depositor or manager of the assets in question, if any.

The following table states the general WHT rates on income obtained by resident/non-resident companies. The most significant peculiarities regarding the rates for each type of income are stated in footnotes to the table.

### Withholding rates

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations and individuals | 19 (1) | 19 (2a) | 19 (2b) |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 19 (3) | 19 (4) | 24 (5) |
| Treaty (*): | | | |
| Albania | 10 (6) | 6 (10, 44) | 0 |
| Algeria | 5 (7) | 5 ( 8, 9, 10, 11) | 7 (12) |
| Argentina | 10 (14) | 12.5 (8,9, 10, 14) | 15 (15) |
| Australia | 15 | 10 | 10 |
| Austria | 10 (3, 16) | 5 (4) | 5 (5) |
| Belgium | 15 (3, 18) | 10 (4, 18, 19) | 5 (5, 18) |
| Bolivia | 10 (13, 18) | 15 ( 8, 9, 10, 14, 18) | 15 (18, 20) |
| Bosnia | 5 (21) | 7 (22) | 7 |

# Spain

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Brazil | 10 (23) | 15 (9, 24, 25) | 12.5 (26) |
| Bulgaria | 5 (3, 27) | 0 (4) | 0 (5) |
| Canada | 15 | 15 (28) | 10 (20, 28) |
| Chile | 5 (29) | 15 (30) | 10 (31) |
| China | 10 | 10 | 10 (32) |
| Columbia | 5 (33) | 10 (34) | 10 |
| Costa Rica | 12 (35) | 10 (34, 36a) | 10 |
| Croatia | 0 (13, 18) | 8 (9, 18, 36b) | 8(18) |
| Cuba | 5 (13 ,18) | 10 (18, 37) | 5 (18, 20) |
| Czech Republic | 5 (3, 27) | 0 (4) | 5 (5, 38) |
| Ecuador | 15 | 10 (39) | 10 (40) |
| Egypt | 12 (41) | 10 (42) | 12 |
| El Salvador | 12 (43) | 10 (44) | 10 |
| Estonia | 5 (3, 13, 18) | 10 (4, 9, 10, 11, 18) | 10 (5, 18, 31) |
| Finland | 10 (3, 13) | 10 (4) | 5 (5) |
| France | 15 (3, 45) | 10 (4, 46) | 5 (5, 47) |
| Georgia | 0 (48a) | 0 | 0 |
| Germany | 10 (3, 13) | 10 (4, 48b) | 5 (5) |
| Greece | 5 (3, 49) | 8 (4, 50) | 6 (5) |
| Hungary | 5 (3, 13) | 0 | 0 |
| Iceland | 5 (13, 18) | 5 (18) | 5 (18) |
| India | 15 | 15 (9, 51, 52) | 20 (53) |
| Indonesia / Timor Oriental | 10 (13) | 10 (9, 54, 55) | 10 |
| Iran | 5 (56) | 7.5 (9, 10, 11) | 5 |
| Ireland | 15 (3, 18) | 10 (4, 18, 55) | 10 (5, 18, 57) |
| Israel | 10 (18) | 10 (18, 58) | 7 (18, 59) |
| Italy | 15 (3) | 12 (4, 9) | 8 (5, 60) |
| Jamaica | 5 (49, 61) | 10 (44, 61) | 10 (61) |
| Japan | 10 (23) | 10 | 10 |
| Kazajstan | 5 (90) | 10 (8, 9, 97) | 10 |
| Latvia | 5 (3, 18, 49) | 10 (4, 9, 10, 18) | 10 (5, 18, 31) |
| Lithuania | 5 (3, 18, 49) | 10 (4, 9, 10, 18) | 10 (5, 18, 31) |
| Luxembourg | 10 (3, 62) | 10 (4, 9, 63) | 10 (5, 64) |
| Macedonia | 5 (7) | 5 (65) | 5 |
| Malaysia | 5 (18, 66) | 10 (8, 18) | 7 (18, 67) |
| Malta | 5 (3, 68) | 0 | 0 |
| Mexico | 5 (13) | 15 (69) | 10 (20, 38) |
| Moldova | 0 (70) | 5 (44) | 8 |
| Morocco | 10 (13) | 10 | 10 (40) |
| Netherlands | 15 (3, 71) | 10 (4) | 6 (5, 72) |
| New Zealand | 15 | 10 | 10 |
| Norway | 10 (13) | 10 (9, 10, 36a, 55) | 5 (64, 73a) |
| Pakistan | 10 (73b) | 10 (8, 9) | 7.5% |
| Philippines | 10 (74) | 15 (75) | 15 (76) |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Poland | 5 (3, 23) | 0 (4) | 10 (5, 20) |
| Portugal | 10 (3, 13, 18) | 15 (4, 18) | 5 (5, 18) |
| Romania | 10 (3, 13) | 10 (4, 77) | 10 (5) |
| Russian Federation | 15 (18, 78) | 5 (9, 18, 79) | 5 (18) |
| Saudi Arabia | 5 (68) | 5 (8, 9) | 8 |
| Serbia | 5 (13) | 10 (9) | 10 (80) |
| Slovakia | 5 (3, 27) | 0 (4) | 5 (5, 38) |
| Slovenia | 5 (3, 13, 18) | 5 (4, 8, 9, 18) | 5 (5, 18) |
| South Africa | 5 (13, 18) | 5 (18, 81) | 5 (18) |
| South Korea | 10 (13) | 10 (9, 82) | 10 |
| States of the former URSS (except Russia) | 18 | 0 | 5 |
| Sweden | 10 (3, 16) | 15 (4) | 10 (5) |
| Switzerland | 15 (83) | 10 (84) | 5 (85) |
| Thailand | 10 | 15 (86) | 15 |
| Trinidad and Tobago | 0 (70, 87a) | 8 (8, 9, 63, 82, 87a) | 5 (87a) |
| Tunisia | 5 (87b) | 10 (88) | 10 |
| Turkey | 5 (13) | 15 (89) | 10 |
| United Arab Emirates | 5 (9, 90) | 0 | 0 |
| United Kingdom | 10 (3, 7) | 12 (4) | 10 (5) |
| United States | 10 (13) | 10 (9, 65) | 10 (57, 91a) |
| Uruguay | 5 (91b) | 10 (8, 9, 92) | 10 (93) |
| Venezuela | 0 (49) | 10 (94, 95) | 5 |
| Vietnam | 7 (18, 96) | 10 (9, 18, 63) | 10 (18) |

Notes

The general rates in the table above are for guidance only and should not be treated as tax advice.

The rates above are for income obtained by non-residents which is not related to any PEs they may have in Spain.

(*) Aside from these tax treaties, the following tax treaties are not yet in force as they are currently being negotiated or are not yet approved or published: Armenia, Barbados, Georgia, Hong-Kong, Kuwait, Namibia, Nigeria, Panamá, Peru, Senegal, Singapore, and Syria.

1. If a corporate taxpayer, as a shareholder, is entitled to full tax relief on the dividend received, no WHT is levied. As a general rule, corporate shareholders with at least a 5% interest held for at least one year are granted full tax relief.
2. 
   a. The 19% WHT rate does not apply if, amongst other cases, the recipient is a resident bank or savings or other financial institution subject to CIT, provided that this income is not portfolio income. In addition, no WHT is levied on interest arising between companies taxed under the tax consolidation regime.
   b. A 19% WHT rate is levied on income generated under royalty and technical assistance agreements, from leases, or from the granting of rights when ownership is not transferred. A 24% rate is levied on fees received by a company for the transfer of rights to an image or consent or authorisation to its use.
3. Implementation of the EU Parent-Subsidiary Directive in Spanish law gives EU shareholders a WHT exemption on dividends from Spanish companies, subject to compliance with certain requirements. Luxembourg recipients of income which are companies under paragraph 1 of the protocol to the Tax Treaty with Spain (holding companies) are not allowed this exemption.
4. The EU Interest and Royalties Directive WHT exemption for interest obtained by EU lenders is applicable when appropriate.
5. Taxable income from supplies of services, technical assistance, or assembly/installation work under engineering contracts provided or carried out by non-resident companies with no PE in Spain does not follow the general rule for gross income. In such cases, total income can be reduced by related

staff costs, certain supplies (water, electricity, telephone) and materials used for the services/work, provided that, in the case of staff costs, evidence can be furnished that they were actually taxed in Spain. According to the EU Interest and Royalties Directive, royalties paid to other EU member state associate companies are exempt from WHT as of 1 July 2011 (WHT was limited to a maximum 10% prior to 1 July 2011).

6. A 5% WHT is levied if the beneficial owner is an Albanian company which holds at least 10% of the capital of the company paying the dividends; no WHT is levied if the Albanian company holds at least 75% of the capital of the Spanish company paying the dividends.
7. Levied if the recipient is a company holding at least a 10% interest in the paying company; otherwise, a 15% rate is levied.
8. Interest paid by certain public institutions is tax exempt.
9. Interest paid to certain public institutions is tax exempt.
10. Interest arising from the acquisition of commercial, industrial or scientific equipment is tax exempt.
11. Interest paid on loans granted by a bank or other financial institution is tax exempt.
12. For royalties for any copyright of artistic, scientific, or literary work (including cinematograph films and films or tapes for radio or television broadcasting), the rate levied is 14%.
13. Levied if the recipient is a company holding at least a 25% interest in the paying company; otherwise, a 15% rate is levied.
14. No WHT is levied on interest when both contracting states agree this and the loan is for no less than five years.
15. A 3% WHT rate is levied on royalties for the use of or right to use news. A 5% WHT rate is levied on royalties for any copyright of artistic, theatrical, musical, or literary work. A 10% WHT rate is levied on royalties for the use of or right to use copyright of industrial property, know-how, or scientific, commercial, or industrial equipment.
16. Levied if the recipient is a company holding a direct interest of at least 50% in the paying company for at least one year; otherwise, a 15% rate is levied.
17. No WHT is levied if the recipient is a company holding at least a 25% interest in the paying company.
18. Reduced WHT rates or exemptions are not levied/applied if the income is paid to a company resident in a contracting state more than 50% of whose shares are directly or indirectly held by non-residents. This clause will not apply if the company can prove that it carries out important industrial or commercial activities and does not merely manage or hold shares.
19. A tax exemption can be applied to interest on commercial loans, loans guaranteed by public bodies for the promotion of exports, and on current accounts in banks or nominative advances between banks of both contracting states.
20. Royalties for any copyright of literary, theatrical, musical, or artistic work (with some exceptions, such as films and TV programs) are exempt from WHT.
21. 5% WHT is levied if the recipient (beneficial owner) is the shareholder of the paying company with at least a 20% interest; otherwise, 10% WHT is levied.
22. No WHT is levied on interest if: (i) the recipient is the other contracting state, its central bank, or its political divisions; (ii) the payer is a contracting state or its political divisions; (iii) the interest arises from a loan or credit granted or guaranteed by a contracting state or its political divisions; (iv) the recipient is a financial institution; or (v) the recipient is a pension fund qualifying for tax purposes in a contracting state and the income from such fund is tax exempt in the contracting state paying the dividend.
23. Levied if the recipient is a company with at least a 25% interest in the paying company with voting rights; otherwise, a 15% rate is levied.
24. The maximum WHT is 10% for interest paid to financial institutions for loans and credits granted for a minimum term of ten years for the purchase of capital equipment.
25. Interest arising from securities issued by a contracting state is exempt from WHT.
26. A 10% WHT rate is levied on royalties for copyrights of any literary, scientific, or artistic work (including films and TV programs).
27. Levied if the beneficial owner is a company (excluding partnerships) with at least a 25% interest in the paying company held directly or indirectly; otherwise, a 15% rate is levied.
28. A reduced WHT rate is only levied if the income is taxed in Canada; otherwise the general rate is levied.
29. Levied if the recipient is a company with at least a 20% interest in the paying company held directly or indirectly; otherwise, a 10% rate is levied.
30. Interest arising from bank or insurance company loans, bonds, some securities that are regularly negotiated on stock markets, and credit sales of industrial equipment are taxed at a 5% tax rate.
31. A 5% WHT rate is levied on royalties for the use of industrial, commercial or scientific equipment.
32. WHT is levied on 60% of gross royalties for the use of industrial, commercial or scientific equipment.
33. A 0% WHT rate is levied if the recipient is a company with at least a 20% interest in the paying company held directly or indirectly.
34. No WHT is levied if: (i) the beneficiary is a contracting state, one of its political subdivisions or one of its local entities; (ii) interest is paid in connection with the sale on credit of merchandise or equipment to a company of a contracting state; or (iii) interest is paid on a loan granted by a bank or financial institution resident in a contracting state.
35. A 5% WHT is levied if the beneficial owner is a company which directly holds at least 20% of the capital of the company paying the dividends.
36. 
    a. 5% WHT is levied if the interest is paid on a long-term loan (more than five years).

b. No WHT is levied: (i) if interest is paid to a Croatian bank, (ii) on interest arising from the acquisition of commercial, industrial, or scientific equipment, (iii) on interest arising from a credit sale.

37. No WHT is levied if: (i) the beneficiary is a contracting state, one of its political subdivisions or one of its local entities; (ii) interest is paid in connection with the sale on credit of merchandise or equipment to a company of a contracting state; or (iii) interest is paid on a long-term loan (five or more years) granted by a bank or financial institution resident in a contracting state.
38. Royalties for copyrights of any literary, theatrical, musical, or artistic work, excluding films and TV programs, are tax exempt if the recipient is resident in the other contracting state and taxed on such income in such state.
39. A 5% WHT rate is levied on interest arising from the sale of industrial, commercial or scientific equipment, the sale of merchandise from one business to another business, or the financing of construction, installation or assembly works. No WHT is levied if the interest is paid on a long term loan (more than five years) or if the interest is paid to the other contracting state or one of its political subdivisions or a financial institution totally owned by the other contracting state or one of its political subdivisions.
40. A 5% WHT rate is levied on royalties for copyrights of any literary, theatrical, musical, or artistic work (excluding films and TV programs).
41. A 9% WHT rate is levied on the gross amount of the dividends if the beneficiary owner is a company (other than a partnership) which has at least a 25% direct interest in the company paying the dividends.
42. WHT is not levied on interest if the recipient is a contracting state, one of its political subdivisions, or one of its public bodies or local authorities, or if the interest is paid to the Central Bank of the other contracting state.
43. No WHT is levied if the recipient is a company with at least a 50% direct interest in the company paying the dividends, provided that the dividends are distributed from profits taxed in Spain.
44. No WHT is levied on interest if: (i) the recipient is the other contracting state, its central bank or its political divisions; (ii) the payer is a contracting state or its political divisions, (iii) the interest arises from a loan or credit granted or guaranteed by a contracting state or its political divisions, (iv) the recipient is a qualifying financial institution; or (v) the recipient is a pension fund qualifying for tax purposes in a contracting state and the income from such fund is tax exempt in the contracting state paying the dividend.
45. No WHT is levied if the French company has at least a 10% direct interest in the company distributing the dividend.
46. No WHT is levied if the French company receives interest (i) from the other contracting state or any of its political divisions, (ii) from a resident in the other contracting state from an underlying commercial or industrial activity, (iii) in connection with a credit sale of industrial, commercial or scientific equipment, or (iv) for a loan granted by a financial institution.
47. No WHT is levied on royalties on copyright of any literary or artistic work (excluding films and TV programs) if the recipient is the beneficiary owner or royalties paid for the use or licensing of containers and bare hull vessels or aircraft used in international trade.
48. No WHT is levied on interest paid to ‘Deutsche Bundesbank’ or ‘Kreditanstalt für Wiederaufbau’.
49. Levied if the recipient is a company with at least a 25% direct interest in the paying company; otherwise, a 10% rate is levied.
50. No WHT is levied on interest if: (i) the interest is paid by a contracting state, one of its political subdivisions, or one of its local entities; (ii) the interest is paid to the other contracting state, one of its political subdivisions, or one of its local entities or to a body (including financial institutions) of such contracting state; or (iii) the interest is paid to another body (including financial institutions) in relation to loans granted by virtue of an agreement between both contracting states.
51. No WHT is levied on interest paid to the Central Bank of the other contracting state.
52. No WHT is levied on interest paid to companies in the other contracting state if the operation that generates the debt has been authorised by the government of the state where the company paying the interest is resident.
53. A 10% WHT rate is levied on royalties for the use or cession of use of industrial, commercial, or scientific equipment. The general 20% WHT rate is levied on technical services and other royalties.
54. No WHT is levied on interest if the recipient is a contracting state, one of its political subdivisions, or one of its local entities or if the interest is paid to the Central Bank or a financial institution controlled by the other contracting state, its political subdivisions, or its local entities.
55. No WHT is levied on interest arising from the credit sale of industrial, commercial, or scientific equipment.
56. Levied if the recipient is a company with at least a 20% interest in the paying company; otherwise, a 10% rate is levied.
57. Royalties for copyright on literary, theatrical, musical, or artistic work are taxed at a 5% WHT rate. Royalties on films or other means of audio or video transmission, for the use or right to use industrial, commercial, or scientific equipment, or on scientific works or under agreements between both states are taxed at an 8% rate.
58. A 5% WHT rate is levied on interest arising from the sale of industrial, commercial, or scientific equipment, the sale of merchandise from one business to another business or loans granted by a financial institution.
59. A 5% WHT rate is levied on royalties for copyright on literary, theatrical, musical, or artistic work (excluding films and TV programs).
60. A 4% WHT rate is levied on royalties for copyright on literary, theatrical, musical, or artistic work (excluding films and TV programs).

61. Reduced WHT rates are not levied when more than 75% of the shares of the recipient company resident in a contracting state are owned directly or indirectly by non-residents and the income generated by the paying company is not taxed in its country of residence.
62. Levied if the recipient is a company with at least a 25% interest in the paying company; otherwise, a 15% rate is levied.
63. No WHT is levied on interest arising from a loan guaranteed by a contracting state.
64. Consideration received for waiving, either totally or partially, the use or right to use goods or rights is considered to be a royalty.
65. No WHT is levied on interest paid in connection with the sale on credit of merchandise or equipment to a company of a contracting state or on interest paid on a long-term loan (five or more years) granted by a bank or credit institution resident in a contracting state.
66. No WHT is levied if the recipient is a company with at least a 5% direct interest in the paying company.
67. A 5% WHT rate is levied on royalties for technical services.
68. No WHT is levied on dividends paid to a shareholder resident in the other contracting state of the company distributing the dividend with at least a 25% interest.
69. A 10% WHT rate is levied on interest received by a bank (beneficial owner).
70. Levied if the recipient is a company with at least a 50% direct interest in the paying company. A 5% WHT rate is levied if the recipient is a shareholder with at least a 25% direct interest; otherwise, a 10% rate is levied. WHT is reduced to 5% if the recipient company is not taxed in the Netherlands for this dividend.
71. WHT is reduced to 10% if the recipient is a Dutch company with at least a 50% direct interest in the paying company or if the recipient holds 25% of its capital and another Dutch company holds at least the other 25%.
72. No WHT is levied on capital gains from sales of assets/rights when they are considered to be a royalty.
73.
    a. No WHT is levied on fees paid for the use or licensing of containers and bare hull vessels or aircraft used in international trade.
    b. A 5% WHT is levied if the beneficial owner is a company that has owned directly, during a period of six months, at least 50% of voting shares of the company paying the dividends; a 7.5% WHT is levied if the beneficial owner is a company that has owned directly, during a period of six months, at least 25% of voting shares of the company paying the dividends.
74. Levied if the recipient is a shareholder of the paying company holding voting rights with at least a 10% direct interest; otherwise, a 15% rate is levied.
75. A 10% WHT rate is levied on interest paid for bonds or similar securities generally offered to investors and related to transfers of industrial, commercial, or scientific equipment. No WHT is levied on interest from bonds or similar securities issued by the state or a local entity or from loans given or guaranteed by either of the two contracting states, Central Banks, or financial institutions as agreed between the contracting states.
76. A 20% WHT rate is levied on royalties for films or audio or TV tapes.
77. No WHT is levied on interest from loans granted or guaranteed by a contracting state.
78. If the recipient has invested more than EUR 100,000 in the company that pays the dividend or the dividend is tax exempt in its country of residence, the WHT rate levied is 10%. If both of these requirements are fulfilled, the rate applicable is 5%.
79. Interest on loans with a maturity period of over seven years is tax exempt.
80. A 10% WHT rate is levied on any patents, trademarks, designs or models, plans, secret formulae, or processes and computer software, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experiences. A 5% WHT rate is levied on any copyright of literary, artistic, or scientific work, excluding computer software and including cinematographic films or tapes used for radio or television broadcasting.
81. No WHT is levied on interest paid to a contracting state, one of its political subdivisions, or one of its local entities or interest paid in connection with the sale on credit of merchandise or equipment to a company of a contracting state or interest paid on any long-term loan (seven years minimum) granted by a bank resident in a contracting state.
82. No WHT is levied on interest arising from the credit sale of industrial, commercial, or scientific equipment or merchandise.
83. No WHT is levied on dividends when they are paid to a shareholder with at least a 25% interest held for at least two years, provided that the company distributing the dividends is effectively taxed.
84. No WHT is levied on interest paid to a bank resident in Switzerland on a long-term loan (over five years).
85. No WHT is levied if the royalties are paid between associated companies, affiliated by at least a 25% direct interest held for at least two years or both held by a third company with at least a 25% interest in both companies, and CIT is levied on all of the companies.
86.
    a. A 10% WHT rate is levied on interest received by financial and insurance entities. No WHT is levied on interest from loans granted by the government, Central Bank, or certain institutions.
    b. A 5% WHT rate is levied on royalties for any copyright of literary, artistic, theatrical, musical, or scientific work (excluding cinematograph films and films or tapes for radio or television broadcasting); an 8% WHT is levied on financial leasing related with the use or the right to use industrial, commercial, or scientific equipment.

87.
   a. Reduced WHT rates or exemptions are not levied/applied if the income is paid to a company resident in a contracting state more than 75% of whose shares are directly or indirectly held by non-residents and such income is not subject to taxation in such contracting state.
   b. Levied if the recipient is a shareholder of the paying company with at least a 50% interest; otherwise, a 15% rate is levied.
88. A 5% WHT rate is levied for long-term loans (more than seven years).
89. The WHT rate is 10% if the interest arises from a loan granted by a bank or is related to a credit acquisition of merchandise or equipment.
90. Levied if the recipient is a shareholder of the paying company with at least a 10% interest; otherwise, a 15% rate is levied.
91.
   a. No WHT is levied on royalties paid for the use or licensing of containers used in international trade.
   b. No WHT is levied on dividends when they are paid to a company holding at least a 75% direct interest in the paying company.
92. No WHT is levied if the interest is paid on a long-term loan (more than three years) to finance investment projects, if the interest is paid to a pension fund that meets certain requirements, or if the interest is paid in relation to a credit acquisition of merchandise, equipment, or services.
93. A 5% WHT is levied on royalties for any copyright of literary, artistic, or scientific work.
94. A 4.95% WHT rate is levied on interest received by financial institutions.
95. No WHT is levied on interest if: (i) the recipient is the other contracting state, its central bank, or its political divisions; (ii) the interest is paid by one contracting state or its political divisions, (iii) the interest arises from a loan or credit granted or guaranteed by a contracting state to promote exports and development, (iv) the recipient is a pension fund qualifying for tax purposes in a contracting state and the income generated from the fund is tax exempt in the contracting state paying the dividend, or (v) the interest is paid in relation to the credit acquisition of industrial, commercial or scientific equipment.
96. Levied if the recipient is a shareholder of the paying company with at least a 50% interest. A 10% WHT rate is levied if the recipient is a company with at least a 25% direct interest; otherwise, a 15% rate is levied.
97. No WHT is levied on interest arising from loans granted or guaranteed by qualifying public institution or interest paid to public financial institutions.

# *Tax administration*

## *Returns*

The tax system in Spain is a self-assessment system, and tax returns may be inspected by the tax authorities. The tax year for CIT purposes is the company's accounting year. The tax year cannot exceed 12 months, and the commencement, termination, or change of a tax year can give rise to a period of less than one year.

Annual CIT returns must be filed and the tax paid within 25 calendar days following the six months subsequent to the end of the tax year (i.e. if the tax year coincides with the calendar year, the return must be filed between 1 July and 25 July of the following calendar year).

## *Payment of CIT*

For CIT, three on-account payments of the annual tax payment must be made during the first 20 calendar days of April, October, and December. Large companies must calculate these advance payments as a percentage (21%) of their annual tax profits for each period, i.e. at 31 March, 30 September, and 30 November. Some allowances and the tax year advance payments can be credited against this percentage of tax profits. Small companies can opt to calculate their advance payments in the same way as large companies or to apply a rate (currently 18%) on the tax liability arising from the CIT returns that should have been filed in April, October, and December.

## Other issues

### *Special tax regime applicable in the Basque Country*

The three provinces that make up the region of the Basque Country (Alava, Guipúzcoa and Vizcaya) have an 'economic agreement' with Spain's central government (laid down and regulated by Law 12 of 23 May 2002) in accordance with which these regions are granted the right to regulate their own tax regimes.

There are certain provisions in this law regarding CIT which make this area of Spain more attractive for companies.

#### General tax rate

The general tax rate is 28%.

#### Lower tax rates

A reduced rate of 24% is levied on small companies. From 1 January 2010, a small company is considered to be a company which meets the following requirements in the year prior to the application of the special tax regime:

- Carries on an economic business activity.
- Net turnover or assets under EUR 10 million.
- Average number of staff under 50.
- An interest of 25% or more in the company is not held, directly or indirectly, by a company that does not meet the above requirements.

A 20% rate (24% in Guipúzcoa) is levied on real estate companies which comply with the following requirements:

- Their share capital is wholly owned by individuals during the whole tax year.
- More than half of their assets are securities or more than half of their assets are not used for economic business activities during at least 90 days of the tax year.
- At least 90% of their profits are generated from investment income and capital gains.

A 21% rate is levied on companies that are floated on the Bilbao Stock Exchange and on brokerages and cooperatives. Companies that are floated on the Bilbao Stock Exchange are taxed at this rate for three years, as long as they are in compliance with certain requirements.

#### Tax-loss carryforwards

Tax losses may be carried forward for the following 15 years in Guipúzcoa. In Vizcaya and Alava, there is no time limit for the offsetting of tax losses.

#### Tax deductibility of amortisation of goodwill and intangible assets

Amortisation recorded for intangible assets (irrespective of whether they have a specific useful life or not), including goodwill, is tax deductible up to a maximum annual limit of 20%, subject to compliance with the following requirements:

- The assets have been acquired for consideration.
- The acquiring and transferring companies are not associated parties.

#### Financial goodwill

Financial goodwill is tax deductible over a period of five years when at least a 5% interest is acquired in the company and these shares are not quoted on a Stock

Exchange or, if they are quoted on a Stock Exchange, they are shares of group or associated companies.

If the company from which the shares have been acquired has an interest in another company, the equity, assets and rights recorded in the group's consolidated annual accounts must be taken into consideration for the purpose of calculating the amount of the financial goodwill.

If the company from which the shares have been acquired is a non-resident company, in addition to the requirements stated above, the following requirements must be fulfilled:

- The company is subject in its country of residence to a tax which is identical or similar to Spanish CIT.
- The company carries on business activities abroad.

If the shares are not acquired on a stock market, the company which acquires the shares must not be in any of the situations provided for in Article 42 of the Spanish Commercial Code in relation to the transferring company.

### Depreciation periods
The depreciation periods for assets are shorter than those under state CIT law.

### Reinvestment of extraordinary income
Income obtained from the sale of tangible fixed assets or intangible assets can be deducted from taxable income, subject to compliance with the following requirements:

- The amount obtained from the sale is reinvested in similar types of assets within a four-year period (as from one year prior to the sale up to three years after the sale).
- The asset in which the reinvestment is made is maintained for five years (three in the case of movable assets), unless its useful life is shorter.
- For sales of shares in other companies when the interest held is at least 5% and has been held or a period of one year prior to the date of sale, 60% of the income obtained from the sale can be deducted from taxable income.

### Income generated from intellectual or industrial property
30% of the income obtained from the transfer of intellectual or industrial property rights can be deducted from taxable income, subject to compliance with certain requirements, and 60% if the company has created the intellectual or industrial property itself. There are no quantity limits to be complied with for the application of this deduction.

### Investments in new tangible fixed assets
A 10% tax credit can be applied to investments in new tangible fixed assets, subject to compliance with certain requirements. The minimum depreciation period for the assets, excluding computer equipment, is five years.

The total amount of the investment must be over EUR 60,100 and the investment must comply with at least one of the following requirements:

- Exceeds 10% of the carrying amounts (minus depreciation/amortisation) of the company's tangible fixed assets, buildings and software during the previous year.
- Exceeds 15% of the carrying amount of the same type of tangible fixed assets of the company during the previous year.

### Special reserve for investments in production
A tax credit can be applied for the distribution of profits to a special reserve for investments in production, subject to compliance with the following requirements:

- The company invests the amount distributed to the reserve in new tangible fixed assets during the following two years.
- These assets are maintained by the company during a five-year period or during their useful life if it is less than five years.
- The company's shareholder's equity is increased by the amount distributed to the reserve, and this increase is maintained for a five-year period as from the date on which the investment was made.

The tax credit is 10% of the profits distributed to the reserve.

### Research and development
A 30% tax credit can be availed of for expenses incurred from R&D activities. If the expenses are higher than the average expenses incurred by the company during the previous two years, the tax credit is 50% on the excess amount.

An additional tax credit of 20% can be availed of for the following expenses:

- Staff expenses incurred for staff exclusively carrying out and qualified to carry out R&D activities.
- Expenses incurred for projects contracted from certain universities and public organisations.

A 10% tax credit can be availed of for investments made in tangible fixed assets (excluding buildings) and intangible assets which are exclusively assigned to R&D activities.

### Technological innovation
A 20% or 15% tax credit can be availed of for certain expenses incurred for technological innovation.

### Expenses incurred for environmental conservation and improvement and for conservation of energy
Companies are eligible for a 30% tax credit for investments made in the equipment listed in the Basque List of Environmental Technologies, subject to compliance with certain requirements.

Companies may also qualify for a 15% tax credit for investments made and expenses incurred in respect of tangible fixed assets, subject to compliance with certain requirements.

### Export investments (e.g. foreign advertising, formation of companies, and branches abroad)
As in state CIT law, for periods starting from 1 January 2011, there is no tax credit for export investments.

### Staff training
A 10% tax credit can be applied to expenses incurred in staff training. If the expenses are higher than the average training expenses incurred by the company during the previous two years, the tax credit is 15% of the excess amount.

A tax credit can also be applied for expenses incurred to obtain the Occupational Health and Safety Assessment Sequence (OHSAS) 18001 certificate and to train staff in new technologies.

### Job creation
For tax years commencing during the period 1 January 2010 to 31 December 2011, the following tax credits can be availed of for job creation, subject to compliance with the requirements stated:

- EUR 4,600 for each job created provided that a permanent employment contract is signed with the employee.
- EUR 8,600 for each job created provided that a permanent employment contract is signed with the employee and a person who has special difficulties in finding employment is contracted.

The company's average number of staff with permanent employment contracts must be increased by at least the same number of contracts that generated the tax credit and this increase must be maintained by the company for two years.

### Corporate contribution to an EPSV
A tax credit of 10% applies to corporate contributions to certain pension schemes in favour of the staff of the company, up to the limit of EUR 8,000 per employee each year.

For tax years commencing before 31 December 2011, an additional tax credit of 50%, up to the limit of EUR 200 per employee, could be applied on the excess amount contributed in comparison with the previous year's contribution.

### Time limits for the application of tax credits
In Guipúzcoa, tax credits can be carried forward for a period of 15 years as from the date on which the company qualifies for them. In Vizcaya and Alava, there is no time limit for the application of tax credits.

### Limits on the amount of tax credit applied
The combined sum of all investment tax credits, excluding tax credits for R&D and technological innovation, may not exceed 45% of the company's CIT liability.

### Interim payments
There is no obligation to make interim payments on account of CIT.



### Special Regime for small and medium-sized companies
A small company is considered to be a company which meets the following requirements during the year prior to the application of the special tax regime:

- Carries on an economic business activity.
- Net turnover or assets under EUR 10 million.
- Average number of staff under 50.
- An interest of 25% or more in the company is not held, directly or indirectly, by a company that does not meet the above requirements.

A medium company is considered to be a company which meets the following requirements during the year prior to the application of the special tax regime:

- Carries on an economic business activity.

- Net turnover under EUR 50 million or assets under EUR 43 million.
- Average number of staff under 250.
- An interest of 25% or more in the company is not held, directly or indirectly, by a company that does not meet the above requirements.

The benefits derived from this special tax regime are as follows:

- Free depreciation for new tangible assets (except buildings) for small-sized companies (general free depreciation relief set forth for tax years 2009 to 2015 is not applicable in the Basque Country).
- Accelerated depreciation for new tangible assets (except buildings) for medium-sized companies.
- Global bad debt provisions up to 1% of credit sales and services of small- and medium-sized companies are tax deductible for CIT purposes. Provisions for possible insolvency of credit sales and services are tax deductible up to a limit of 1% of the amount of credit sales and services at the end of the period.

# Sri Lanka

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## Significant developments

The highlight of the 2011 Budget is the reduction of the corporate income tax (CIT) rates, as follows:

| Entities | CIT rate for tax year 2010/2011 (%) | CIT rate for tax year 2011/2012 (%) |
|---|---|---|
| Companies, including non-resident companies, where taxable income exceeds LKR* 5 million | 35 | 28 |
| Companies, including non-resident companies, where taxable income does not exceed LKR 5 million | 15 | 12 |
| Quoted public companies | 33 1/3 | 28 |
| Companies which engage in export, fisheries, tourism, and construction | 15 | 12 |
| Companies engaged in the manufacture or import of liquor or tobacco products. | 35 | 40 |
| Companies engaged in agriculture | Exempt | 10 |
| Companies engaged in the manufacture of animal feed | 35 | 12 |
| Companies engaged in deemed exports | 15 | 12 |
| Companies engaged in the operation and maintenance of facilities for storage, development of software, or supply of labour | 35 | 10 |
| Companies engaged in educational services | 35 | 10 |
| Companies whose annual turnover does not exceed LKR 300 million | 35 | 10 |
| Venture capital companies | 20 | 12 |
| Clubs and associations | 20 | 10 |

* Sri Lankan rupees

## Taxes on corporate income

Resident companies and public corporations are liable for CIT on their worldwide taxable income. Non-resident companies are liable for CIT of their Sri Lanka-source taxable income.

As of 1 April 2011, the CIT rate for companies, including public corporations and quoted public companies, with taxable income greater than LKR 5 million is 28%. The CIT rate for companies with taxable income less than or equal to LKR 5 million is 12%. Prior to

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1 April 2011, the rates were 35% (33 1/3% for any quoted public company, for five years from the year in which it becomes a quoted public company) and 15%, respectively.

As of 1 April 2011, the CIT rate for companies whose annual turnover does not exceed LKR 300 million is 10%. Prior to 1 April 2011, the CIT rate for such companies was 35%.

### Marginal relief
Where the taxable income of any company for any year of assessment exceeds LKR 5 million but does not exceed LKR 6,111,111, then such part of the tax computed for such year of assessment as is attributable to such excess shall not be more than such excess.

### Industry-specific rates
As of 1 April 2011, a 12% CIT rate applies to profits from exports, fisheries, tourism, and construction. The lower CIT rate applicable to the construction industry, however, is restricted to resident companies only. Prior to 1 April 2011, the CIT rate on such profits was 15%.

As of 1 April 2011, a 40% CIT rate applies to profits from companies engaged in the manufacture or import of liquor or tobacco products. Prior to 1 April 2011, the CIT rate on such profits was 35%.

As of 1 April 2011, a 10% CIT rate applies to profits from companies engaged in agriculture. Prior to 1 April 2011, such profits were exempt from CIT.

As of 1 April 2011, a 12% CIT rate applies to profits from companies engaged in the manufacture of animal feed. Prior to 1 April 2011, the CIT rate on such profits was 35%.

As of 1 April 2011, a 12% CIT rate applies to profits from companies engaged in deemed exports. Prior to 1 April 2011, the CIT rate on such profits was 15%.

As of 1 April 2011, a 10% CIT rate applies to profits from companies engaged in the operation and maintenance of facilities for storage, development of software, or supply of labour. Prior to 1 April 2011, the CIT rate on such profits was 35%.

As of 1 April 2011, a 10% CIT rate applies to profits from companies engaged in educational services. Prior to 1 April 2011, the CIT rate on such profits was 35%.

As of 1 April 2011, the CIT rate applicable to venture capital companies is 12%. Prior to 1 April 2011, the applicable CIT rate was 20%.

Unit trusts and mutual funds are treated like resident companies for CIT purposes. Units of investment are treated like company shares, and returns to investors are treated like company dividends. The tax rate is 10% on the profits derived by any unit trust or mutual fund.

### Dividend tax
A dividend tax is payable at 10% on the gross dividends distributed by a resident company, other than such dividends distributed out of any dividend received from another resident company (and few other exceptions).

### Deemed dividend tax
A deemed dividend tax of 15% is payable by any resident company in any tax year if the said company has, in the preceding tax year, distributed dividends of less than 10%

(25% prior to 1 April 2011) of the distributable profits (duly defined) for that preceding tax year.

The tax base for the 15% deemed dividend tax is the book profits of the company reduced by the aggregate of the income tax payable by that company for that year of assessment, the cost incurred by the company in that year of assessment in the acquisition of any land or any capital assert, and any notional profit computed on the bases of a revaluation of any capital asset included in such book profit and increased by the aggregate of the allowance for depreciation deducted in respect of any capital asset and any notional loss computed on the basis of a revaluation of any capital asset included in such book profit.

### *Remittance tax*

Where profits of a non-resident company are remitted in a tax year, a remittance tax is payable in an amount equal to 10% of the remittances.

### *Surtax*

Public corporations are also subject to tax of an additional amount, the excess (if any) of 25% of the balance of profits left after deduction of the CIT payable over the amount of gross dividends distributed out of profits on which taxable income is computed.

### *Social responsibility levy*

Prior to 1 April 2011, a 1.5% social responsibility levy was payable by every company on the amount of CIT, dividend tax, deemed dividend tax, and remittance tax. This levy has been removed as of 1 April 2011.

## *Corporate residence*

A company is treated as resident for tax purposes in Sri Lanka if its registered or principal office is in Sri Lanka or if the control and management of its business is exercised in Sri Lanka.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is payable on imported goods and on the supply of goods (excluding, in particular, the supply to merchants who purchase goods locally) and services in Sri Lanka. Provisions are made for filing returns monthly or quarterly, based on specified criteria. Even where returns can be filed quarterly, the tax payments are required to be made on a monthly basis. Certain specified imports and domestically supplied goods and/or services are exempt.

VAT is payable on the prescribed valuations of imports and domestic supplies at a standard rate of 12%. There was a higher rate of 20% for luxury items, which was abolished effective from 1 January 2011. Exports and certain specified international services are zero-rated.

No registration for VAT is necessary if the total value of taxable supplies in a quarter is LKR 650,000 or less, or LKR 2.5 million or less in a year.

The input tax paid on the imports and supplies of goods (including capital goods) and services in a month, and used in the business of making taxable supplies in that month, can be deducted from the tax payable (output tax) on such supplies, subject to a limitation of the lesser of 100% (85% prior to 1 January 2011) of output tax or the actual input tax paid.

Refunds of excess VAT paid are available to zero-rated supplies, to suppliers who are qualified to issue suspended tax invoices, and to new businesses registered under Section 22 (7) of the VAT Act.

### *Economic service charge (ESC)*

ESC is payable quarterly by every person (a person includes a company) in respect of the aggregate turnover of the trade, business, profession, or vocation at rates varying from 0.1% to 1%, depending on the business activity, if the total turnover exceeds LKR 25 million (7.5 million prior to 1 April 2011) for that quarter. ESC so paid is deductible from the CIT payable for that year of assessment. ESC is not refundable but can be carried forward for four immediately succeeding tax years and offset against CIT payable for those four tax years. Maximum ESC payable for any quarter is LKR 30 million.

### *Nation building tax (NBT)*

NBT is chargeable at 2% (3% prior to 1 January 2011) from every person (a person includes a company) who imports any article on the 'liable turnover' from such importation and who carries on the business of manufacture of any article or carries on the business of providing a service of any description on the liable turnover of the relevant quarter. Certain specified articles or services are exempt from NBT.

Liable turnover means:

- In the case of importer, the value of any article ascertained under section 6 of the VAT Act for the purpose of importation.
- In the case of manufacturer, the proceeds receivable, whether received or not, from the manufacture and sale in Sri Lanka.
- In the case of service provider, the proceeds receivable, whether received or not.

As of 1 January 2011, wholesale and retail traders are also liable to pay NBT; however, 50% of the liable turnover will be taxed at a zero rate and the remaining 50% will be taxed at 2%. In the case of a distributor as defined in the ESC Act, 75% of the liable turnover will be taxed at a zero rate and the remaining 25% will be taxed at 2%.

Bad debts, VAT, and excise duty should not be included in the liable turnover.

### *Turnover tax*

Prior to 1 January 2011, a turnover tax at rates varying from 1% to 5% of turnover was charged on any person who bought or sold articles in any area of Sri Lanka. This tax has been abolished as of 1 January 2011.

### *Excise duties*

Excise duties and special excise levies are charged on tobacco, cigarettes, liquor, motor vehicles, selected petroleum products, paints, air conditioners, dishwashers, household washing machines, and other products.

### *Stamp duty*

Stamp duty is payable on specified instruments and documents at rates prescribed in the Gazette.

### *Construction industry guarantee fund levy*

Construction industry guarantee fund levy is payable by each construction contractor or subcontractor on the contract value arising from any contract entered into, calculated at rates varying from 0.25% to 1%, depending on the value of the construction contract. As of 1 April 2009, any person or partnership that makes any payment, which is subject to such levy, to a contractor should deduct such levy as a withholding tax (WHT) and remit the amount withheld to the Commissioner General of Inland Revenue.

### *Tourism development levy*

Tourism development levy is payable by tourist hotels and institutions licensed under the Tourist Development Act on the turnover of such institution at the rate of 1%.

### *Employees Provident Fund (EPF)*

Employers and employees are required to contribute specified percentages (employer 12%; employee 8%) of each employee's monthly emoluments/salary to the EPF established by the Government. Alternatively, employers and employees must contribute to certain private provident funds approved by the labour authority.

### *Employees Trust Fund*

Employers are also required to contribute a specified percentage (currently 3%) of each employee's monthly emoluments/salary to the Employees Trust Fund established by the Government.

### *Share transaction levy*

Share transaction levy at the rate of 0.3% (0.2% prior to 1 January 2011) is chargeable from the buyer and from the seller on the sale of listed shares.

### *Local taxes*

Taxes (more usually called rates) are currently assessed and collected annually from the owners of land and premises by the local authorities of the areas in which the properties are located. These authorities also charge and collect annual licence fees from certain businesses as well.

## *Branch income*

Foreign companies are permitted to register a place of business in Sri Lanka or to be registered as an overseas company under local company law, where the business carried on conforms to the stipulations made under the exchange control law.



An overseas company registered under the companies act may carry on in Sri Lanka any non-commercial, non-holding, or non-industrial activities, such as the activities undertaken or carried on by a liaison office, representative office, regional office, or other similar office, provided such activities do not provide any income directly or indirectly to the company.

In addition to paying the standard CIT, a branch is also subject to the 10% remittance tax on remittance to its foreign head office.

The Sri Lanka-source income of foreign companies from a local 'place of business' is taxed at the CIT rate. However, under most double-taxation-avoidance treaties that Sri Lanka has entered into, the income of a turnkey or service project will not be liable for CIT if its duration is less than a period specified in the treaty concerned.

Where branch or project income is liable for CIT but the income is not readily ascertainable, the tax authority may prescribe that the income be computed on a fair percentage (not less than 6%) of the branch or project turnover in Sri Lanka.

## Income determination

Business accounting for income tax purposes should, unless otherwise specified by the tax statute, conform to Sri Lanka Accounting Standards.

### Inventory valuation

Inventories should be measured at the lower of cost and net realisable value.

### Capital gains

There is no capital gains tax. Capital gains from transfer of property are exempt from CIT.

### Dividends

Resident company dividends paid on shares held by resident or non-resident persons are not assessable to the recipients if income tax is withheld on such dividends *(see the Withholding taxes section)*, the dividends are exempt from income tax, or the dividends are paid out of dividends received from resident companies.

Stock dividends (bonus shares) are not taxable in the hands of a shareholder at the time of issue; but where such shares are capitalised out of company profits and there is a return of this capital to the shareholder within six years from the date of issue, the amount of capital returned to the extent of the paid-up value of the bonus shares is treated by definition as a dividend and is taxable in the hands of the shareholder. However, if the shareholder is a company, this dividend may not be assessable, as explained above.

## Deductions

In ascertaining the total income liable to CIT from the financial accounts filed by a company, deductions from revenue are permitted for outgoing and matching expenses incurred in producing the income, including special deductions.

### Depreciation

An annual allowance for depreciation for wear and tear is calculated at:

- 33 1/3% for plant, machinery, or equipment for a period of three years.
- 25% of the cost of any information technology for a period of four years.
- 20% of the cost of acquisition of any motor vehicle or furniture for a period of five years.
- 10% of the cost of any qualified building for a period of ten years.

Prior to 1 April 2011, the depreciation rate was 12.5% for a period of eight years for plant, machinery, and equipment and 6 2/3% for a period of 15 years for any qualified building.

The cost of renewal of any capital asset, if no allowance exists, is deductible for the purpose of ascertaining profits and income.

### *Bad debts and doubtful debts*
In the case of a bank or financial institution, deductibility of a specific bad debt provision is restricted to the lesser of the actual amount of the provision or 1% of the aggregate debts as at the end of the period for which profits are ascertained.

### *Interest*
Interest paid or payable on borrowings for purposes of business are deductible, subject to the thin capitalisation rules *(see the Group taxation section)*.

Deductions from the total income from all sources of a company are allowed for any interest payable on loans used for the construction or purchase of any building or the purchase of any site for construction of a building; for any annuity, ground rent, or royalty payable; or for a business loss other than a loss incurred in any business of life insurance and any business of finance leasing, including any loss current or brought forward from a previous year, up to a maximum limit of 35% of the total statutory income in determining the residual balance income, which would be assessable for income tax. Where such deductions exceed the total income, any unrelieved excess is carried forward for deduction in the succeeding tax year from its total statutory income for that year of assessment and so on.

### *Charitable contributions*
Relief is available as a deduction from assessable income for contributions in money to an approved charity, if the charity is established for the provision of institutionalized care for sick or the needy, and contributions in money or in kind to the Government of Sri Lanka. The deduction for the former is subject to a ceiling of one-fifth of the assessable income of the company. In the case of the latter, there is no limit to the deduction, and any un-recouped excess of such contributions over the assessable income is available for carry forward deduction from the following year's assessable income and so on.

### *Royalties*
No deduction is allowed for a royalty paid by a person outside Sri Lanka to another person outside Sri Lanka.

### *Formation or liquidation expenses of a company*
In the case of a company, expenses incurred in the formation or liquidation of that company are allowed in computing the taxable income.

### *Terminal gratuities*
Termination gratuities paid to employees on cessation of business and annual payments made to an approved fund, held for payment under compulsory legislation of gratuities to employees upon termination of their services, are deductible.



### *Taxes*
Sri Lanka income tax payable or any income tax or other similar tax payable in any country with which Sri Lanka has a double-taxation-avoidance treaty is not deductible, other than the excess of the foreign-country tax on doubly taxed income over the maximum amount of the credit allowed in the foreign country for the Sri Lanka income tax on that income.

Taxes paid in a foreign country that does not have a tax treaty with Sri Lanka may be deducted.

NBT paid/payable is fully deductable as of 1 January 2011. Prior to 1 January 2011, 2/3 of NBT was disallowed.

Input VAT is not deductible from CIT since it is creditable against output VAT.

Any other prescribed tax or levy is not deductible.

### *Non-deductible expenses*

Deductions not permitted for certain expenses or allowances, in the determination of total income, are itemised below:

- Business entertainment expenses incurred or entertainment allowances paid to executive officers.
- Any expenditure of a capital nature or any loss of capital, including book depreciation of capital assets.
- Depreciation allowances or rentals or annual payments or renewals in respect of vehicles used for purposes of business travel, or capital assets provided for the use of employees at their places of residence, other than motorcycles or bicycles used by non-executive staff and motor coaches used to transport employees to and from their places of work.
- The excess of management fee paid over LKR 2 million (LKR 1 million prior to 1 April 2011) or 1% of turnover, whichever is lower, or such amount as may be determined by the tax authorities. This restriction does not apply to a venture capital company, unit trust, or mutual fund.
- As of 1 April 2011, any foreign travel or foreign training expense incurred in the production of income of any trade, business profession, or vocation is deductible, subject to a maximum limit of 2% of the previous year's statutory income from the respective trade or business. Prior to 1 April 2011, foreign travel expenses incurred in connection with a business were not deductible, other than those expenses incurred solely in connection with the promotion of the export trade, or the provision of any services for payment in foreign currency or in carrying out an approved programme for the promotion of tourism.

### *Net operating losses*

No deduction from total income is allowed in a tax year for a business loss if, at any time in that year, more than one-third of the issued share capital of the loss-making company is held by persons who did not hold such share capital at any time in the year in which the loss was incurred. In such circumstances, the loss is deferred for deduction only from profits of the particular business in which the loss was incurred.

Any loss incurred in any business of life insurance can be deducted to the extent of any profits from such business included in such total statutory income. Similarly, any loss incurred in any business of finance leasing can be deducted to the extent of any profits from such leasing business included in such total statutory income.

Losses incurred in the creation of a trade or business may be carried forward indefinitely but only up to 35% of statutory income. Carryback of losses is not permitted.

## *Group taxation*

There are no special provisions for taxation of companies in a group in Sri Lanka. Each company is taxed independently of others in the group.

### Thin capitalisation

Deductible interest payments made between members of a group of companies, including holding companies, are restricted to the debt equity ratio of 3:1 for manufacturing companies and 4:1 for other companies.

## Tax credits and incentives

### Tax holidays

A tax holiday is available to companies engaged in:

- Agriculture, agro processing, industrial and machine tool manufacturing, machinery manufacture, electronics, export of non-traditional products, or information technology and allied services.
- Any designated project.
- An undertaking for large-scale infrastructure development.
- Small-scale infrastructure undertakings for generation of power, tourism, recreation, warehousing and cold storage garbage collection or disposal, construction of houses, or hospitals.

The period of the tax holiday will be determined by reference to the nature of the undertaking and the amount invested in the project, as follows:

- A five-year tax holiday is available to a new venture capital company satisfying specified criteria.
- A five-year tax holiday is granted for the profits from the new undertaking of a company that is engaged solely in research and development (R&D) in the field of science or technology with the object of using the results thereof for the production or improvement of products with a minimum investment of LKR 2 million.
- Tax holidays outside the purview of the tax statute are also available in specified areas of investment to companies that enter into agreements with the Board of Investment (BOI) of Sri Lanka and to any strategic development projects indentified in accordance with the provisions of the strategic Development projects Act No 14 of 2008. The specified areas include non-traditional export-oriented manufacturing and thrust industries, export-oriented services, large-scale projects of which the project cost exceed LKR 500 million. Generous waiver of import duties on specified imports and other concessions are also available for these companies.
- Profits and income derived from the sectors of fishing, cultivation, and primary processing of agriculture seeds or planting materials will be exempt from CIT for a period of five years reckoned from the year of assessment commencing from 1 April 2011.



### Inbound investment incentives

- Exemption from CIT is granted on the profits and income earned in foreign currency, remitted to Sri Lanka net of expenses (considered reasonable by the tax authority), by a resident company in respect of services (including a construction project) rendered outside Sri Lanka.
- Exemption from CIT is granted on the profits and income earned in foreign currency by any resident company in Sri Lanka from the services rendered in or outside Sri Lanka in respect of any profession or vocation as is specified by the Commissioner General by notice published in the Gazette, if such profits and income (less such amount, expended outside Sri Lanka as is considered by the Commissioner General to be reasonable expenses) are remitted to Sri Lanka through a bank. As of 1 April

2011, this exemption is extended to cover any service, excluding commissions, discount, or similar type of receipts.
- Exemption from CIT is granted in respect of dividends or interest received on investments made outside Sri Lanka, provided that dividends and interest are remitted to Sri Lanka through a bank.

### *Other incentives*

- New or existing companies that export non-traditional goods are entitled to be taxed on the profits from these exports or services at a concessionary rate of 15% for a period of 20 years, ending on 31 March 2014 and 2015, respectively. As of 1 April 2011, the applicable rate is 12%. Dividends paid by such companies out of profits earned from the exports of non-traditional goods, which are taxed at 15%, are in turn liable to tax of 10% in the hands of corporate shareholders where the income tax is already withheld from the dividends *(see the Withholding taxes section)*.
- Exemption from CIT is granted on the profits arising from trading in shares, rights to any share, bonus, or share warrants in respect of which the share transaction levy has been charged.
- Exemption from CIT is granted on an amount equal to the interest or the discount paid or allowed to any non-resident person or to any licensed commercial bank in Sri Lanka by the issuer of any sovereign bond denominated in foreign currency, issued on or after 21 October 2008, by or on behalf of the government of Sri Lanka and on the profits and income from the sale of such sovereign bond.
- Exemption from CIT is granted on an amount equal to the interest or the discount paid or allowed to any person on or after 1 April 2009, on any Sri Lanka Development Bond denominated in United States dollars, issued by the Central Bank of Sri Lanka and on the profits and income from the sale of such Sri Lanka Development Bond.
- Exemption from CIT is granted on the profits and income derived by or accruing to any person or partnership from investment in Economic Resurgence Certificates, utilising money lying to credit of any account opened in any commercial bank or in any specialised bank with the approval of the Central Bank of Sri Lanka from and out of monies deposited in such account on or after 1 February 2009.

## *Withholding taxes*

Resident companies are entitled to withhold income tax at 10% of gross dividends payable to any shareholder that is chargeable with CIT, excluding any dividend received from another resident company and any dividend that is exempt from CIT.

Any person in Sri Lanka who pays or credits to a person or partnership outside of Sri Lanka any sum due as interest, rent, ground rent, royalty, or annuity is required to withhold income tax at a rate of 20% of the sum, but the requirement to withhold income tax does not apply to interest not sourced in Sri Lanka or to interest on any loan or advance made by a banker or to interest paid on foreign currency held in an account with a foreign currency banking unit.

In particular instances, the tax authority may prescribe that CIT be withheld at a rate other than 20%, or the rate may be reduced for sums falling due as interest or royalties in respect of persons resident in countries with which Sri Lanka has double taxation treaties in force. Sri Lanka-source income from loan interest or royalties accruing to a non-resident company is taxed at a flat 20%, in the absence of a lower rate in the tax treaty with the home country of the non-resident.

Every bank and financial institution is required to withhold income tax at 10% on the amount of any interest paid to a company on any sum of money deposited with it. The depositor is entitled to receive a certificate setting out the gross amount of interest, the amount of tax withheld, and the net amount of interest paid. With respect to Treasury bills and Treasury bonds issued by the Central Bank, the WHT rate of 10% applies to an investor from any country.

Prior to 1 April 2011, every person or partnership that paid a fee to another person or partnership in consideration for services rendered by the latter in the course of any business, profession, vocation, or activity of an independent character was required to withhold income tax at 5% of such fee and furnish a certificate to the payee similar to that described above. The WHT requirement was extended to any commission, brokerage fee, or other income of a like nature, and also to any payment for supply of an article on contract through a tender or quotation. As of 1 April 2011, the 5% WHT has been abolished.

10% WHT on rent, lease rent, or other payment for the use or occupation of any land or building has also been abolished as of 1 April 2011.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Australia | 15 | 10 | 10 |
| Bangladesh | 15 | 15 | 15 |
| Belgium | 15 | 10 | 10 |
| Canada | 15 | 15 | 10 |
| China | 10 | 10 | 10 |
| Denmark | 15 | 10 | 10 |
| Finland | 15 | 10 | 10 |
| France | 15 | 10 | 10/0 (1) |
| Germany | 15 | 10 | 10 |
| Hong Kong (4) | – | – | – |
| India | 15 | 10 | 10 |
| Indonesia | 15 | 15 | 15 |
| Iran | 10 | 10 | 8 |
| Italy | 15 | 10 | 10 |
| Japan | 10 | 15 (2) | (3), 0 (1) |
| Korea, Rep. of | 15/10 | 10 | 10 |
| Kuwait (4) | – | – | – |
| Malaysia | 15 | 10 | 10 |
| Mauritius | 15/10 | 15/10 | 10 |
| Nepal | 15 | 10/15 | 15 |
| Netherlands | 15/10 | 15/10 | 10 |
| Norway | 15 | 10 | 10/0 (1) |
| Oman (4) | – | – | – |
| Pakistan | 15 | 10 | 20 |
| Philippines | 10 | 10 | 10 |
| Poland | 15 | 10 | 10 |
| Qatar | 10 | 10 | 10 |
| Romania | 12.5 | 10 | 10 |
| Russia | 10/15 | 10 | 10 |

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| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Saudi Arabia | – | – | – |
| Singapore | 15 | 10 | 15 |
| Sweden | 15 | 10 | 10 |
| Switzerland | 15/10 | 10 | 10 |
| Thailand | 15 | 10 | 15 |
| United Arab Emirates | 10 | 10 | 10 |
| United Kingdom | 15 | 10 | 10 |
| United States | 15 | 10 | 10 |
| Vietnam | 10 | 10 | 15 |

Notes

1. 0% for copyright royalties.
2. 0% in certain circumstances.
3. 50% of normal tax, which is 7.5%.
4. These treaties are limited to the avoidance of double taxation of income from international transport by air.

## *Tax administration*

### *Returns*

A tax year is any period of 12 consecutive months reckoned from 1 April in any calendar year to 31 March of the following year.

### *Payment of tax*

Sri Lanka has a pay-and-file system under which the CIT payable for each tax year is required to be paid in four instalments, on or before 15 August, 15 November, and 15 February of the tax year and 15 May immediately following the end of the tax year. If each instalment is not less than one-quarter of the CIT payable for the tax year immediately preceding, the balance of any CIT payable may be paid on or before 30 September immediately following the end of the tax year without incurring penalties.

# Swaziland

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## Significant developments

As of 1 January 2011, the Swaziland Revenue Authority was established. This Authority amalgamated the Department of Customs and the Department of Taxes. Although no amendments were made to their corresponding governing legislation, the letter of the law is being applied with a policy of zero tolerance for non-compliance.

## Taxes on corporate income

All companies within Swaziland are taxed on income at a flat rate of 30%.

## Corporate residence

Income tax is levied on all income derived from sources generated within or deemed to be generated within the country, irrespective of whether the recipient of the income is actually resident in Swaziland.

## Other taxes

### Sales taxes

Sales tax is levied at a rate of 14% (25% for liquor and cigarettes) on goods imported into Swaziland and on the first sale of goods manufactured for sale in Swaziland. Customs and excise duties are also imposed on such goods. The 14% sales tax is also applicable to most professional services.

### Customs duties

Swaziland has a provision for customs duties for various goods imported into the country. Details are available in the Harmonized Tariff Schedule (HTS).

### Excise duties

Swaziland has an excise duty provision for various goods manufactured in the country.

| Goods | Excise duty rate (%) |
|---|---|
| Cigarettes | 6.34 |
| Cigarette tobacco | 8 |
| Cigars | 6.19 |
| Other tobacco products | 16.1 |
| Spirits | 8.9 |

| Goods | Excise duty rate (%) |
|---|---|
| Beer | 8.2 |
| Alcoholic fruit beverage | 8.3 |
| Wine | 8.1 |

### *Transfer taxes*
Transfer taxes are applied on a variable rate basis to property transfers based on the fair market value of the property being transferred.

### *Stamp taxes*
Swaziland has a provision for stamp taxes on various documents. The tax is determined either by way of a set fee or on a sliding scale percentage basis.

## *Branch income*

Income tax on registered branch profits is calculated as for a resident company, and a branch profits tax of 15% is assessed for deemed repatriated income. In practice, however, branches are rare since most foreign companies incorporate local subsidiary companies.

| | |
|---|---|
| Net profit before tax | 100 |
| Tax @ 30% | 30 |
| **Repatriated income** | **70** |

## *Income determination*

### *Inventory valuation*
Inventory valuation is not specific but is effectively at the lower of cost (i.e. first in first out (FIFO) or average cost) and net realisable value.

### *Capital gains*
Capital gains are not subject to income tax, provided it can be demonstrated that the gains are of a capital and not an income nature (i.e. not recurring transactions).

### *Inter-company dividends*
Inter-company dividends are not subject to income tax.

### *Stock dividends*
Stock dividends are paid out of taxed profits. Such dividends are not subject to income tax when received by a local company, but they are subject to taxation in the hands of local individual taxpayers at the rate of 10%.

### *Foreign income*
Foreign income is not subject to income tax unless it is deemed to be from a Swaziland source.

## Deductions

### Accrued expenses

Expenses incurred in earning income during the year, regardless of whether such expenses were actually paid or not within that year, qualify for deduction in that year, provided they are not of a capital nature.

### Depreciation

Depreciation (wear-and-tear) allowances, calculated by the net-reducing-balance method, are available as follows:

| Asset | Rate (%) |
|---|---|
| Aircraft | 25 |
| Casino equipment | 15 |
| Construction equipment | 25 |
| Computer hardware | 33.33 |
| Computer software | 33.33 |
| Furniture and fittings | 10 |
| Hotel soft furnishings, including carpets | 10 |
| Legal and professional libraries | 5 |
| Lifts and elevators | 25 |
| Motor vehicles: | |
| Buses | 33.33 |
| Cars | 20 |
| Light delivery vehicles | 25 |
| Lorries | 33.33 |
| Office equipment | 10 |
| Plant and machinery | 10 |
| Sound and projection equipment | 20 |
| Television sets | 20 |
| Tractors | 25 |
| Trailers | 20 |
| Video recorders | 33.33 |
| Videotapes | 25 |

For the first year after the addition of an asset, the wear-and-tear allowance is calculated on a monthly basis. With respect to leased assets, the lessor's claim for wear-and-tear allowance is usually spread over the lease period.

An initial allowance of 50% is granted for plant and machinery used in a manufacturing process, including hotel equipment. An initial allowance of 50% is also granted for industrial buildings used for manufacturing purposes and hotels, together with a 4% annual allowance.

### Bad debt

Swaziland does allow a deduction for bad debts, subject to the Commissioner's approval and provided that the debts were included in the taxpayer's income in the year of assessment or in years past.

### *Charitable contributions*
Subject to the Commissioner's approval in regard to the amount allowable as a deduction in the year of grant and subsequent years, Swaziland allows a deduction for, among other things, grants made to the government for the building of schools and hospitals.

### *Fines and penalties*
Fines and penalties resulting from late payment of any tax or levied as payable under any Act administered by the Commissioner will be a non-deductible expense

### *Net operating losses*
Losses may not be carried back but may be carried forward for as long as trading continues (i.e. indefinitely). If any break in trading occurs, however, the losses are forfeited.

### *Payments to foreign affiliates*
Deductions may be claimed for payments of management service fees, interest, and royalties to foreign affiliates, provided the payments are made under a written agreement, are reasonable, and receive exchange control approval for transfers outside the rand monetary area. Note that this approval is routinely given without any significant delay for bona fide transactions.

## *Group taxation*

Swaziland does not have group taxation legislation. All companies are assessed on their individual profits and losses.

### *Transfer pricing regime*
Swaziland does not have transfer pricing legislation; however, under the anti-avoidance provision, the Revenue Authority will look for arm's-length transactions.

### *Thin capitalisation rules*
Swaziland does not have thin capitalisation rules.

## *Tax credits and incentives*

### *Development Approval Order*
The Minister of Finance, along set guidelines and with prior consent of the Cabinet, may nominate a business as a developmental enterprise (i.e. a business the Minister deems to be beneficial to the development of the economy) for a grant of a Development Approval Order. If approved, the business generally will be granted tax concessions, such as a lower corporate tax rate.

### *Training expenditures*
Approved training schemes, resulting in a 150% tax deduction of salaries, are no longer available.

## *Withholding taxes*

Non-resident withholding taxes (WHT) are levied as follows.

### *Dividends*
WHT for dividends is payable at the rate of 15% (12.5% for companies registered in Botswana, Lesotho, and the Republic of South Africa).The rate drops to 10% under the double taxation agreement (DTA) with South Africa where the holding company owns more than 25% of the shares. Non-resident shareholders' WHT is payable within 30 days of the date on which the dividend is payable.

### *Interest*
WHT for interest is payable at the rate of 10%. Non-resident WHT on interest is payable within 14 days of the date of the accrual of the interest.

### *Entertainers and sportsmen*
WHT is payable at the rate of 15% on income earned in Swaziland by entertainers and sportsmen. This tax relates only to public entertainers and sportsmen not ordinarily resident in Swaziland. The payer is required to deduct the tax and pay it within 15 days.

### *Contractors or professionals*
WHT is payable at the rate of 15% on services provided by contractors or professionals in Swaziland (materials are not taxed to the extent that materials are incidental to the overall charge). The Commissioner of Taxes must be notified of any agreement relating to construction operations or professional services under which payments are made to non-resident persons within 30 days after entering into the agreement. It is required that the tax be paid within 15 days from the date of payment.

## *Tax administration*

### *Returns*
The tax year runs from 1 July to 30 June. Companies are required to have a 30 June year end unless another year end date is approved by the Commissioner of Taxes; such approval is routinely given. Income tax returns should be submitted within 30 days of 30 June unless an extension of time for submission is granted, which also is routinely given.

### *Payment of tax*
Notice of the date of payment is usually given on the tax assessment.

### *Provisional tax payments*
With respect to companies, provisional tax is payable in two instalments: one payment is due within six months of the company's financial year-end, and the other payment is due no later than the last day of the company's financial year.

The estimate of taxable income for provisional tax purposes should not be less than the taxable income assessed for the latest preceding year of assessment, for which an assessment has been issued not less than 21 days before the date the estimate is made. This rule does not apply if the taxpayer can convince the Commissioner of Taxes that the taxable income for the current year will be less than the taxable income for the preceding year.

A provisional taxpayer becomes liable to pay a penalty if the estimate for taxable income for the second payment of provisional tax is found to be both less than 90% of the taxable income as finally determined and less than the taxable income as assessed for the immediately preceding tax year.

# Sweden

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## Significant developments

There have been no significant corporate tax developments in Sweden during the past year.

## Taxes on corporate income

### State (national) income tax

Resident legal entities are liable for tax on their worldwide income unless tax treaties or special exemptions apply. Non-resident entities are taxed on income that is deemed to have its source within Sweden.

Taxable income is subject to tax at the rate of 26.3% for financial years commencing on or after 1 January 2009. The previous rate was 28%. All income of corporate entities is treated as business income.

## Corporate residence

A company is considered to be a tax resident of Sweden if it is incorporated in Sweden.

### Permanent establishment (PE)

The term permanent establishment (PE) is defined in Sweden as a fixed place of business through which the business is carried on from a specific establishment, such as a place of management, branch, office, factory, or workshop. Places where entrepreneurial work is carried on are also regarded as PEs if an agent or a representative who is dependent upon the foreign company habitually exercises authority in Sweden.

## Other taxes

### Value-added tax (VAT)

The Swedish VAT system is harmonised with the European Community rules. The general VAT rate is 25% and chargeable on most goods and services. Reduced rates apply to a few goods and services, such as food, which is taxed at the rate of 12%, and transport of passengers, which is taxed at the rate of 6%. Certain financial and insurance services are exempt from VAT.

VAT returns are filed and tax is paid monthly or quarterly. However, for companies with a turnover of less than 1 million Swedish kronor (SEK), VAT may be reported in the income tax return.

### Stamp tax
Stamp tax at 4.25% is payable on a transfer of real estate. The tax base consists of the highest of the purchase consideration or the tax assessed value of the real estate. Stamp tax on an intra-group transfer of real estate may be deferred as long as the real estate remains within the group.

### Social fees
Mandatory social security charges payable by employers on remuneration to employees (or by the self-employed) are levied at approximately 31%. Reduced rates apply for very young or old people. Social security charges are deductible for corporate tax purposes.

Pension benefits beyond the mandatory system are customary amongst most Swedish employers. A special salary tax is levied at approximately 24% on these additional pension premiums/commitments and is deductible for corporate tax purposes.

### Real estate tax
The real estate tax rate on business premises is 1% of the tax assessed value. For industrial property, the tax rate is 0.5%. Other rates exist for special property.

## Branch income

Branch income (i.e. PE income) is taxed at the corporate tax rate of 26.3%, and general corporate tax rules apply for branch offices in Sweden. No withholding tax (WHT) is levied on the outbound repatriation of taxed profits.

The receipt of Swedish source royalties or fees for use of tangible or intangible assets by a foreign resident is also (subject to treaty restrictions) regarded as a special form of PE income.

## Income determination

### Inventory valuation
Inventories (stock-in-trade) are valued at acquisition cost or market value, whichever is lower. As an alternative, inventories may be valued at 97% of the total acquisition cost, which is determined on a first in first out (FIFO) basis. Last in first out (LIFO) is not permitted. Generally, inventories should be stated at the same amount for tax and accounting purposes.



### Capital gains
There is a capital gains tax exemption for Swedish corporate entities on gains related to the disposal of shares held for business reasons. This abolishment of capital gains taxation for corporations, under the participation exemption provisions, has made Sweden a favourable holding company location.

Note that non-tax-exempt capital gains are included in business income and taxed at the corporate tax rate.

Shares in Swedish corporations as well as in foreign companies can qualify as shares held for business reasons. Unquoted/unlisted shares will always be considered as held for business reasons. Quoted/listed shares are considered held for business reasons provided that the company has a holding corresponding to at least 10% of the voting rights or the shares are held in the course of the business. An additional condition regarding quoted/listed shares is that the shares must be held for a period of at least one year.

An exception from the capital gains tax exemption applies for the sale of shares in a 'shell company', which is a company or partnership where the market value of cash, shares and other marketable instruments (other than shares held for business reasons), and similar assets exceeds 50% of the consideration paid for the shares. The sale of a shell company results in harsh taxation of the gross consideration. Provided certain formalities are fulfilled, however, it is possible to avoid such taxation.

A consequence of the participation exemption is that capital losses on shares or participations held for business reasons are not deductible.

Capital losses on portfolio holdings of shares, share options, convertible debentures, and similar financial instruments are allowed only as an offset to capital gains on the same group of financial instruments.

Certain special rules apply to computation of capital gains and losses on real estate.

As of 2010, participation in partnerships (tax transparent entities) are included in the capital gains tax exemption regime (making losses non-deductible), including qualifying indirect holdings via a partnership.

### *Dividend income*
A participation exemption will apply for dividends received on shares held for business reasons *(see above)* and on qualifying holdings via partnerships. The requirement of a minimum holding period for a holding of quoted/listed shares can be fulfilled retroactively.

### *Foreign income*
Companies resident in Sweden are taxed on their worldwide income. Non-resident entities are taxed on income that is deemed to have its source within Sweden.

A Swedish corporation is taxed on foreign branch income. Double taxation normally is avoided by means of either a deduction for foreign tax, or a foreign tax credit.

Dividends and capital gains from foreign subsidiaries are generally exempt from taxation according to the participation exemption provisions applicable to shares held for business reasons *(see above)*.

## *Deductions*

### *Depreciation, amortisation, and depletion*
#### Depreciation on fixed assets
Land improvements may be depreciated at the rate of 5% per year of the acquisition cost. The maximum allowance is 100% of the tax basis of the improvement.

Buildings may be depreciated at rates between 2% and 5% per year of the taxable basis, depending on type and usage of the building. The maximum allowance is 100% of the tax basis of the building.

For machinery, equipment, and motor vehicles, the depreciation for tax purposes should correspond to the depreciation charged in the books and accounts, as long as the total net value of the assets is not less than the 70% of net value in previous accounts plus additions less proceeds of sales (i.e. 30% declining balance depreciation) or cost less 20% per year (i.e. 20% straight-line depreciation on remaining assets).

**Immediate deduction of certain assets**
The cost of assets having an expected life of not more than three years and the cost of assets not exceeding certain levels, depending on size of operations, may be deducted immediately. Certain costs for repairs, maintenance, and modifications of buildings may also be deducted immediately.

**Amortisation of intangibles and goodwill**
The amortisation of patents, leaseholds, and goodwill follows the same rules as depreciation for machinery, equipment, and motor vehicles *(see above)*.

**Depletion of mines and quarries**
The entire cost of mines and quarries may be depleted over their expected exploitation period. These depletion amounts may be deducted annually but are limited to 100% of the acquisition cost of the mine or quarry.

### *Taxes*
Generally, Swedish taxes are not deductible for tax purposes. However, specific taxes, fees, and foreign taxes may be deductible. Recoverable VAT is not treated as an expense or cost.

### *Net operating losses*
Tax losses may be carried forward indefinitely, subject to restrictions or forfeiture upon ownership changes, mergers and demergers, dispositions with creditors, and certain other reorganisations. No carryback of losses is possible.

### *Payments to foreign affiliates*
Transactions with an affiliate not liable for tax in Sweden must be at arm's length. Formal transfer pricing documentation requirements apply since 1 January 2007.

In 2009, Sweden enacted anti-debt push down provisions under which a deduction is not allowed for interest payments on any intra-group loans for the acquisition of shares from an affiliate, unless the creditor is taxed on the interest income at a rate of at least 10% or it is shown that the share transfer and the debt is based on commercial reasons. Note that loan agreements signed prior to 2009 are covered by these new provisions.



## *Group taxation*

Swedish companies are not taxed on a consolidated basis. However, it is possible for qualifying groups (i.e. a holding of greater than 90% of the capital which must have been owned during the whole fiscal year) to effectively offset operating losses of one Swedish company against operating profits of another Swedish company by way of group contributions, which are tax deductible for the contributor and taxable for the recipient. European Economic Area (EEA) companies are regarded as Swedish companies for these purposes, if the recipient is taxable in Sweden.

A similar Swedish deductibility is, under certain circumstances, also available for cross-border consolidation within the EEA for final subsidiary losses.

### *Transfer pricing*
The Swedish transfer pricing regime is generally an Organisation of Economic Co-operation and Development (OECD) type of regime.

### *Thin capitalisation*
There are no thin capitalisation rules for tax purposes in Sweden.

### *Controlled foreign company (CFC) legislation*
Sweden's CFC provisions aim at taxing a Swedish resident shareholder for shareholdings in low-taxed foreign entities. A Swedish resident shareholder with a holding in a CFC-entity will annually be taxed for its ownership portion of the CFC's income, according to provisions applicable to a Swedish corporation. For a corporation, the portion will be taxed at the Swedish corporate tax rate. Only holdings, direct or indirect through other foreign entities, corresponding to at least 25% (capital or voting rights) in the foreign entity could lead to CFC taxation. A foreign company is considered lowly taxed if the income in the company, calculated in accordance with Swedish provisions, is taxed at a rate below 14.47%. However, if the foreign entity is resident in an 'approved country', CFC taxation should not arise. Approved countries appear in an official 'black/white' list. Active European Economic Area (EEA) entities are, under certain circumstances, excluded from CFC taxation.

## *Tax credits and incentives*

There are no specific tax incentives in Sweden for corporations. However, some generally applicable regimes exist.

For example, Sweden has an accruals reserve regime. The accruals reserve regime allows for a tax-deductible appropriation for corporations of 25% of the taxable profit before appropriation to a reserve. Each year's appropriation forms a separate reserve that must be reversed to income no later than the sixth year following the appropriation. However, a standardised interest income is imposed on former years' appropriations at 72% of the interest rate on governmental debt notes.

### *Foreign tax credit*
A foreign tax credit is generally available, provided certain conditions are fulfilled, but the tax credit allowed is always limited to an amount corresponding to the Swedish tax on the foreign income in question. Tax treaty implications may exist.

## *Withholding taxes*

There are no Swedish taxes on interest and service fees paid to non-resident corporations or individuals. Such payments to resident corporations and individuals are taxed as ordinary income.

WHT on dividends, royalties, and certain rentals vary according to domestic law and tax treaties, as shown below.

Apart from the highlighted treaties, Sweden has concluded agreements on exchange of information in tax matters and partial tax treaties with many tax haven jurisdictions.

| Recipient | Cash dividends (%) (1, 2) | Royalties, certain rentals (%) (3) |
|---|---|---|
| Resident corporations | 0 (4) | 0 (5) |
| Resident individuals | 30 (4) | 0 (5) |
| | | |
| Non-resident corporations and individuals: | | |
| Non-treaty | 30 | 0 (5) |
| | | |
| Treaty: | (6) | |
| Albania | 5/15 | 5 |
| Argentina | 10/15 (7) | 3/5/10/15 (7) |
| Australia | 15 | 10 |
| Austria | 5/10 (6) | 0/10 (8) |
| Bangladesh | 10/15 | 10 |
| Barbados | 5/15 | 0/5 (9) |
| Belarus | 0/5/10 | 3/5/10 (10) |
| Belgium | 5/15 (6) | 0 |
| Bolivia | 0/15 | 15 |
| Botswana | 15 | 15 |
| Brazil | 15/25 | 15/25 |
| Bulgaria | 10 | 5 |
| Canada | 5/10/15 | 0/10 (11) |
| Chile (12) | 5/10 | 5/10 |
| China, P.R (13) | 5/10 | 10 |
| Cyprus | 5/15 (6) | 0 |
| Czech Republic (14) | 0/10 (6) | 0/5 (9) |
| Denmark (15, 16) | 0/15 (6, 16) | 0 (16) |
| Egypt | 5/20 | 14 |
| Estonia | 5/15 (6) | 5/10 (17) |
| Faroe Islands (15, 16) | 0/15 (16) | 0 (16) |
| Finland (15, 16) | 0/15 (6) | 0 |
| France | 0/15 (6) | 0 |
| Gambia | 0/5/15 | 5/12.5 (18) |
| Germany | 0/15 (6) | 0 |
| Greece | 0 (6) | 5 |
| Hungary | 5/15(6) | 0 |
| Iceland (15, 16) | 0/15 (16) | 0 (16) |
| India | 10 | 0/10 |
| Indonesia | 10/15 | 10/15 (19) |
| Ireland, Rep. of | 5/15 (6) | 0 |
| Israel | 5/15 | 0 |
| Italy | 10/15 (6) | 5 |
| Jamaica | 10/22.5 | 10 |
| Japan | 0/5/15 | 10 |
| Kazakhstan | 5/15 | 10 |
| Kenya | 15/25 | 20 |
| Korea, Rep. of | 10/15 | 10/15 (20) |
| Latvia | 5/15 (6) | 5/10 (17) |

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# Sweden

| Recipient | Cash dividends (%) (1, 2) | Royalties, certain rentals (%) (3) |
|---|---|---|
| Lithuania | 5/15 (6) | 5/10 (17) |
| Luxembourg | 0/15 (6) | 0 |
| Macedonia | 0/15 | 0 |
| Malaysia (12) | 0/15 | 8 |
| Malta | 0/15 (6) | 0 |
| Mauritius | 5/15 | 15 |
| Mexico | 5/15 | 10 |
| Namibia | 0/5/15 | 5/15 (21) |
| Netherlands | 0/15 (6) | 0 |
| New Zealand | 15 | 10 |
| Norway (15, 16) | 0/15 (16) | 0 (16) |
| Pakistan | 15/30 | 10 |
| Philippines | 10/15 | 15 |
| Poland (12) | 5/15 (6) | 5 |
| Portugal | 0/10 (6) | 10 |
| Romania | 10 | 10 |
| Russia | 5/15 | 0 |
| Singapore | 10/15 | 0 |
| Slovak Republic (14) | 0/10 (6) | 0/5 (9) |
| South Africa | 0/7.5/15 | 0 |
| Spain | 10/15 (6) | 10 |
| Sri Lanka | 15 | 10 |
| Switzerland | 0/15 | 0 |
| Taiwan | 10 | 10 |
| Tanzania | 15/25 | 20 |
| Thailand | 15/20/30 | 15 |
| Trinidad and Tobago | 10/20 | 0/20 (22) |
| Tunisia | 15/20 | 5/15 (23) |
| Turkey | 15/20 | 10 |
| Ukraine | 0/5/10 | 0/10 |
| United Kingdom | 0/5 (6) | 0 |
| United States | 0/5/15 | 0 |
| Venezuela | 5/10 | 7/10 (24) |
| Vietnam | 5/10/15 | 5/15 (25) |
| Yugoslavia (former) (26) | 5/15 | 0 |
| Zambia | 5/15 | 10 |
| Zimbabwe | 15/20 | 10 |

Notes

1. According to domestic law there is no WHT on dividends to a foreign company on shares held for business reasons *(for the definition of shares held for business reasons, see Capital gains in the Income determination section),* provided that the foreign company is similar to a Swedish limited liability company (and some other legal entities) and is subject to income tax at similar level to that imposed on a Swedish company. Further, there is no tax liability for a legal entity of a member state of the European Union if the entity owns 10% or more of the share capital in the distributing company and fulfils the conditions of the Directive (90/435) regarding parent company and subsidiaries.
2. The reduced rate shown before a stroke (/) refers to payments to corporations having requisite control. Where appropriate, the particular treaty should be consulted to see whether the reduced rate is applicable.

3. Swedish source royalties and certain rental fees are treated as a special form of PE, taxable at the corporate tax rate, subject to treaty reduction or waiver. Royalties paid from Sweden to a company within the European Union should not be taxed in Sweden if one of the companies holds at least 25% (capital) of the other, or where there are two companies concerned, at least 25% are held by another company within the European Union. Indirect participation does not benefit from the legislation. Both the payer and the recipient must be legal entities under the EU directive.
4. Payments to resident corporations and individuals are taxed as ordinary income. Only resident banks and similar entities are required to withhold tax on payments of cash dividends to resident individuals.
5. Royalties and certain rentals paid by Swedish licensees are treated as business income taxable in Sweden and do not incur WHT *(see Note 3).*
6. Note also the domestic provision stating a 0% WHT on dividends distributed on shares held for business reasons to qualifying entities *(see Note 1).*
7. Dividends: 10% of the gross amount if the company receiving the dividends owns at least 25% of the foreign company's capital. Royalties: of the gross amount paid for the use of, or the right to use:
   - News: 3%.
   - Copyright of literary, dramatic, musical, or other artistic work: 5%.
   - Any patent, trademark, design or model, plan, or secret formula or process; industrial or scientific equipment or information concerning industrial, commercial or scientific experience; payments for the rendering of technical assistance: 10%.
   - All other cases: 15%.
8. Royalties are normally taxable only in the recipient's home country. However, where the royalty is paid by a Swedish legal entity that is more than 50% owned by one Austrian recipient, entity or individual, the tax in Sweden is a maximum of 10%.
9. Literary, artistic or scientific royalties: 0%; other royalties: 5%.
10. Royalties for use of industrial, commercial, or scientific equipment: 5%; with respect to patents, secret formulas or processes, or for information concerning industrial, commercial, or scientific experience: 3%; other royalties: 10%.
11. Royalties for use of copyright and literary, dramatic, musical, and artistic royalties: 0%. Other royalties: 10%. (Treaty should be consulted).
12. The treaty has effect on income derived on or after 1 January 2006.
13. The double taxation treaty does not include Hong Kong.
14. The same treaty is applicable to the Czech Republic and the Slovak Republic.
15. According to the Nordic multilateral tax treaty.
16. Dividends are exempt from tax if the recipient of the dividends is a company directly owning at least 10% of the capital of the company paying out the dividends. Certain rentals are subject to tax if there is a PE in a country other than the home country and the claim is connected with the business carried on from the PE. Concerning Iceland, dividends are normally exempt from tax for companies, but the tax rate is 15% if the dividends have been deducted from the income of the distributing company.
17. Royalties for the use of industrial, commercial, or scientific equipment: 5%; other royalties: 10%.
18. Royalties with respect to patents, secret formulas or processes, or for information concerning industrial, commercial, or scientific experience: 5%; other royalties: 12.5%.
19. Royalties for the use of industrial, commercial, or scientific equipment or for information concerning industrial, commercial, or scientific experience: 10%; other royalties: 15%. (Treaty should be consulted.)
20. Literary, artistic, or scientific royalties including films: 15%; other royalties: 10%. (Treaty should be consulted.)
21. Royalties with respect to patents, secret formulas or processes, or for information concerning industrial or scientific experience: 5%; other royalties: 15%.
22. Commercial royalties, including films: 20%; copyright, literary, dramatic, musical, or artistic royalties: 0%.
23. Commercial royalties, including films: 15%; literary, dramatic, musical, or artistic royalties: 5%.
24. Literary, artistic, scientific, or film royalties: 10%; other royalties: 7%.
25. Royalties with respect to patents, designs or models, secret formulas or processes, or for information concerning industrial or scientific experience or for the use of industrial, commercial, or scientific equipment involving a transfer of know-how: 5%; other royalties: 15%.
26. The treaty is applicable to all republics and autonomous provinces of the former Yugoslavia with the exception of Macedonia, with which Sweden has concluded a bilateral treaty.



## *Tax administration*

### *Returns*

If the income is derived from business, the basis for tax assessment is the financial year. The year-end for a company may be fixed at any of the following dates: 30 April, 30 June, 31 August, or 31 December. Another year-end can be used if special permission by the tax agency is requested and granted. Swedish subsidiaries of foreign parents are generally permitted to adopt the same year-end as the parent company, provided it ends on the last day of the month.

Every corporate entity or registered branch must file an annual corporate income tax return, which generally should be filed by 2 May each year, covering the financial year ending during the preceding calendar year. An extension may be available. The annual assessments are made by the local tax offices during the calendar year following the income year and should be completed by the end of November. VAT returns and employer returns (employee Pay As You Earn (PAYE) and employer withholding) are normally due on a monthly basis.

### *Income tax payments*

Income taxes are collected during the year in which the income is earned, under a preliminary tax system. A corporate entity's preliminary tax liability is determined by a preliminary tax assessment based either on the latest available final tax assessment or on a preliminary tax return filed by the company. The preliminary taxes are payable in monthly instalments. Interest surcharges on underpayment of preliminary taxes, however, generally apply from 12 February the year after the financial year (the assessment year). Any balance owed by the taxpayer is payable in 90 days after the assessment has been made. Normally, any balance owed to the taxpayer is refunded in December of the assessment year.

### *Tax penalty*

A taxpayer that submits incorrect or insufficient information in a tax return is charged a penalty amounting to up to 40% of the tax which, if the incorrect information had been accepted, would have been imposed or credited. The penalty and the rate may vary depending on the type of the incorrect information given.

### *Appeals*

Taxes are assessed by the tax agency. Depending on the circumstances, reassessments and/or appeals generally can be initiated within one and five years after the assessment year. Appeals can be made to the administrative court, and onwards to the administrative court of appeal, and in case of granted trial dispensation, onwards to the supreme administrative court.

# Switzerland

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## Significant developments

### Corporate tax reform II

Although the corporate tax reform II (CTR II) was, in general, put into force as of 1 January 2009, the following significant amendments entered into force as of 1 January 2011:

**Extension of participation relief on dividend income**

The thresholds to obtain participation relief on dividend income after the effective date of 1 January 2011 were reduced to a participation of at least 10% from the prior 20% of capital, or a market value of at least 1 million Swiss francs (CHF) instead of the prior CHF 2 million *(see Participation relief in the Income determination section)*.

**Extension of participation relief on capital gains on the sale of investments**

After the effective date of 1 January 2011, at a federal corporate income tax (CIT) level, limited companies and cooperatives desiring participation relief on capital gains must sell an interest of at least 10%, instead of the prior 20% requirement. The minimum holding period of one year remains unchanged. Even though voluntary, most cantons grant the participation relief on capital gains derived from the sale of investments *(see Participation relief in the Income determination section)*.

**Introduction of the capital contribution principle**

The change from the nominal principle to the capital contribution principle entered into force as of 1 January 2011. It allows repayment of shareholders' capital contributions without liability for Swiss withholding tax (WHT) at the level of the distributing company and without income tax at the level of the Swiss individual shareholder (holding the shares in one's private assets). According to the transition period, capital contributions are qualifying if accumulated after 31 December 1996 and meeting some further requirements (e.g. timely recordings in the statutory books and vis-à-vis the tax authority; *see Introduction of the capital contribution principle in the Withholding taxes section*).

### Relief on intra-group financing

Improvements regarding intra-group financing were implemented effective on 1 August 2010. According to the new standards, liabilities to group (affiliated) companies, regardless of their terms, their number, or their amount, are, on constitution, no longer subject to issuance duty, and the interest on them is no longer subject to WHT (to this extent abolition of the so-called 10/20 lender rule). With this revision, Switzerland will be much more attractive in tax respects for inter-company financing activities for international groups, in particular for cash pooling activities *(see Issuance stamp tax in the Other taxes section)*.

# Switzerland

### *New value-added tax (VAT) rates as of 1 January 2011*
As of 1 January 2011, the Swiss VAT rates were temporarily increased in order to support the solvency of disability insurance. The increase is limited to seven years. The regular rate has increased by 0.4% to 8%, the privileged rate by 0.1% to 2.5%, and the special rate by 0.2% to 3.8% *(see Value-added tax in the Other taxes section)*.

## *Taxes on corporate income*

Resident companies are subject to CIT on their worldwide income levied at three levels, the federal, cantonal, and communal level.

### *Federal level*
Switzerland levies a direct federal CIT at a flat rate of 8.5% on profits after tax (i.e. taxes are deductible from the tax basis in Switzerland, consequently, the tax rate on income before taxes amounts to approximately 7.83%). At a federal level, no corporate capital tax is levied.

### *Cantonal/communal level*
In addition to the direct federal CIT, each canton has its own tax law and levies cantonal and communal (municipal) income and capital taxes at different rates. Therefore, the tax burden of income (and capital) varies from canton to canton. Some cantonal and communal taxes are imposed at progressive rates.

### *Overall tax rates*
As a general rule, the overall approximate range of the maximum effective CIT rate on profit for federal, cantonal, and communal taxes is between 12.7% and 24.2%, depending on the company's location.

Income attributable to permanent establishments (PE) or immovable property located abroad is excluded from the Swiss tax base and only taken into account for rate progression purposes in the cantons that still apply progressive tax rates.

## *Corporate residence*

A company is considered resident in Switzerland if its place of incorporation is in Switzerland. Residency is also linked upon the place of effective management, which may be the centre from which day-to-day activities are directed or the place from which managerial decisions are made.

## *Other taxes*

### *Value-added tax (VAT)*
In 2009, a new Swiss VAT law was approved by the Swiss Parliament and put in force effective as of 1 January 2010. The new VAT law features a noticeable simplification of the system, enhances transparency, is more customer-friendly, and aims at providing more legal certainty.

As a matter of principle, proceeds of sales and services conducted in Switzerland are subject to VAT at the standard rate of 8%. However, goods for basic needs are subject to VAT at the rate of 2.5%, and services in connection with the provision of lodging are subject to VAT at the rate of 3.8%. A registered taxpayer generally is entitled to offset the amount of VAT charged by suppliers or paid on imports against the VAT payable. These rates represent a temporary increase that went into effect as of 1 January 2011 in order to support the solvency of disability insurance. The increase is limited to seven years.

Prior to 1 January 2011, the regular rate was 7.6%, the privileged rate was 2.4%, and the special rate was 3.6%.

### *Capital tax*

Corporate capital tax is only levied at a cantonal but not at a federal level. It is based on the corporation's equity (i.e. the taxable equity corresponds to the sum of nominal capital, paid in surplus, retained earnings, other equity reserves, and – according to Swiss thin capitalisation rules – potential deemed equity). Tax rates vary from 0.001% to 0.5288%. Reduced rates are applicable for companies subject to a special cantonal tax regime (e.g. holding companies, mixed trading companies).

As a result of the CTR II, the cantons may now choose to credit CIT to the capital tax in order to reduce the overall tax burden *(for more information in connection with the CTR II in general, see Corporate tax reform II in the Significant developments section)*.

### *Issuance stamp tax*

Issuance stamp tax (often known as capital duty) on the issue and increase of the equity of Swiss corporations is levied at the rate of 1% on the fair market value of the assets contributed, with an exemption on the first CHF 1 million of capital paid in, whether it is made in an initial or subsequent contribution.

A tax ruling may be obtained to exempt a multitude of transactions from issuance stamp tax. In particular, special rules allow for most reorganisations to take place on a tax neutral basis. In addition, an existing non-resident company may generally transfer assets to Switzerland without incurring Swiss issuance stamp tax. However, if the company was formed abroad and re-domiciled to Switzerland exclusively or mainly in order to avoid Swiss stamp taxes, the issuance stamp tax may apply.

Issuance stamp tax is further payable with respect to the following instruments:

- Bonds, which are defined for the purposes of this tax as bonds, promissory notes issued in sequence and similar paper, discount paper, and any other evidence of indebtedness in the form of a debt security or traded as if there were a debt security which is intended for public placement as well as participations in loans granted to Swiss debtors.
- Money market papers, which are identical instruments to bonds with a fixed term of not more than 12 months, issued by a Swiss body.



Effective on 1 August 2010, improvements regarding intra-group financing were implemented. According to the new standards, liabilities to group (affiliated) companies, regardless of their terms, their number, or their amount, are, on constitution, no longer subject to issuance duty, and the interest on them is no longer subject to WHT (to this extent abolition of the so-called 10/20 lender rule). Consequently, Switzerland will be much more attractive in tax respects for inter-company financing activities for international groups, in particular for cash pooling activities. Due to tax evasion reasons, these rules are, however, not available for a domestic group company, which guarantees a bond issued by a foreign group company. These amendments were prioritised by singling out from the pending (new) Corporate tax reform III, which, however, stagnated some time ago.

The following tax rates apply:

- 0.12% of the nominal value for each year or part thereof up to the maturity of a bond.
- 0.06% each year on the same basis for sub-participations and medium term bonds.
- 0.06% each year on commercial paper with the face value calculated at 1/360th for each day on which such paper is outstanding.

### *Securities transfer stamp tax*

Swiss securities transfer stamp tax (often called 'securities turnover tax') is levied on the transfer of Swiss and foreign securities in which Swiss securities dealers participate as contracting parties or as intermediaries. The ordinary tax rate of Swiss securities transfer stamp tax is 0.15% for securities issued by a tax resident of Switzerland and 0.3% for securities issued by a tax resident of a foreign country.

Swiss securities dealers are defined as any person professionally engaged in the buying or selling of securities for one's own account or for another person, including Swiss banks and other Swiss bank-like institutions. The definition also includes companies holding taxable securities whose book value exceeds CHF 10 million and remote members of a Swiss stock exchange with regard to Swiss titles, which are quoted on the Swiss stock exchange.

Taxable securities include, but are not limited to, shares (including participations, i.e. main interests in other companies) and bonds. Options and many other derivative instruments are not subject to Swiss securities transfer stamp tax. However, the exercise of such financial instruments or derivatives may result in a taxable transfer of a security.

Various transactions are exempt from Swiss securities transfer stamp tax. Generally, no Swiss securities transfer stamp tax is levied in the case of a merger or a reorganisation in which a Swiss securities dealer is involved and taxable securities (including participations) are transferred. Furthermore, the merger law also states an exemption from Swiss securities transfer stamp tax in case of a replacement of a participation. This is particularly important for holding companies, which qualify as Swiss securities dealers.

## *Branch income*

The same tax principles that apply for non-resident corporations also apply for Swiss branches, provided that transactions with the head office or other branches are at arm's length. There is no Swiss WHT on profit transfers to the head office.

## *Income determination*

The statutory accounts of a Swiss company (or in the case of a non-resident company, the branch accounts) serve as the basis for determining taxable income. There are generally very few differences between statutory profit and taxable profit apart from the participation relief for dividend and capital gains income (*see below*), adjustments required by tax law, and the usage of existing tax loss carryforwards (*see Net operating losses in the Deductions section*).

### *Participation relief*

Participation relief is the name generally attributed to the tax relief received for qualifying dividend and capital gains income of a company. Participation relief is not an outright tax exemption, but rather a tax abatement mechanism. It is therefore also commonly referred to as 'participation deduction'.

Participation relief is a percentage deduction from CIT that is equal to net participation income divided by taxable income. Net participation income consists of the gross participation income from qualifying dividends and (usually) qualifying capital gains income less related administration and financing costs and any depreciation of the participation that is linked to the dividend distribution. In most cases, participation relief results in a full exemption of participation income from federal CIT, or one close thereto. Note that participation relief may be diluted in certain cases (e.g. if loss carry forwards are offset).

The participation relief on dividend income is mandatory at the federal CIT as well as on the cantonal/municipal level. The participation relief on capital gains is voluntary for cantonal/municipal purposes but nevertheless implemented by most cantonal tax acts. Specific privileged cantonal/municipal tax regimes may foresee more favourable rules for dividend income and capital gains than the participation relief *(see Privileged cantonal tax regimes in the Tax credits and incentives section)*.

#### Dividend income

As of 1 January 2011, dividends qualifying for participation relief are those from participations representing at least 10% of the share capital or 10% of profits and reserves of another company or those having a market value of at least CHF 1 million. Prior to 1 January 2011, the thresholds were 20% of the share capital of another company or a market value of at least CHF 2 million. Note that there is neither a minimum holding period nor a requirement that the dividend paying subsidiary is liable to income tax in its jurisdiction of residence.

#### Capital gains income

As of 1 January 2011, capital gains derived from the disposal of a qualifying participation are entitled to participation relief if the following conditions are cumulatively met:

- The participation sold was owned by the company for a period of at least one year.
- The amount sold constitutes at least 10% of the share capital or 10% of profits and reserves of the underlying subsidiary. Partial sales of residual holdings of less than 10% are possible, provided their market value at the beginning of the year still amounted to at least CHF 1 million.

Prior to 1 January 2011, the threshold was 20% of the share capital of the underlying subsidiary.

It is noteworthy that capital gains are only entitled to participation relief to the extent the sales price exceeds the original investment costs of the participation, whereas the so-called 'recaptured depreciation' (i.e. the amount of former depreciations) is taxable.

### *Foreign income*

Swiss tax resident corporations are basically taxed on their worldwide income. However, income attributable to a foreign PE outside Switzerland is not taxed in Switzerland but may be taken into account only to determine the rate of tax applicable to taxable income. The same rule applies for income from real estate situated abroad.

Dividends, interest, and royalties from Swiss or foreign sources are included in assessable income. However, in certain cantons, special methods of assessment may apply for dividend and other income originating outside Switzerland. For dividend income, a relief generally is available at a federal income tax level as well as at a cantonal level *(see Participation relief above)*. The irrecoverable portion of foreign WHT of most treaty countries can be credited against the related Swiss income taxes on the same income. Foreign WHT of all non-treaty countries generally are not creditable, but they are deductible for income tax purposes.

There are no controlled foreign company (CFC) rules in Switzerland. Consequently, undistributed income of foreign subsidiaries is usually not taxed in Switzerland (*see Controlled foreign company (CFC) regime in the Group taxation section)*.

### Foreign exchange gains

Realised foreign exchange gains are included in the tax basis of a corporation as taxable. Based on a recent federal court decision, for which applicability for a specific case has to be reviewed, unrealised gains (or losses) resulting from the translation of financial statements in a foreign (functional) currency to CHF may not be taxable (respectively tax deductible).

## Deductions

The statutory accounts of a Swiss company are the basis for determining taxable income. To be tax deductible, an expense has to be booked in the statutory accounts accordingly.

In principle, it can be said that all business expenses that are booked in the statutory accounts are tax deductible assuming they are economically justified from a tax perspective. If an expense is not a justifiable business expense in the sense of the tax law, it will be added back to taxable income. Examples typically include excessive depreciation, non-justified payments to related parties (e.g. hidden profit distributions), etc.

### Depreciation

Maximum depreciation/amortisation rates allowed for tax purposes are issued by the Federal Tax Administration. Higher depreciation/amortisation is allowed for tax purposes if the taxpayer can prove that such higher depreciation/amortisation is required from a statutory accounting perspective. Some cantons follow the federal guidelines, whereas some cantons apply and/or have published their own (more liberal) applicable depreciation/amortisation rates.

The following summary of the rates specified by the Federal Tax Administration provides the general range of allowable depreciation:

| Assets | Declining balance (%) | Straight-line (%) |
|---|---|---|
| **Commercial buildings** | | |
| Buildings alone | 4 | 2 |
| Buildings and land combined | 3 | 1.5 |
| **Equipment** | | |
| Office furniture and equipment | 25 | 12.5 |
| Computer hardware and software | 40 | 20 |

| Assets | Declining balance (%) | Straight-line (%) |
|---|---|---|
| **Other assets** | | |
| Motor vehicles | 40 | 20 |
| Intangible assets | 40 | 20 |

Some cantons (such as Zurich and Basel-City) take a more liberal approach and even permit a write-down of certain assets (including fixed assets) to 20% or nil of the purchase price in the first year, provided that such write-downs do not, in the aggregate, result in a drastic decline in taxable income or even a tax loss and are commercially justified. For this accelerated depreciation to be tax deductible, it must be booked in the statutory accounts and generally disclosed in the tax return. As the cantonal tax authorities are responsible for assessing not only cantonal/communal CIT but also federal CIT, the accelerated depreciation usually will be accepted for federal CIT purposes as well.

### *Goodwill*

Only acquired goodwill (derivative goodwill) may be capitalised in the statutory accounts and amortised. Amortisation is generally allowed over five years.

### *Interest expense*

Interest paid by a corporation to a third party is a deductible business expense. Interest paid to related parties (affiliates or shareholders) has to reflect the fair market rate and is subject to limitations *(see Thin capitalisation rules in the Group taxation section)*.

With respect to related parties, the Federal Tax Administration annually issues safe harbour interest rates to be used on loans in CHF on the one hand and in foreign currencies on the other hand. The corporation may deviate from these safe harbour rates as long as it can prove that the rates used are at arm's length and more appropriate in the present case. The cantons usually follow the federal guidelines.

The safe harbour rules for loans denominated in CHF applicable as of 1 January 2011 are as follows:

| For loans made to related parties | Minimum interest rate (%) |
|---|---|
| Financed from equity | 2¼ |
| Financed from debt (actual costs plus at least): | |
| On amount up to CHF 10 million | ½ |
| On amounts of more than CHF 10 million | ¼ |
| But in all cases **at least** | 2¼ |

| For loans made to related parties | Maximum interest rate (%) | |
|---|---|---|
| **Type of loan** | **Home construction / agriculture** | **Industry and business** |
| Real estate loans | 2 | 2 ½ |
| A loan up to the amount possible for mortgage (i.e. 2/3 of the market value of the real estate) | | |
| Rest, whereby the following maximum interest rates for debt are applicable: | 2 ¾ | 3 ¼ |
| Land, villas, residences, vacation houses, business premises up to 70% of the market value | | |

| For loans made to related parties | Maximum interest rate (%) | |
|---|---|---|
| Type of loan | Home construction / agriculture | Industry and business |
| Other real estate up to 80% of market value | | |
| Operational loans | | |
| Made to trading and production companies | – | 4½* |
| Made to holding and asset administration companies | – | 4* |

*In calculating the amount of the maximum interest permissible from a tax perspective, any potentially existing hidden equity (under Swiss thin capitalisation rules) has to be considered.

### *Royalties*
Royalty payments are generally deductible for tax purposes as long as the royalty rate is at arm's length.

### *Bad debt provision*
Based on a longstanding but not published practice, it is admissible in Switzerland to set up an accounting provision for specific impaired debts, which will be accepted for tax purposes. Unlike most other countries, it is also possible in Switzerland to set up an additional ('lump sum') bad debt provision of 5% on all domestic and 10% on all foreign receivables (i.e. after deduction of specific impaired debts), except for inter-company receivables and receivables to the public, enabling the taxpayer to defer the related tax liability until this provision has been released. Some cantons, such as Zurich, accept an even higher reserve (i.e. 10% on domestic and 20% on foreign receivables). This additional bad debt provision may have the character of a 'hidden' (i.e. undisclosed) reserve and is possible to build because the Swiss accounting standards favour prudence over true and fair view accounting principles.

### *Obsolete inventory provision*
Similarly to the bad debt provision, it is also possible to build a 'hidden' (i.e. undisclosed) reserve on a company's inventory. This provision, which must also be booked in the statutory accounts, is accepted for tax purposes (similar to the bad debt provision). Specifically, a company may build a provision for obsolete inventory as well as a hidden reserve on 33.3 % of the inventory value after deduction of the obsolete inventory.

### *Costs of employee share plans and stock option plans*
The cost of employee share plans and stock option plans are generally deductible, assuming the employees eligible for the plan are employed by the Swiss company. The same holds true for the recharge of costs for plans covering local employees.

### *Charitable contributions*
At a federal level, charitable contributions up to 20% of the net profit of a company are tax deductible, if certain criteria are met. In particular, the charitable contribution has to be remitted to (i) Swiss legal entities which are exempt from taxation based on their public welfare or exclusively charitable objective or to (ii) the Swiss Federation, a Swiss Canton or Municipality, or their agencies ('Anstalten'). The cantons usually apply the same rules and similar thresholds.

Sponsoring contributions are only tax deductible if commercially justified (without specific thresholds).

### *Fines and penalties*
Under Swiss tax law, tax fines are usually not tax deductible. The potential tax deductibility of other fines or penalties has to be analysed with respect to the specific case.

### *Tax expenses*
Corporate income and capital taxes paid to Switzerland as well as to the cantons and the municipalities are tax deductible.

### *Net operating losses*
Losses may be carried forward for at maximum seven tax years and offset from the preceding seven years' taxable profits. There is no carryback of losses.

### *Payments to foreign affiliates*
Management and services fees paid by a Swiss company to a related party are generally tax deductible as long as the fees are at arm's length.

## *Group taxation*

Tax is levied on each corporation as a separate entity. A parent company and its Swiss subsidiaries are taxed separately, and only the dividends from the subsidiaries (but not their profits) are taxable in the parent company's hands. However, usually for dividend income, the participation relief is applicable *(see Participation relief in the Income determination section)*. As a result, in general, there are no rules on group consolidation for tax purposes.

### *Transfer pricing*
Switzerland is of the opinion that transfer pricing matters cannot be addressed by legislation and therefore has no plans to issue any domestic provisions on transfer pricing in the near future. There is, however, an increasing awareness of the issue and concern on the part of the Swiss tax authorities that taxpayers may transfer profits without economic justification to countries with strict transfer pricing rules and documentation requirements in order to avoid challenges by the respective local tax authorities. In this context Swiss tax authorities take an increasing interest in a company's transfer pricing position in order to defend their own position. Some cantonal tax authorities have started to particularly focus on low risk/low profit entities located in Switzerland.

Switzerland follows the OECD Guidelines as closely as possible and recognises the arm's-length principle based on interpretation of actual legislation. To clarify transfer pricing issues, Switzerland offers an informal procedure for agreeing to pricing policies in advance.

### *Thin capitalisation rules*
Swiss thin capitalisation rules are, in general, only applicable for related parties. Thereafter, the debts of a company are added to its equity if, economically, they are to be treated as equity. The respective circular letter issued by the Federal Tax Administration provides for debt/equity ratios as safe harbour rules. As an example, the debt/equity ratio is generally fixed at 6:1 for financial companies (safe harbour). Interests paid on loans that exceed the relevant ratios are not deductible; further, these interests may be deemed as a hidden distribution and hence subject to Swiss WHT. There are no limitations on the financing of Swiss corporations by independent third parties (e.g. banks).

Interest rates paid to affiliated companies are also subject to periodic fixed ceilings *(see Interest expense in the Deductions section)*. The deduction of interests in excess of the permitted rate may be disallowed and treated as a hidden distribution subject to Swiss WHT.

***Controlled foreign company (CFC) regime***
There are no CFC rules in Switzerland. Certain Swiss tax evasion instruments (i.e. tax avoidance or 'Steuerumgehung') may lead to a result similar to CFC rules; however, they are very rarely assumed by Swiss Courts for affiliated companies.

## ***Tax credits and incentives***

The Swiss cantons offer, in general, competitive tax rates for cantonal and communal tax purposes. Depending on the specific cantonal and municipal tax location in Switzerland, the ordinary overall (federal, cantonal and municipal) CIT charge may vary between 12.7% and 24.2% *(see the Taxes on corporate income section)*. The cantons continually try to improve their environments as business locations. As a result of the CTR II, the cantons may now choose to credit CIT to the capital tax to reduce the overall tax burden *(see Capital tax in the Other taxes section)*. As a further example, the canton of Nidwalden introduced a tax relief for certain licensing income (so-called license-box), whereupon net licence income from the use of intangible assets is taxed separately at a reduced corporate tax rate of 1/5 of the regular rate.

In addition, many cantons offer tax incentives for newly established companies or for expansion investments, such as tax holidays or significant tax relief for cantonal and communal tax purposes for up to ten years. In some cantons or for specific regions, a tax holiday may even be granted for federal CIT purposes if certain conditions are met.

***Privileged cantonal tax regimes***
Many cantons offer privileged corporate tax regimes. Usually, an up-front confirmation for such privileged tax regimes can be obtained by way of an advance tax ruling with the cantonal tax authorities. Such ruling process usually takes at least four to six weeks.

The privileged tax regimes, as described below, are usually granted for an unlimited period of time and can be relied upon unless the Swiss company's circumstances change materially.

***Holding company tax regime***
A qualifying holding company is exempt from all cantonal/communal CIT (with the exception of income from Swiss real estate, which is subject to tax after deduction of typical mortgage expenditures on such real estate).

Consequently, a holding company is in principle only subject to an effective tax rate of 7.83% (i.e. federal CIT rate) prior to participation relief for qualifying dividends and capital gains. A reduced capital tax at the cantonal/communal tax level also usually applies.

The holding company tax status is available to companies which meet all of the following conditions:

- The primary purpose of the company must be to hold and manage long term equity investments in affiliated companies and this purpose must be stated in the by-laws.
- The company must not be engaged in a commercial activity in Switzerland.

- The company must pass an alternative asset or income test, whereby either two-thirds of the company's assets must consist of substantial shareholdings or participations or two-thirds of total income of the company must consist of participation income (dividend income or capital gains) from such shareholdings and participations.

A tax ruling may be obtained from the cantonal tax authorities in the proposed canton of residence in order to confirm eligibility for the holding company status prior to forming the holding company.

### *Domicile company tax regime*

The domicile company tax status is available for companies which only carry out administrative functions in Switzerland but no commercial activities.

Insofar as a company fulfils the above mentioned criteria, it may apply to the cantonal tax authorities in the proposed canton of residence for a tax ruling entitling it to the following taxation:

- A modest portion of foreign source income (i.e. from 0% - 15%) is subject to tax in accordance with the importance of the administrative function in Switzerland.
- Income from qualifying participations (including dividends, capital gains, and re-evaluation gains) is usually tax exempt (whereas losses deriving from qualifying participations usually are non-tax-deductible).
- All income from Swiss sources is taxed at ordinary rates.
- Expenditures which are justified for business purposes are deductible from the income to which they have a business correlation.
- Reduced capital tax rates usually are applicable.

The conditions to qualify as a domicile company vary from canton to canton. This is particularly the case with regard to determining the percentage of income from foreign sources subject to tax in Switzerland and to the definition of exactly what type of income is considered foreign source income.

A domicile company can be expected to be subject to an effective tax rate of 7.83% - 11% on foreign source income.

### *Administrative/auxiliary/mixed company tax regime*

This tax status, which is very similar to the domicile company tax status, has been given different names by the cantons. Internationally, it is most often referred to as the 'mixed company' tax status.



In contrast to the pure domicile company status, it is permissible for a mixed company to undertake limited commercial activity in Switzerland. As a general rule, at least 80% of the income from commercial activities of a mixed company must derive from non-Swiss sources (i.e. a maximum of 20% of income may be linked to Swiss sources). Many cantons additionally require that at least 80% of costs must be related to activities undertaken abroad.

Insofar as a company fulfils the above mentioned criteria, it may apply to the appropriate cantonal tax authorities for a tax ruling entitling it to tax treatment analogous to the rules set forth above for domicile companies. Depending on the concrete Swiss activity and infrastructure, the portion subject to cantonal and communal income tax generally varies from 5% to 25% of the foreign source income and is generally higher than is the case for domicile companies. The exact portion needs to be clarified with the responsible cantonal tax authorities in the tax ruling.

## Withholding taxes

The statutory rate of Swiss WHT is 35%. Relief, if any, is generally granted by refund. With respect to related companies, a mere notification/reporting procedure may be requested for the fraction of the Swiss WHT exceeding the residual WHT. The table further below shows the residual/remaining tax for the recipient. Credit for the unrelieved portion of Swiss WHT may (in case the notification/reporting procedure does not apply) be available in the country of the recipient.

### Introduction of the capital contribution principle in 2011

By the CTR II, the change from the nominal principle to the capital contribution principle was introduced. It entered into force as of 1 January 2011. The capital contribution principle allows repayment of shareholders' capital contributions without liability for Swiss WHT at the level of the distributing company and without income tax at the level of the Swiss individual shareholder (holding the shares in his private assets). According to the transition period, capital contributions are qualifying if accumulated after 31 December 1996 and meeting some further requirements, e.g. special and timely recordings in the statutory books and vis-à-vis the tax authority. In general, the new rules apply for premiums, additionally paid-in capital and contributions into the reserves of a company without increasing the nominal share capital *(see Corporate tax reform II in the Significant developments section)*.

### Treaties in force (as of 1 January 2011)

| | Dividends | | | Interest (1) | Royalties (2) |
|---|---|---|---|---|---|
| **Recipient** | **Portfolio** | **Substantial holdings** | | | |
| | **%** | **%** | **Min. shareholding %** | **%** | **%** |
| Resident corporations and individuals | 0 (3) | 0 | (4) | 0 (1) | 0 |
| Non-resident corporations and individuals: | | | | | |
| Non-treaty | 35 | 35 | -- | 0/35 (1) | 0 |
| Treaty: | | | | | |
| Albania | 15 | 5 | 25 | 5 | 0 |
| Algeria | 15 | 5 | 20 | 10 (5) | 0 |
| Argentina | 15 | 10 | 25 | 12 (5) | 0 |
| Armenia | 15 | 5 | 25 | 10 (5) | 0 |
| Australia | 15 | 15 | Not applicable | 10 | 0 |
| Austria* | 15 | 0 | 20 | 0 | 0 |
| Azerbaijan | 15 | 5 (17) | 20 (17) | 10 (5, 8) | 0 |
| Bangladesh | 15 | 10 | 20 | 10 (5) | 0 |
| Belarus | 15 | 5 | 25 | 8 (5, 8) | 0 |
| Belgium* | 15 | 10 | 25 | 10 (5) | 0 |
| Bulgaria* | 15 | 5 | 25 | 10 (5) | 0 |
| Canada | 15 | 5 | 10 | 10 (5) | 0 |
| Chile | 15 | 15 | Not applicable | 5/15 (23) | 0 |
| China | 10 | 10 | Not applicable | 10 (5) | 0 |
| Croatia | 15 | 5 | 25 | 5 | 0 |

| | Dividends | | | Interest (1) | Royalties (2) |
|---|---|---|---|---|---|
| **Recipient** | **Portfolio** | **Substantial holdings** | | | |
| | % | % | Min. shareholding % | % | % |
| Czech Republic* | 15 | 5 | 25 | 0 | 0 |
| Denmark* | 15 | 0 | 10 | 0 | 0 |
| Ecuador | 15 | 15 | Not applicable | 10 (5) | 0 |
| Egypt | 15 | 5 | 25 | 15 (5) | 0 |
| Estonia* | 15 | 5 | 20 | 10 (5, 15) | 0 |
| Finland* | 10 | 0 | 10 | 0 | 0 |
| France* | 15 | 0/15 (6) | 10 | 0 | 0 |
| Germany* | 15 | 0 (20) | 20 | 30/0 (19) | 0 |
| Ghana | 15 | 5 | 10 | 10 (5) | 0 |
| Greece* | 15 | 5 | 25 | 10 | 0 |
| Hungary* | 10 | 10 | Not applicable | 10 | 0 |
| Iceland | 15 | 5 | 25 | 0 | 0 |
| India | 10 | 10 | Not applicable | 10 (5) | 0 |
| Indonesia | 15 | 10 | 25 | 10 | 0 |
| Iran | 15 | 5 | 15 | 10 (5, 13) | 0 |
| Ireland* | 15 | 10 | 25 | 0 | 0 |
| Israel | 15 | 5 | 10 | 10 (5, 7, 8) | 0 |
| Italy* | 15 | 15 | Not applicable | 12.5 | 0 |
| Ivory Coast | 15 | 15 | Not applicable | 15 | 0 |
| Jamaica | 15 | 10 | 10 | 10 (5) | 0 |
| Japan | 15 | 10 | 25 | 10 (5) | 0 |
| Kazakhstan | 15 | 5 (9) | 10 | 10 (5) | 0 |
| Korea (South) | 15 | 10 | 25 | 10 (5) | 0 |
| Kuwait | 15 | 15 | Not applicable | 10 | 0 |
| Kyrgyzstan | 15 | 5 | 25 | 5 | 0 |
| Latvia* | 15 | 5 | 20 | 10 (5) | 0 |
| Lithuania* | 15 | 5 | 20 | 10 (5) | 0 |
| Luxembourg* | 15 | 5/0 (24) | 10 | 10 | 0 |
| Macedonia | 15 | 5 | 25 | 10 (5) | 0 |
| Malaysia | 15 | 5 | 25 | 10 | 0 |
| Mexico | 15 | 0 | 10 | 5/10 (25) | 0 |
| Moldova | 15 | 5 | 25 | 10 (5, 13) | 0 |
| Mongolia | 15 | 5 | 25 | 10 (5, 13) | 0 |
| Montenegro | 15 | 5 | 20 | 10 | 0 |
| Morocco | 15 | 7 | 25 | 10 | 0 |
| Netherlands* | 15 | 0 | 25 | 5 | 0 |
| New Zealand | 15 | 15 | Not applicable | 10 | 0 |
| Norway | 15 | 0 | 10 | 0 | 0 |
| Pakistan | 20 | 10 | 20 | 10 | 0 |
| Philippines | 15 | 10 | 10 | 10 | 0 |
| Poland* | 15 | 5 | 25 | 10 | 0 |
| Portugal* | 15 | 10 | 25 | 10 | 0 |
| Qatar | 15 | 5 | 10 | 0 | 0 |
| Romania* | 10 | 10 | Not applicable | 10 (5) | 0 |

S

# Switzerland

| | Dividends | | | Interest (1) | Royalties (2) |
|---|---|---|---|---|---|
| **Recipient** | **Portfolio** | **Substantial holdings** | | | |
| | % | % | Min. shareholding % | % | % |
| Russia | 15 | 5 (18) | 20 (18) | 10 (5, 8, 12) | 0 |
| Serbia | 15 | 5 | 20 | 10 | 0 |
| Singapore | 15 | 10 | 25 | 10 | 0 |
| Slovakia* | 15 | 5 | 25 | 10 (5, 13) | 0 |
| Slovenia* | 15 | 5 | 25 | 5 | 0 |
| South Africa | 15 | 5 | 20 | 10/5 (22) | 0 |
| Spain* | 15 | 0 (16) | 25 (16) | 0 | 0 |
| Sri Lanka | 15 | 10 | 25 | 10 (8) | 0 |
| Sweden* | 15 | 0 | 25 | 5 | 0 |
| Thailand | 15 | 10 | 10 | 15 (5, 10) | 0 |
| Trinidad and Tobago | 20 | 10 | 10 | 10 | 0 |
| Tunisia | 10 | 10 | Not applicable | 10 | 0 |
| United Kingdom* | 15 | 0 | 10 | 0 | 0 |
| Ukraine | 15 | 5 | 20 | 10 (5, 13) | 0 |
| United States | 15 | 5/0 (11) | 10 | 0 | 0 |
| Uzbekistan | 15 | 5 | 20 | 5 (5, 13) | 0 |
| Venezuela | 10 | 0 | 25 | 5 (5, 14) | 0 |
| Vietnam | 15 | 10/7 (21) | 20/50 (21) | 10 (5) | 0 |

*Bilateral Agreements (in particular Art. 15 of the Savings Agreement) between Switzerland and the European Union (EU) apply as of 1 July 2005 and provide the following benefits:

Upon request, Swiss WHT on dividends paid by a Swiss subsidiary company to its EU parent company may be reduced to 0% (reduction at source) and is only subject to a notification/reporting procedure, if the following conditions are cumulatively met:

- Direct minimum holding of 25% of the subsidiary's capital for at least two years.
- Both companies are subject to CIT.

Upon request, WHT on interest and royalty payments made between associated companies or their PE resident respectively situated in Switzerland and the European Union may be reduced to 0% (reduction at source) in the source state, if the following conditions are cumulatively met:

- Direct minimum holding of 25% for at least two years (parent/subsidiary) or direct holding by a third company of minimum 25% in the capital of both companies for at least two years (sister companies).
- Both companies are subject to CIT.

Transition periods/rules:

- Greece, Latvia, Poland, and Portugal: WHT rate on interest is at maximum 10% as of 1 July 2005 to 30 June 2009; as from 1 July 2009 to 30 June 2013, the maximum WHT rate is 5%, afterwards 0%.
- Lithuania: WHT rate on interests is at maximum 10% as of 1 July 2005 to 30 June 2009; as from 1 July 2009 to 30 June 2011, the maximum WHT rate is 5%, afterwards 0%.
- Specific transition rules applied in relation to Spain until 31 May 2007. The above mentioned transition rules only cover the Swiss outbound perspective. Further transition rules may apply for Swiss inbound payments (e.g. for royalties paid to a Swiss company), e.g. with respect to Czech Republic and Spain.

In general, the Bilateral Agreements between Switzerland and the European Union are applicable with all EU countries. Consequently, the 35% Swiss WHT can also be reduced in connection with the EU countries, if the requirements above are met. In lack of a DTT, this is in particular to be mentioned with respect to Malta and Cyprus. The application of the Bilateral Agreements is subject to domestic and STA misuse conditions.

DTTs between Switzerland and EU countries with more favourable tax treatment of dividend, interest, and royalty payments remain unaffected.

Notes

1. In Switzerland, there is no WHT on interest deriving from regular loan agreements. The Swiss WHT of 35% is only levied on interest paid by banking institutions (or paid by entities tax-wise qualified as 'banking institutions') to non-banks, interest on bonds, and interest on bond-like loans. Further, the Swiss WHT of 35% may be levied on interest paid on mortgage loans with respect to Swiss located real estate; however, this is not covered in the table above.
2. There is no Swiss WHT on royalties, licenses, and similar fees payable by Swiss individuals or corporations (provided that the dealing at arm's-length principle is met).
3. The statutory Swiss WHT rate of 35% is levied but refunded, provided that the respective earnings are declared as income for tax purposes.
4. Between Swiss group companies, the Swiss WHT of 35% can usually fully be refunded; in many cases, the tax liability can be met by the notification/reporting procedure. For this purpose, a substantial holding is a participation of at least 10% in the share capital or profits and reserves or otherwise a market value of at least CHF 1 million.
5. Certain types of interest payments income deriving from several countries are exempt from WHT.
6. 15% residual tax for French companies with more than 10% shareholding if fulfilling the following requirements: i) No predominant shareholder of the company is EU or Swiss resident and ii) The shares are not traded at a stock exchange (neither the shares of the receiving nor of the distributing company).
7. Full relief of the WHT on interest paid for a loan granted by the Israel Government (including political subdivisions and local corporate bodies) or granted by the Israel Central Bank.
8. Interest on bank loans is 5%.
9. Full relief if certain requirements are met.
10. Interest on bank loans is 10%.
11. Full relief for certain dividend payments to certain US pension funds.
12. Full relief on certain categories of interest.
13. Interest on bank loans is 0%.
14. According to the territorial principle of Venezuela, only certain persons can benefit from the tax relief.
15. Interest on bank loans to corporations is 0%.
16. 0% WHT rate on dividends of participations of at least 25% if participation was held for at least two years.
17. 20% minimal shareholding plus foreign investment of minimal USD 200,000.
18. 20% minimal shareholding plus foreign investment of minimal CHF 200,000.
19. 30% only on income bonds ('Gewinnobligationen') and on profit participating loans ('partiarische Darlehen').
20. 5% for specific power houses ('Grenzkraftwerke').
21. 10% WHT for shareholdings between 20% and 50%; 7% WHT for shareholdings of more than 50%.
22. 5% WHT for shareholdings of more than 20%; 10% WHT for others.
23. 5% WHT on loans from banks and insurance institutions, bonds or other securities traded on a stock market and on certain credit buying; 15% on any other interest.
24. 5% WHT if the shareholding of 10% was held less than two years, 0% WHT if the shareholding of 10% was held longer than two years.
25. 5% WHT if interest is paid to a bank or a securities dealer or an insurance/reinsurance institution; 10% Swiss WHT in all other cases.

## *Tax administration*



### *Returns*

The tax year is the business year. Thus, the basis for corporate taxation is the applicable accounting period, which may end at any date within a calendar year.

The tax system is based on taxpayers' declarations, with subsequent assessments being issued by the tax authorities on the basis of the tax returns filed. The due date varies from canton to canton. Companies are initially assessed on a provisional basis, with the final assessments being issued after the tax base has been either the subject of a tax audit or declared final by the authorities.

### *Payment of tax*

Unless payments on account are specifically requested, federal, cantonal, and communal taxes on income and capital are, in most cantons and for federal tax purposes, payable only upon receipt of a demand based on a provisional or final assessment.

Note that cantonal exemptions apply. As an example, based on the date of maturity of the respective tax year (30 September), the canton of Zurich levies late payment interest to the extent that the full (final) tax amount had not been paid in time (independent from any earlier provisional tax invoices). About one month before the due date, a (provisional) tax bill based on the latest tax return filed or the assessment of the preceding period is sent to the taxpayer. Payment is usually in two or three instalments. If the entire amount is paid up front, a discount may be granted.

The provisional federal CIT is usually due by 31 March of the year following the tax period at question. The due date of the final federal CIT and the provisional and definitive cantonal CIT varies.

## *Other issues*

### *Reorganisations*

Some corporate reorganisations (transfer of business assets within a group of companies, vertical and horizontal spin-off of business or part of business, share-for-share transactions, cross-border reorganisation where the Swiss tax residence is maintained, and replacement of participations) are possible without triggering adverse tax consequences (tax neutrality). In addition, special rules apply for the tax neutral substitution of assets and qualifying shareholdings.

# Syria

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## Significant developments

The Ministry of Economy and Trade has reduced the minimum capital required to establish a partnership to 300,000 Syrian pounds (SYP). The decision was approved by the Syrian Cabinet on 27 April 2010. Prior to this decision, the minimum capital required for a partnership stood at SYP 1 million. In March 2010, the Ministry also reduced the minimum capital required to establish a limited liability company to SYP 1 million from SYP 3 million.

A new bill has been issued (Law No. 13/2011) to encourage Syrian companies to transfer to limited liability and shareholding forms. This law extends the facilities provided by Law No. 61/2007 and grants additional ones to companies. The law provides for companies to pay between 1% and 2% of the difference in the value of their assets as taxes after their revaluation, instead of a rate of between 14% and 28%, and exempts them from any additional taxes or fees that would fall on them because of the revaluation.

Syria has approved a new law regulating the establishment and operations of companies, less than three years after a similar bill was passed. The new text, Law No. 29/2011, brings a number of additions and improvements to the rules regulating the establishment of companies in Syria, such as:

- the establishment of one-person limited liabilities
- the transformation of state-owned entities into companies (currently state-owned institutions operate under specific regulations)
- the establishment of holding firms as limited liabilities, and
- the establishment of non-public shareholding companies.



The minimum face value of shares to be sold by joint stock companies (JSCs) has been lowered to SYP 100 from SYP 500.

In order to ease the establishment of limited liability companies (LLCs), investors will be able to apply to set their company up through the regional offices of the Syrian Investment Agency, the Industrial Cities located across the country, or the Domestic Trade Directorate of the Governorates.

## Taxes on corporate income

### General income tax rates (including branches of foreign companies)

Except for the special cases listed below, common corporate income tax (CIT) rates (including branches of a non-resident entity) vary between 10% and 28% of profits, as follows:

# Syria

| Taxable profit (SYP) | Tax rate (%) |
|---|---|
| Up to 200,000 | 10 |
| From 200,001 to 500,000 | 15 |
| From 500,001 to 1,000,000 | 20 |
| From 1,000,001 to 3,000,000 | 24 |
| Over 3,000,000 | 28 |

CIT is levied on all corporeal and incorporeal persons, residents and non-residents, on all profits generated in Syria. Profits are considered to be realised in Syria if they occurred from efforts exerted in Syria, irrespective of the taxpayer's identity or place of residency.

Syria does not tax residents on a worldwide basis. Syria's tax is based on territoriality.

### *Surtaxes*

Depending on the location of the taxpayer, an additional local administration surtax of 4% to 10% (of the CIT amount) will apply.

### *Joint-stock companies with more than 50% shares offered to the public*

Joint-stock companies offering more than 50% of their shares to the public are subject to a flat CIT rate of 14% on profits. In this case, the 4% to 10% administration surtax does not apply.

### *Other joint-stock and limited liability companies and projects included under investment encouragement laws*

Joint-stock companies offering less than 50% of their shares to the public, limited liability companies, and projects signed with Syrian companies included under the investment encouragement laws are subject to a flat CIT rate of 22% on profits. In this case, the 4% to 10% local administration surtax applies.

### *Hotels, restaurants, and recreational establishments*

International standard, first and second-class hotels, restaurants, lodging houses, related services, and all recreational establishments are subject to tax based on their turnover. The tax rate is 3%, and it covers both CIT and salary tax.

### *Contracts with public sector, oil companies, and non-residents*

A Syrian company contracting with the public sector and/or with an oil company or with a non-resident entity will be subject to a withholding tax (WHT) based on the contract value (on that specific contract only) rather than CIT on real profits.

The same tax rate applies to non-residents operating directly from abroad; they are subject to a 1%, 2%, 4%, 7%, or 10% WHT on the value of the contract. The applicable rates vary according to the nature of the contract and the customer. The non-resident tax covers both income tax and salary tax of the foreign and local employees working on the contract.

## *Corporate residence*

The following entities are considered Syrian residents for tax purposes:

- An entity whose principal activities are administered in Syria.

- An entity that adopts the Syrian Arab Republic as its headquarters.
- Branches or offices of foreign companies in Syria.

## Other taxes

### Value-added tax (VAT)
There is no VAT in Syria.

### Property taxes
Tax on real estate ranges from 14% to 60% based on the type of property. Property tax is also paid on rental income at progressive rates ranging from between 14% and 60%.

### Customs duties/import tariffs
In setting the rules for valuation of merchandise, Syrian customs take into consideration the related explanatory notes issued by the World Trade Organization (WTO).

Customs duties classified in the Harmonized Tariff Schedule apply to goods introduced into Syria. Import operations are subject to prior licenses granted to all importers after they present their documents to the commercial registration and chambers of commerce or industry in Syria.

The value of the goods imported to Syria that should be declared is based on the transaction value. It includes the price which is actually paid or payable for the goods when purchased for the purpose of being exported to Syria and any and all other subsequent expenses incurred by the buyer that were not covered by the price (including but not limited to, shipment, insurance, unloading, etc.) until the arrival of goods to Syria.

In practice, customs duty is levied on the higher of the value of the transaction to which are added subsequent expenses or the price specified by the General Foreign Trade Organization (GFTO).

#### Ordinary tariffs and preferential tariffs
Ordinary tariffs apply to goods which are not qualified for preferential tariffs. Preferential tariffs apply to all goods or part thereof originating from a country or a group of countries with which Syria is bound by special customs agreements that qualify these goods for preferential status within limits specified in the said agreements.

Merchandise that has been put into use in a country other than its country of origin, and that is imported from that country, is subject to the higher customs tariff between country of origin and country of import. Merchandise that has been manufactured in a country other than its country of origin is subject to customs tariff related to country of origin or country of manufacture depending on the degree of manufacture in each country and according to the rules set by the Minister.

### Consumption tax/excise tax
Consumption tax is imposed on certain services and luxury goods with rates ranging from 1.5% to 40%. Taxpayers are required to register for consumption tax purposes, and tax is withheld by the party provided the service or goods or by customs (at import) and paid on a monthly basis to the Ministry of Finance.

### Registration taxes
The estimated cost of establishing a company ranges from USD 4,000 to USD 8,300 plus 0.5% of the capital stamp duty plus local administration tax of 5% of the stamp duty.

For branch offices, establishment costs are lower and may be estimated at USD 3,000.

### Stamp duty
Stamp duty generally is imposed on transactions such as the formation of corporations or the execution of documents, licenses, contracts, etc. at a rate ranging from 0.4% to 0.7%.

The surtax is applicable on the stamp duty tax.

## Branch income

The taxes on branch income are the same as taxes on corporate income (i.e. tax rate varies between 10% and 28%). *See the Taxes on corporate income section for more information.*

## Income determination

### Inventory valuation
Inventory is typically valued at the weighted average cost.

### Capital gains
Capital gains are considered taxable income and are taxed at the normal CIT rates (10% to 28%).

Capital gains include dividends, interest, revenue, premiums, and other cash income sources.

### Dividend income
Dividends paid by Syrian corporations on previously taxed income are not subsequently subject to tax upon distribution.

Dividends received from a non-resident entity are subject to tax upon distribution in Syria of 7.5%.

### Rental income
Rental income should be deducted from the accounting result to reach the taxable result.

Property tax is paid on rental income at progressive rates ranging between 14% and 60%.

### Royalty income
Royalties received are taxed as ordinary income.

### Partnership income
Profits of partnerships are deemed to be distributed and are taxed at progressive rates of 10% to 28%.

### Foreign income
Income from any source, domestic or foreign, received by a company in Syria is subject to the applicable CIT rate. The scope of tax covers the activities carried out inside and outside Syria, which are administered or managed from Syria.

## Deductions

### Deductible expenses
The following expenses are deductible:

- Cost of goods sold.
- Cost of services rendered.
- Rent paid for the business premises (or rent value if the taxable entity owns the property).
- Salaries and incentives paid to employees/workers.
- Payments representing employer's portion of social security contributions.
- Indemnities and allowances (end of service) paid according to the labour law.
- Depreciation accepted according to each kind of profession and industry, except depreciation of real estate.
- Taxes and duties levied during the year except CIT.
- Grants paid by taxable persons against official receipts for known public or private entities on condition the grants do not exceed 3% of net profits.

### Non-deductible expenses
The following expenses are not deductible:

- Expenses leading to the increase of the value of fixed assets (capital expenditures).
- Personal expenses considered by the business owner (or/and his partner) as personal compensation.
- Compensations for partners in some business entities.

### Depreciation
Depreciation of property, plant, and equipment (at rates fixed by the law) is deductible.

### Net operating losses
Losses may be carried forward for five years. The carryback of losses is not available.

### Payments to foreign affiliates
Payments to foreign affiliates are considered normal payments because Syria has no transfer pricing rules. However, the payments may be subject to WHT.



## Group taxation

There is no group taxation in Syria.

### Transfer pricing
No transfer pricing rules exist in Syria.

### Thin capitalisation
No thin capitalisation rules exist in Syria.

## Tax credits and incentives

### Investment incentives

Investment encouragement regulations allow foreign investors to benefit from customs exemptions for the imports used in the investment.

### Permanent CIT exemptions

Physical and moral persons and associations exempted from CIT, either through the real profit or lump-sum profit method, are the following:

- Types of consumers and investors' cooperative associations.
- Farmers harvesting and selling crops; this exemption includes animals and livestock bred on their farming lands.
- Facilities in which stocks are bred or where poultry farming is exercised; subject to CIT according to the real-profit tax.
- Day-care centres.
- Institutes and associations taking care of people with special needs.
- 75% of the yearly net profits for air and maritime transportation.
- 50% of net profits of stock breeding and poultry farming facilities.

## Withholding taxes

### Interest

The income, revenue, and interest earned from accounts opened at Syrian banks and from treasury bonds are subject to an 8.25% total WHT (i.e. 7.5% WHT and 10% surtax).

### Royalties

Royalties paid to non-residents are subject to a 7% total WHT (i.e. 5% CIT as well as a 2% salary tax).

### Resident contractors

When a Syrian company performs contracts with the public sector, with an oil company, or with a non-resident entity, it will be subject to a WHT based on the contract value (on that specific contract) rather than CIT on real profits.

### Non-resident contractors

Revenue earned by non-resident contractors in Syria is subject to a WHT based on the contract value (of that specific contract) rather than CIT on real profits.

### Double taxation treaties (DTTs)

The table below shows the treaty and non-treaty WHT rates:

| Recipient | Interest (%) | Dividends (%) | Royalties (%) |
|---|---|---|---|
| Non-treaty: | 7.5 | 0 | 7 |
| Treaty: | | | |
| Algeria | 10 | 10 | 18 |
| Armenia | 10 | 10 | 12 |
| Bahrain | 10 | (1) | 18 |
| Bulgaria | 10 | 10 | 18 |
| Croatia | 10 | (10) | 12 |

| Recipient | Interest (%) | Dividends (%) | Royalties (%) |
|---|---|---|---|
| Cyprus | 10 | 15 | (8) |
| Czech Republic | 10 | 10 | 12 |
| Egypt | 15 | 15 | 20 |
| France | 10 | 15 | N/A |
| Germany | 10 | (2) | 12 |
| India | 10 | (2) | 10 |
| Indonesia | 10 | 10 | (9) |
| Iran | 10 | 7 | 17 |
| Italy | 10 | (3) | 18 |
| Jordan | 10 | 10 | 18 |
| DPR Korea | 10 | 10 | 18 |
| Kuwait | 10 | (1) | 20 |
| Lebanon | 10 | 5 | 18 |
| Malaysia | 10 | (3) | 12 |
| Malta | 10 | (4) | 18 |
| Pakistan | 10 | 10 | (5) |
| Poland | 10 | 10 | 18 |
| Romania | 10 | (1) | (6) |
| Russia | 10 | 15 | (7) |
| Slovak Republic | 10 | 5 | 12 |
| Tunisia | 10 | 0 | 18 |
| Turkey | 10 | 10 | (8) |
| Ukraine | 10 | (1) | 18 |
| United Arab Emirates | 10 | (1) | 18 |

Notes

1. Taxed only in the dividend beneficiary's jurisdiction (when the beneficiary is owner of the shares).
2. Tax should not exceed:
   - 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that owns at least 10% of the shares of the company paying the dividends or
   - 10% of the gross amount of the dividends in all other cases.
3. Tax should not exceed:
   - 5% of the gross amount of the dividends if the beneficial owner is a company that has owned at least 25% of the capital of the company paying the dividends or
   - 10% of the gross amount of the dividends in all other cases.
4. Total Malta or Syrian tax on the profits of a company and the dividends distributed by such company, as the case may be, shall not exceed the maximum tax chargeable on the company's profits out of which the dividends are paid.
5. Tax should not exceed:
   - 18% of the gross amount for any patent, trademark, design or model, plan, secret formula or process, industrial or scientific equipment, or for information concerning industrial or scientific experience
   - 15% of the gross amount paid for any copyright of literary, artistic, or scientific work, or
   - 10% of the gross amount paid for any copyright of cinematographic films, or tapes for television, or radio broadcasting.
6. Tax should not exceed:
   - 10% of gross amount paid for cinematographic films, magnetic films, and tapes for television and radio or
   - 5% of the sum paid for any copyright of a literary, artistic, or scientific work, including cinematographic films and films and recordings for other forms of radio transmission or television transmission; any patent, trademark, design or model, plan, secret formula, or secret process, as well as for the use or right to use industrial, commercial, or scientific equipment, and for information related to experience in the industrial, commercial, or scientific area.
7. Tax should not exceed:
   - 18% of the gross amount of royalties paid for any patent, trademark, design or model, plan, secret formula or process, any computer software program, or for information concerning industrial, commercial, or scientific experience

- 13.5% of the gross amount of royalties paid for any copyright of literary, artistic, or scientific work, or
- 4.5% of the gross amount of royalties paid for cinematographic films, programmes, and recordings for radio or television broadcasting.

8. Tax should not exceed:
   - 15% of the gross amount of royalties paid for any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial, or scientific experience or
   - 10% of the gross amount of the royalties for the use of or the right to use any copyright of literary, artistic, or scientific work including cinematographic films and recordings for radio and television.
9. Tax should not exceed:
   - 20% of the gross amount of royalties paid for any patent, trademark, design or model, plan, or any industrial or scientific equipment, or for information concerning industrial or scientific experience or
   - 15% of the gross amount of the royalties for any copyright of literary, artistic, or scientific work including cinematographic films, or tapes for television or radio broadcasting.
10. Tax should not exceed:
    - 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10% of the capital of the company paying the dividends or
    - 10% of the gross amount of the dividends in all other cases.

## *Tax administration*

### *Returns*

The tax year in Syria is the calendar year.

Taxpayers in Syria shall comply with the following requirements:

- Tax returns must be filed by 31 May for limited liability and joint-stock companies and 31 March for other types of companies.
- Salary WHT should be submitted by the employer on a semi-annual basis.

### *Payment of tax*

Payment is due at the time of filing.

### *Penalties*

A penalty is assessed for late payments 30 days after the filing date at a rate of 10%, up to the amount of the tax liability.

### *Statute of limitations*

In Syria, the statute of limitations with respect to tax is five years.

# Taiwan

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## Significant developments

In January 2011, Taiwan introduced a thin capitalisation rule in the amended Income Tax Act. From 2011 onwards, deductible interest expense on inter-company loans is capped at a prescribed debt-to-equity ratio to be determined by the Ministry of Finance (MOF).

The amendment to the Income Tax Act in January 2011 also introduces the tonnage tax system. From 2011 onwards, a qualifying enterprise having its head office in Taiwan engaged in maritime transportation may elect to be taxed under the tonnage tax system.

The Taiwan-France tax treaty took effect from 1 January 2011. The withholding tax (WHT) rates imposed on dividends, royalties, and interests have been reduced from 20% to 10%. After signing this treaty, Taiwan currently has double taxation agreements (DTAs) with 20 countries.

On 4 May 2011, the Presidential Office promulgated the Selective Goods and Services Tax (also known as luxury tax), which imposes a 10% to 15% tax on real estate properties purchased not for self use and sold within two years, as well as various luxury products.

## Taxes on corporate income

To help improve Taiwan's investment environment and boost foreign investors' interest in injecting money into Taiwan, the current CIT rate has been reduced from 20% to 17% effective from taxable year 2010 and onward.



Resident companies in Taiwan are taxed on their worldwide income as follows:

| Taxable income | Tax thereon |
|---|---|
| Up to TWD* 120,000 | Exempt |
| TWD 120,001 and over | 17% of total taxable income |

* New Taiwan dollars

A non-resident company is taxed on income derived from Taiwan sources. A non-resident company with a fixed place of business or business agent in Taiwan will be taxed similarly to a resident company (i.e. subject to filing of annual CIT return based on the same CIT rate provided above). Whereas, a non-resident company having no fixed place of business or business agent in Taiwan is subject to WHT at source on its Taiwan-sourced income. WHT rates on dividends, interest, and royalties may be reduced if the recipient is a tax resident of a tax treaty country and the relevant treaty provides for a reduced rate. *See the Withholding taxes section for more information.*

### *Tonnage tax system*

The amendment to the Income Tax Act in January 2011 introduced the tonnage tax system. From 2011 onwards, a qualifying enterprise having its head office in Taiwan engaged in maritime transportation may elect to be taxed under the tonnage tax system, where a lump sum tax is calculated on the net tonnage of their fleet. Once the application is approved, the enterprise must remain under the tonnage tax system and cannot switch to the regular tax system at its discretion for ten consecutive years. Furthermore, loss carryforwards and tax incentives are not eligible under the tonnage tax system.

### *Profit retention tax*

For earnings accumulated on or after 1 January 1998, an additional 10% profit retention tax is imposed on any current earnings that remain undistributed by the end of the following year.

### *Imputation tax system*

Taiwan operates an imputation tax system to eliminate double taxation on earnings of a corporation. The 17% CIT and 10% profit retention tax already paid by the corporation can be distributed to the resident individual shareholders as tax credits to offset against their individual income tax. However, the tax credits distributable to shareholders are subject to certain limitations.

Non-resident shareholders may credit the 10% profit retention tax previously paid by the investee company against the dividend WHT where the dividends are distributed from retained earnings that have already been subject to the 10% profit retention tax. Please note that credit for profit retention tax from dividend WHT is calculated based on a prescribed formula.

### *Income basic tax (IBT)*

All Taiwan resident companies, as well as non-resident companies with a fixed place of business or business agent in Taiwan, should calculate IBT if they earn certain income that is tax-exempt. The basic income of a company is the amount calculated in accordance with a formulae stipulated by the government, with a deduction of TWD 2 million. Currently, the IBT rate is 10%. If the IBT amount is greater than the regular CIT amount, taxpayers must pay income tax based on the regular CIT amount plus the difference between the IBT amount and the regular CIT amount. On the other hand, if the regular CIT amount is greater than the IBT amount, no special action is required.

## *Corporate residence*

A company is a resident of Taiwan for income tax purposes if it is incorporated in Taiwan. A non-resident company which has a fixed place of business or business agent in Taiwan is obligated to file corporate income tax returns in Taiwan on its Taiwan sourced income.

## *Other taxes*

### *Business tax*

All sales of goods and services in Taiwan, as well as the importation of goods into Taiwan, are subject to business tax. There are two types of business tax systems: value-added tax (VAT) and gross business receipts tax (GBRT).

The sellers and service providers are generally obligated to pay business tax for the sales of goods or services within Taiwan unless the law provides otherwise. For importation of goods, the business tax will be paid by the goods receivers or buyers via customs. For importation of services sold by foreign companies to Taiwanese buyers, business tax shall be paid by the service buyers. However, if the foreign service purchased is under TWD 3,000 per transaction, the business tax shall not apply. Furthermore, the service buyer (corporate entity) will not be required to pay business tax if it adopts the VAT system and is exclusively engaged in taxable transactions.

#### Value-added tax (VAT)

VAT is applicable to general industries, and the VAT rate is 5%. Under the VAT system, each seller collects output VAT from the buyer at the time of sale, deducts input VAT paid on purchases from output VAT, and remits the balance to the tax authority.

#### Gross business receipts tax (GBRT)

GBRT is applicable to specified industries (e.g. financial institutions, small businesses). For banks, insurance companies, investment trust companies, securities and futures firms, short-term commercial paper enterprises, and pawnshops, the rate is 2%. For re-insurance enterprises, the rate is 1%.

### *Stamp tax*

Stamp taxes are imposed on each copy of the following documents executed within the territory of Taiwan (with the following respective tax rates):

- Monetary receipts must have a revenue stamp of 0.4% of the amount received per piece. However, a receipt for the money deposited by the bidder requires a revenue stamp of 0.1% of the amount received per piece.
- Contract or deed for the sale or purchase of movable property must have revenue stamp of TWD 12 per piece.
- Contractual agreement under which one party agrees to complete a specific piece of work for the other party for consideration must have a revenue stamp of 0.1% of the contract price.
- Contract for the sale, transfer, and partition of real estate must have a revenue stamp of 0.1% of the contract price.



### *Commodity tax*

Commodity tax (excise duty) is levied on certain commodities, as specified in the Commodity Tax Act (including rubber tyres, beverages, cement, plate glass, oil and gas, electrical appliances, and vehicles), at the time when such goods are dispatched from a factory or when imported. Tax rates vary from 8% to 30% and are applicable to different types of commodities based on the value of the goods or the volume in specific circumstances.

| Type of commodity | Tax rates/amount |
|---|---|
| Rubber tyres | 10% or 15% |
| Beverages | 8% or 15% |

| Type of commodity | Tax rates/amount |
|---|---|
| Cement | TWD 280 to TWD 600 per ton |
| Plate glass | 10% |
| Oil and gas | TWD 110 to TWD 6,830 per kiloliter or TWD 690 per ton |
| Electrical appliances | 10% - 20% |
| Vehicles | 15% - 30% |

### *Property tax*
A tax is levied on land and buildings annually. The land tax rate ranges from 1% to 5.5% of the assessed land value. The building tax rate for business properties is 3% of the assessed value and the rate for non-business properties is 1.2% or 2% of the assessed value.

### *Securities transaction tax*
Tax is levied on securities transactions at the rate of 0.3% on gross proceeds from the sale of domestic shares. Trading in corporate bonds and financial bonds issued by Taiwan companies is temporarily exempt from securities transaction tax assessment.

### *Customs duties*
Taiwan uses the Customs Cooperation Council Nomenclature (CCCN) to classify goods and set duty rates. The customs duty is payable by the consignee or the holder of the bill of lading for imported goods and is based on the dutiable value or the volume of goods imported.

### *Luxury tax*
On 4 May 2011, the Presidential Office promulgated the Selective Goods and Services Tax (also known as luxury tax). With an aim to curb real estate speculation, luxury tax of 10% will apply on real estate properties purchased not for self use and sold within two years, as well as various luxury products such as upscale automobiles, yachts, private jets, helicopters, fur, ivory, high-end furniture, and membership rights. However, the rate is increased to 15% where real estate properties purchased not for self use are sold within one year. The new law was implemented on 1 June 2011.

## *Branch income*

A non-resident company whose head office is located outside of Taiwan must keep separate books for its branch in Taiwan. A head office or regional headquarters' general and administrative expenses may be allocated to the branch under certain conditions. CIT is assessed only on the branch's profits. A Taiwan branch should complete an annual CIT return.

A Taiwan branch of a foreign company may remit after-tax profits to its foreign head office without further tax due.

### *Motion picture leasing*
A foreign motion picture's branch in Taiwan can deem 45% of its revenue from leasing of motion pictures as cost. However, if a foreign enterprise with no branch office in Taiwan leases motion pictures through agents, 50% of the revenues can be deemed as taxable income.

### *Deemed profit method*
A non-resident company which is engaged in international transportation, construction contracting, provision of technical services, or machinery and equipment leasing within Taiwan, and where the cost and expenses are proven to be difficult to calculate, may apply for an advance approval from the National Tax Administration (NTA) to adopt the deemed profit method to determine the taxable income as 10% or 15% of the gross revenues. This will effectively reduce the WHT rate to 2% to 3% on gross revenues once the approval is obtained from the NTA.

## *Income determination*

A Taiwan resident company is taxed on its net income which is defined as gross annual income after deduction of costs, expenses, losses, and taxes. Except for certain exempt items, income from all sources, including offshore and onshore, is subject to CIT.

A non-resident company is only taxed on its Taiwan-sourced income. Article 8 of the Income Tax Act and the related Guideline defines the types of income that should be regarded as sourced from Taiwan.

The Guideline issued by the MOF on 3 September 2009 clarifies the scope of Taiwan-sourced income for the existing income categories. For example, fees received by a non-resident company for service performed entirely outside of Taiwan are exempt from income tax assessment, subject to supporting evidentiary documents.

### *Inventory valuation*
Inventory must be valued at cost. If cost exceeds market price, the latter may be used as the valuation basis except where the last in first out (LIFO) method is used. Cost may be determined by the LIFO, first in first out (FIFO), moving-average, weighted-average, specific identification, or any other method approved by the tax authorities. Conformity between financial and tax reporting is not required.

### *Capital gains*
Gains on the disposal of fixed assets are taxable as current-year income of the company, with the exception of gains on the sales of land. The capital gains tax on marketable securities is currently exempt. Instead, securities transaction tax is levied on the sales proceeds *(see the Other taxes section)*. However, if a non-resident company has a fixed place of business or business agent in Taiwan, capital gains on the sale of marketable securities may trigger IBT.

### *Dividend income*
Dividends received from resident investee companies by a resident corporate shareholder are not included in taxable income. In addition, the imputation tax credit derived from the dividend income of the investee corporation can be distributed to the domestic corporate shareholders, but this tax credit cannot be used to offset the domestic corporation's income tax liability; rather, the tax credits must be recorded in a separate book until they are further distributed to the resident individual shareholders of the resident corporate shareholders.

Dividends received from foreign subsidiaries are taxable, but credits are given for the WHT paid offshore, limited to the incremental tax liability that would result if the dividends were added to the Taiwan corporate shareholder's taxable income and taxed at the Taiwan CIT rate.

### *Interest income*

Interest received on commercial paper and certain other interest-bearing financial instruments are subject to WHT of 10% and 15% for resident and non-resident taxpayers, respectively *(see the Withholding taxes section)*. However, such income is not subject to any other form of income tax and is effectively taxed separately from other income.

### *Foreign income*

Taiwan adopts a worldwide tax system to tax its resident company (including the Taiwan subsidiaries of foreign companies). In theory, taxation on foreign investment income of a Taiwanese company is deferred until cash is repatriated to Taiwan and then subject to CIT. However, given Taiwan also taxes undistributed profits based on net income shown on the income statement *(see Profit retention tax in the Taxes on corporate income section),* foreign investment income may still be taxed in Taiwan before cash is repatriated back to Taiwan.

## *Deductions*

### *Depreciation*

Depreciation on all fixed assets other than land, including premises, plants (buildings), and equipment used to generate income is allowed as a deduction. The straight-line, fixed percentage on diminishing book value, sum-of-years-digit, unit-of-production, and working-hour methods are acceptable depreciation methods to the tax office. The useful lives of typical assets are shown below:

| Asset category | Useful life |
|---|---|
| Computer equipment | 3 |
| Furniture and fixtures | 5 |
| Automobile | 5 |
| Building | 50 |

With the approval of the tax authority, a company may revalue its fixed assets each time the government's wholesale price index increases by 25% over the base period. A company's base period is established at the time of purchase of fixed assets or at such time when a company revalues its fixed assets. Any increase in fixed assets may then be depreciated for tax purposes.

### *Taxes*

All taxes other than income tax are generally deductible, unless where such taxes are related to tax-exempt income. However, tax penalties are not deductible. The tax associated with the acquisition of real estate should be included in the cost of the land or building.

### *Other significant items*

If a company invests in a foreign entity and holds at least 20% equity ownership (this limitation does not apply if special approval is obtained from the Executive Yuan), the company can attribute 20% of the investment amount to a 'reserve for foreign investment loss'.

### *Net operating losses (NOLs)*

A company's NOLs can be carried forward for ten years. Losses cannot be carried back.

### *Payments to foreign affiliates*
Royalties, interest, and service fees paid to a foreign affiliate are subject to WHT. Royalties or service fees paid to a foreign entity may be tax-exempt if certain requirements are met and prior approval is obtained.

## *Group taxation*

Group enterprises meeting certain criteria under the Financial Holding Company Act and Business Mergers & Acquisitions Act may file consolidated tax returns for the Taiwan parent and its first tier Taiwan subsidiaries. For other enterprises, group taxation is not permitted. The Taiwan parent is eligible to file consolidated tax returns if it continuously holds over 90% of the shares of the subsidiaries for 12 months in a tax year.

### *Transfer pricing*
The Taiwan MOF announced the Assessment Rules for non-arm's-length transactions by Profit-seeking Enterprises (TP Assessment Rules) on 28 December 2004. The transfer pricing regulations were established to constrain multinational corporations from leaving their profits in countries with lower tax rates. For applicable companies, the disclosure of related party transactions in the CIT return and the preparation of a transfer pricing report is required. Upon request, the transfer pricing report will have to be submitted to the Taiwan tax authority within one-month of notice. The transfer pricing report must demonstrate the company's good faith effort to comply with the assessment rules. Without proper reason, failure to comply with such rules will result in additional tax payable and financial penalties. The types of transactions governed by these regulations include the following: transfer of tangible assets, use of tangible assets, transfer of intangible assets, use of intangible assets, rendering of services, use of funds, and other types of transactions prescribed by the MOF.

### *Thin capitalisation rules*
In January 2011, Taiwan introduced a thin capitalisation rule in the amended Income Tax Act. From 2011 onwards, deductible interest expense on inter-company loans is capped at a prescribed debt-to-equity ratio (tentatively 3:1) to be determined by the MOF. The thin capitalisation rule generally applies to profit-seeking enterprises, except banks, credit cooperatives, financial holding companies, bills finance companies, insurance companies, and securities companies.

## *Tax credits and incentives*



Certain tax incentives are provided to investors if they are located in prescribed areas such as science parks, economic processing zones, free-trade-zones, etc. Other tax credits are granted to qualifying companies that invest in specific businesses or industries promoted by the government, such as biotech.

### *R&D tax incentive*
Under the Statute for Innovating Industries (SII), R&D credits are available for up to 15% of qualified R&D expenses incurred, with the maximum amount of tax credit capped at 30% of the tax payable for the year in which the expenses were incurred, including the 10% profit retention tax. Unutilised R&D credits will be forfeited and cannot be carried back or carried forward.

According to Regulation Governing R&D Investment Tax Credit (ITC) Available to Profit-seeking Enterprises, applications should be made in the current year for designated R&D costs when they are first allocated or incurred in order to qualify for R&D ITC. A separate annual application for R&D ITC should be made with the central competent authorities within four months prior to the CIT return filing due date till one month immediately following the filing due date. Information relating to R&D ITC should be provided with the CIT return.

### *Tax concessions on merger*

Under the Business Mergers and Acquisitions Act, a merger or consolidation of companies can be exempt from stamp tax, deed tax, securities transaction tax, and business tax if certain conditions are met. After the merger or consolidation, any tax concession previously enjoyed by the merged entities will continue to be applicable to the surviving company (or new company) after the merger or consolidation. However, the surviving company is required to manufacture the same products or provide the same services which were approved for tax concessions by the merged entities in order to continue the concessions obtained previously.

The unexpired and unutilised NOLs of the participating entities prior to the merger or consolidation may be carried over to the surviving or newly-created entity according to the percentage of shareholding in the surviving or newly-created entity held by all shareholders of the participating entities.

### *Free-trade-zones*

According to the Statute for the Establishment and Management of Free-trade-zones, foreign companies or their branch offices in Taiwan that apply for establishment in the free-trade-zone or delegate companies already established in the free-trade-zone to store and/or perform simple processing in the free-trade-zone and selling the goods within and outside of Taiwan shall be exempted from CIT. However, in the event that the annual domestic sales exceed 10% of the total annual domestic and foreign sales, the portion in excess shall not be exempted from CIT.

### *Foreign tax credit*

Taiwan uses the credit method to avoid double taxation of income. Foreign taxes paid on foreign-sourced income may be credited against a company’s total Taiwan income tax liability. However, the credit is limited to the incremental taxes derived from foreign-sourced income.

## *Withholding taxes*

Resident corporations paying certain types of income are required to withhold tax as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations and individuals | N/A | 10 | 10 |
| Non-treaty | 20 | 15/20 (1) | 0/20 (2) |
| Treaty: | | | |
| Australia | 10/15 (3) | 10 | 12.5 |
| Belgium | 10 | 10 | 10 |
| Denmark | 10 | 10 | 10 |
| France | 10 | 10 | 10 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Gambia | 10 | 10 | 10 |
| Hungary | 10 | 10 | 10 |
| Indonesia | 10 | 10 | 10 |
| Israel | 10 | 7/10 (4) | 10 |
| Macedonia | 10 | 10 | 10 |
| Malaysia (5) | 12.5 | 10 | 10 |
| Netherlands | 10 | 10 | 10 |
| New Zealand | 15 | 10 | 10 |
| Paraguay | 5 | 10 | 10 |
| Senegal | 10 | 15 | 12.5 |
| Singapore | (6) | Not prescribed | 15 |
| South Africa | 5/15 (7) | 10 | 10 |
| Swaziland | 10 | 10 | 10 |
| Sweden | 10 | 10 | 10 |
| United Kingdom | 10 | 10 | 10 |
| Vietnam | 15 | 10 | 15 |

Notes

1. For non-resident enterprises, a 15% WHT applies to interest income derived from short-term bills, securitised certificates, corporate bonds, government bonds, or financial debentures, as well as interest derived from repurchase transactions involving these bonds or certificates. The rate in all other cases is 20%, unless reduced under a tax treaty.
2. Royalties received by foreign enterprises that are specially approved in advance by the government are exempt from income tax.
3. A rate of 10% for shareholders that are companies (other than partnerships) with at least a 25% shareholding.
4. 7% of the gross amount of the interest arising in a territory and paid on any loan of whatever kind granted by a bank of the other territory.
5. The WHT rate on technical service fee is reduced to 7.5%.
6. The total tax burden of CIT and dividends tax is not to exceed 40% of the total profits of the company.
7. A rate of 5% for shareholders with at least a 10% shareholding.

### *Tax treaties*

Double taxation treaties entered into with the following countries: Australia, Gambia, Belgium, Denmark, France, Senegal, United Kingdom, Sweden, Indonesia, Hungary, Israel, New Zealand, Netherlands, Paraguay, Singapore, South Africa, Swaziland, Macedonia, Malaysia, and Vietnam relate to corporate and individual income tax. Treaties with Canada, the European Union, Germany, Israel, Japan, Korea, Luxembourg, Netherlands, Norway, Sweden, Thailand, Macau, and the United States relate to certain earnings from the operation of ships and/or aircraft.



## *Tax administration*

### *Returns*

The tax year in Taiwan runs from 1 January to 31 December. Tax returns are filed on a self-assessment basis. Businesses may request approval from the local collection authority to file CIT returns using a fiscal year-end other than 31 December. CIT returns are due no later than five months after the end of the tax year.

### *Payment of tax*

Tax is paid on a self-assessment basis in two instalments. The first payment is based on 50% of the tax liability of the prior year's tax return and is made in the ninth month of the enterprise's fiscal year. However, if the taxpayer meets certain requirements, it may self-assess the provisional tax based on the taxable income of the first half of the current fiscal year. The second payment is made at the time of filing the annual tax return. The returns are subsequently reviewed by the tax authorities, and a final assessment is issued.

Any overpaid tax as a result of the tax collection authority's mistake shall be refunded to the taxpayer within two years of acknowledgement of such mistake and shall not be subject to the original five-year period for applying for refund where the taxpayer is responsible for the mistake.

# Tajikistan

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## Significant developments

Starting from 1 January 2011, the following changes, updates, and clarifications were implemented and introduced:

- Excise tax on cellular communication services was introduced at the rate of 3%.
- Persons importing lint cotton and smelt in the territory of Tajikistan are now also obliged to pay tax on sales.
- VAT on pharmaceuticals was introduced at the rate of 5%.
- Reduction of allowed deduction of provision for doubtful debts for banks and other financial institutions.
- Change in the real estate tax rates.
- Changes in tax returns submission deadlines.

## Taxes on corporate income

Generally, all Tajik legal entities are subject to taxation in Tajikistan. Corporate income tax (CIT) is computed by applying the statutory 15% rate to taxable income (25% for enterprises operating in transport, communication, banking, and service sectors), which is calculated based on gross income decreased by allowed deductions and losses carried forward from previous periods.

Tajik residents are taxed on their worldwide income. Non-residents are subject to CIT in Tajikistan only on Tajikistan source income. Non-residents operating through a permanent establishment (PE) are generally subject to the same CIT provisions.

### Minimum income tax

In Tajikistan, there is a minimum income tax on company income at the rate of 1% of aggregate annual income. The minimum income tax should always be paid in full. If CIT is less than the minimum income tax, then CIT should not be paid. If CIT is greater than the minimum income tax, then only the positive difference between CIT and the minimum income tax should be paid.



## Corporate residence

Legal entities formed under Tajik law, as well as legal entities whose effective control (management) is in Tajikistan, are recognised as residents for CIT purposes.

### Permanent establishment (PE)

Under general provisions of the Tax Code, any place of activity associated with production, assembling, packaging, supply, construction, and exploration activity on the territory of Tajikistan, regardless of duration of such activities, will be deemed as PE of a non-resident.

Non-residents providing services in the territory of Tajikistan continuously during 90 days in any consecutive 12 month period also create PE in Tajikistan.

## Other taxes

### Value-added tax (VAT)

VAT is generally assessed on taxable turnover, which includes goods and services. The current VAT rate is 18%. Individuals and businesses are required to register as VAT payers if the taxpayer's taxable turnover exceeds a threshold of 200,000 Tajik somoni (TJS) (approximately USD 43,000) for the preceding 12-month period.

Generally, the Tax Code exempts the following from VAT: goods and services that are not provided in Tajikistan under the place of supply rules; sale, transfer, or rent of real property; financial services; medical services; publishing; and certain other goods and services.

For goods, the place of supply is determined as the initial point of transportation. Services are generally considered to be provided at the place of business of the service provider or the actual place where services are rendered. However, for certain types of services, such as consulting and accounting, the services are considered to be provided at the location of the buyer.

A VAT refund is generally available for qualified exporters if input VAT exceeds assessed VAT.

VAT returns, together with issued and received invoices, are filed monthly, not later than the 15th day of the month following the reporting month. Payments are due by the same date.

### Land tax

Land tax is paid based on the area of the land plot and varies depending on the location. The land tax rate ranges from TJS 180 to TJS 500 (approximately USD 39 to 108) per hectare, depending on the location of the land plot.

### Real estate tax

Real estate tax applies to immovable real property such as buildings, houses, and flats. The real estate tax rate is calculated by multiplying the land tax rates by relevant coefficients (from 15 to 60), which depend on the purpose of real property and may be adjusted by the state authorities in each specific case.

### Customs duties

The tariff rates established by the government, ranging from 0% to 15%, are applied on an *ad valorem* basis, at a specific rate, or via a combination of the two. The tax rate of 0% is granted to certain types of goods (e.g. some types of printed publication, unwrought wool, gaseous hydrocarbons, electricity).

Note that Tajikistan is signatory to several free trade agreements, primarily among the following Commonwealth of Independent States (CIS) countries: Russia, Belarus, Kazakhstan, and Kyrgyzstan.

### *Customs fees*
Customs clearance could not be performed without certification of goods, for which importer should pay based on time spent by certification specialist. Fees for customs clearance range from approximately USD 10 to USD 450, depending on customs value.

### *Excise taxes*
Excise tax is assessed on beverages, tobacco products, fuel, tires, and passenger automobiles. Excise tax rates are established by the government.

### *Social tax*
An employer is obliged to make social tax payments at the rate of 25% of salary.

### *Road tax*
The formula for calculating road tax is total deductions of the reporting year multiplied by the 2% tax rate (0.5% for trade companies). If actual deductions do not exceed 70% of gross income, the tax base for road tax would be 70% of gross income.

### *Vehicle tax*
Vehicle tax is computed as a percentage of the calculation index applied for horse power of the vehicle engine. The percentage ranges from 2.5% to 13.75%.

## *Branch income*

In addition to CIT, PEs are subject to branch profit tax at the rate of 8% of net profit after CIT, unless a lower rate is prescribed by an applicable double taxation treaty (DTT).

## *Income determination*

Income tax is assessed on taxable income, which is the difference between gross income and allowed exemptions and deductions.

### *Inventory valuation*
Inventory accounting for tax purposes generally follows inventory accounting for financial reporting purposes. Starting from 2011, legal entities should apply International Financial Reporting Standards (IFRS).

### *Capital gains*
In general, capital gains on securities are taxed as business profits.

### *Inter-company dividends*
Inter-company dividends received by a resident parent company from a resident subsidiary are exempt from CIT.

### *Foreign income*
Tajik residents are taxed on their worldwide income. Non-residents are subject to CIT in Tajikistan only on Tajikistan source income. There are no provisions in the Tax Code for tax deferral.

The Tax Code contains CFC provisions, according to which, income received by the resident's subsidiary (more than 10% ownership) registered in countries with privileged taxation should be included in the income of the resident.

## Deductions

In general, all business expenses (e.g. materials, payroll) are allowed as a deduction if the expenses are connected with the earning of income, not of a capital nature, and supported by proper documentation.

### Depreciation

The deduction for costs related to fixed assets generally is made through depreciation at rates ranging from 7% to 20%, using the declining balance method.

### Goodwill

There are no special provisions for goodwill deduction in the Tax Code; however, goodwill is not deductible in accordance with the general rules on intangible assets amortisation.

### Interest

Interest deductibility is generally limited to three times the refinancing rate of the National Bank of Tajikistan (currently 9%). For certain entities, additional limitations may apply.

### Bad debts

A taxpayer is allowed a bad debts deduction in cases where the income associated with such bad debts is already recognized for CIT purposes. Bad debts are deductible when they are written-off in the accounting books. Special provisions apply for banks and other financial institutions.

### Charity contributions

Charity contributions are limited to 10% of taxable income.

### Taxes, penalties, and fines

Taxes paid to the budget of Tajikistan and other states are deductible, except for CIT and minimum income tax. Penalties and fines paid to budget are not deductible.

### Other significant items

Among other deductions specifically mentioned in the Tax Code are research and development, repair expenses, and geological and geophysical expenses.

### Non-deductible expenses

Non-deductible expenses specifically mentioned by the Tax Code include meals and entertainment, personal expenses, passenger vehicles, and non-business expenses.

### Net operating losses

Net operating losses may be carried forward for three years but may not be carried back.

### Payment to foreign affiliates

No special provisions for deduction of payments to foreign affiliates exist in the Tax Code; therefore, general rules for deductibility of expenses should apply.

## Group taxation

There are no rules permitting grouping for tax purposes in Tajikistan.

### Transfer pricing
The tax authorities have the right to review prices applied in the following transactions for their compliance with market-level pricing:

- Transactions between related parties.
- Barter transactions.
- Cross-border transactions.
- All transactions with deviation of more than 30% from market level.

### Thin capitalisation
There are no thin capitalisation rules in Tajikistan; however, interest deductibility is limited *as described in the Deductions section.*

## Tax credits and incentives

Tax incentives include the special economic zones of Sogd, Pyandj, Ishkoshim, and Dangara. Sodj and Pyandj are actively functioning economic zones.

Also, an exemption from CIT is available for taxpayers that have made a certain amount of investments into chartered capital of a production company, as follows:

- Two years exemption if volume of investments is up to USD 500,000.
- Three years exemption if volume of investment is from USD 500,000 up to USD 2 million.
- Four years exemption if volume of investment is from USD 2 million up to USD 5 million.
- Five years exemption if volume of investment exceeds USD 5 million.

### Foreign tax credit
Taxes paid outside Tajikistan may be credited against the same types of taxes in Tajikistan, if appropriate supporting documents are provided. The amount of credit may not exceed the amount of tax assessed in respect of such income at the rates applicable in Tajikistan.

## Withholding taxes

Tajikistan source income of non-residents is subject to WHT at its source at the rates shown in the following table:



| Types of income at source of payment | Tax rate (%) |
|---|---|
| Dividends and interest | 12 |
| Insurance and reinsurance premiums | 4 |
| International transport and telecommunications | 4 to 6 |
| Royalties, rent, lease income, management fees, and other income | 15 |

In accordance with the DTTs as of 1 January 2010, the rate of WHT may be reduced as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| No treaty | 12 | 12 | 15 |
| Armenia | 10 | 10 | 10 |
| Azerbaijan | 10 | 10 | 10 |
| China | 5/10 (1) | 8 | 8 |
| Czech Republic | 5 | 7 | 10 |
| Germany | 5/15 (2) | 0 | 5 |
| India | 10 | 10 | 10 |
| Kazakhstan | 10/15 (3) | 10 | 10 |
| Kyrgyzstan | 5/15 (4) | 10 | 10 |
| Latvia | 0/5/10 (5) | 7 | 5/10 (6) |
| Moldova | 5/10 (7) | 5 | 10 |
| Pakistan | 5/10 (7) | 10 | 10 |
| Poland | 5/15 (8) | 10 | 10 |
| Russia | 5/10 (9) | 10 | 15 |
| Turkey | 10 | 10 (10) | 10 |
| Turkmenistan | 10 | 10 | 10 |
| Ukraine | 10 | 10 | 10 |

Notes

1. A rate of 5% of the gross amount of the dividends if the recipient is an enterprise (except a partnership) that directly holds at least 25% of the capital of the company paying the dividends; 10% of the gross amount of the dividends in all other cases.
2. A rate of 5 % of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 10% of the capital of the company paying the dividends; 15% of the gross amount of the dividends in all other cases.
3. A rate of 10% of the gross amount of the dividends if the beneficial owner is a legal entity and directly holds no less than a 30% stake in the company paying the dividends; 15% of the gross amount of the dividends in all other cases.
4. A rate of 5% of the gross amount of the dividends if the beneficial owner is a company that holds at least 50% of the share capital of the company paying the dividends; 15% of the gross amount of the dividends in all other cases.
5. A rate of 0% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 75% of the capital of the company paying the dividends; 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 25% of the capital of the company paying the dividends; 10% of the gross amount of the dividends in all other cases.
6. A rate of 5% of the gross amount of the royalties paid for the use of or the right to use software, or industrial, commercial, or scientific equipment; 10% of the gross amount of the royalties in all other cases.
7. A rate of 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 25% of the share capital of the company paying the dividends; 10% of the gross amount of the dividends in all other cases.
8. A rate of 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 25% of the share capital of the company paying the dividends; 15% of the gross amount of the dividends in all other cases.
9. A rate of 5% of the gross amount of the dividends if the beneficial owner is a person who holds directly at least 25 % of the share capital of the company paying the dividends; 10 % of the gross amount of the dividends in all other cases.
10. Interest arising in Tajikistan and paid to the government of Turkey or to the Central Bank of Turkey shall be exempt from Tajikistan tax; interest arising in Turkey and paid to the government of Tajikistan or to the National Bank of Tajikistan shall be exempt from Turkish tax.

## *Tax administration*

### *Returns*

The Tax Code prescribes a calendar year as the tax year. Annual CIT declarations are due by 1 April in the year following the tax year-end.

Taxpayers are required to submit their estimated calculation of monthly advance payments of CIT.

### *Payment of tax*
With respect to CIT, advance payments are due every 15th day of the month. Payment of any outstanding CIT liabilities is required not later than 10 April following the reporting tax period.

The settlement of minimum income tax should be done by 10 April following the reporting tax period in case it exceeds CIT liability.

### *Fines and interest penalties*
The fine for failure to file a tax return ranges from a minimum amount of 1 calculation index (CI), which is currently TJS 35 (approximately USD 7.6), to a maximum fine of 100 CI, or TJS 3,500 (approximately USD 761). The amount of the fine depends on the taxpayer's category and should be assessed based on each ten days of delay. In the absence of tax returns, the tax authorities are entitled to assess taxes based on any information available.

Fines may be assessed in the amount of 10% to 20% of the understated tax liabilities. In severe cases, a violation may be considered a criminal offence.

A fine for failure to withhold and remit tax may be assessed in the amount of 3 to 200 CI (approximately TJS 1,225 to 7,000 (USD 266 to 1,522)) of the tax not withheld.

Interest penalties may apply to late tax payments in the amount of 0.08% of the underpaid tax amount, for each day of tax underpayment.

### *Statute of limitations*
Taxpayers are allowed to make changes to prior period tax returns within the statute of limitations (three years). No fines should apply to corrections in this case.

## *Other issues*

### *Accounting system*
In accordance with the governmental Resolution of the Republic of Tajikistan concerning International Standards of Financial Statements, the Ministry of Finance of the Republic of Tajikistan shall adopt IFRS through a step-by-step approach. Starting from 2011, juridical legal entities should apply IFRS.

Accounting policies and practices are being revised in light of the legal requirement that companies adopt IFRS and International Accounting Standards. Such revised accounting policies should be adopted by companies' boards of directors and disseminated to all the accounting units with clear instructions on how to introduce and follow the new policies and procedures.

# *Tanzania*

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## *Significant developments*

The most significant recent change in relation to income tax on corporations is the introduction of thin capitalisation restrictions on the amount of deductible interest. The thin capitalisation rules have replaced the interest cover provisions *(see Thin capitalisation in the Group taxation section)*.

## *Taxes on corporate income*

Income tax is charged at a rate of 30% on income of a resident corporation and of a permanent establishment (PE) of a non-resident corporation.

A reduced corporate tax rate of 25% applies for three consecutive years for companies newly listed on the Dar es Salaam Stock Exchange. To qualify, at least 30% of the company's shares must be issued to the public.

Alternative minimum tax applies at a rate of 0.3% of the gross turnover of a company that is in 'perpetual loss status' for a period of at least three consecutive years as a result of tax incentives. The practical application of this tax is unclear, but it has been provided that this tax will apply to income years ending on or after 31 July 2008.

Non-residents are also subject to tax on any income with a source in Tanzania. Certain payments to non-residents are subject to tax at the relevant non-resident withholding tax (WHT) rate *(see the Withholding taxes section for the relevant rates)*.

Income from the disposal of investments in Tanzania is subject to income tax where such investments fall within the source rules, and, in such a case, the income will be taxed at a rate of 30%.

## *Corporate residence*

A company is tax resident if it is incorporated or formed under the laws of Tanzania or if the management and control of its affairs is exercised in Tanzania.

A Tanzanian resident is taxed on worldwide income, irrespective of source. Non-residents are taxable on income with a source in Tanzania.

## Other taxes

### Value-added tax (VAT)

VAT is chargeable on all taxable goods and services supplied in, or imported into, mainland Tanzania. For imported goods, VAT is payable at the time of importation together with any customs and excise duties. For imported services, VAT is accounted for by registered businesses through a 'reverse charge' mechanism. The standard rate of VAT is currently at 18%, but the export of goods and certain services is eligible for zero-rating. Businesses with an annual taxable turnover of more than 40 million Tanzanian shillings (TZS) must register for VAT.

The Commissioner for VAT has the discretion to register as intending traders, investors whose projects have not commenced production, but who wish to be VAT-registered in order to reclaim the tax they incur on start-up costs. VAT payable with respect to capital goods (as defined), which are imported or purchased in Tanzania, may be permanently deferred, subject to certain procedures being followed.

Supplies of certain goods and services are exempt from VAT. A business that produces only exempt supplies is unable to register for VAT and consequently unable to recover the VAT incurred on inputs. However, businesses in this category that import taxable services with a value over the registration threshold must register for VAT to account for the VAT on such services.

Certain goods and services supplied to specified entities are eligible for 'special relief' from VAT. The 'special relief' provisions enable supplies, which would otherwise be chargeable with VAT, to be made VAT free provided certain administrative requirements are followed.

Registered businesses must submit VAT returns, with any tax due, on a monthly basis.

Businesses entitled to VAT refunds can claim any remaining credit six months after a refund first became due, subject to all intervening returns being rendered. Any claim for a VAT refund must be supported by an auditor's certificate. Businesses in a consistent refund position (e.g. exporters) can apply for approval to lodge their refund claims on a monthly basis.

Zanzibar has its own VAT Act, but it is similar to the Mainland Tanzania Act.

### Customs duties

Tanzania is a member of the East African Community, which became a Customs Union on 1 January 2005 on the implementation of the East African Customs Union Protocol. This protocol provides for a common external tariff (CET), elimination of internal tariffs, rules of origin, anti-dumping measures, a common customs law, and common export promotion schemes.

The customs duty rates applicable under the CET are as follows:

| Category | Rate (%) |
|---|---|
| Raw materials, capital goods, agricultural inputs, pure-bred animals, medicines | 0 |
| Semi-finished goods | 10 |
| Finished final consumer goods | 25 |

Tanzania is also a member of the Southern African Development Community (SADC). Where goods are subject to a lower rate of duty from another trade bloc such as SADC, the lower duty rate applies until such a time as the trading arrangements between the trading blocs are harmonised.

### *Excise duties*

Excise duty rates apply as follows.

| Item | Rate for FY 2010/11 |
|---|---|
| Sugared mineral water and aerated waters | TZS 63 per litre |
| Other, including club soda | TZS 63 per litre |
| Carbonated soft drinks | TZS 63 per litre |
| Lemonade and flavoured minerals or aerated waters | TZS 63 per litre |
| Malt beer | TZS 382 per litre |
| Clear beer (from unmalted barley) | TZS 226 per litre |
| Wine with more than 25% imported grapes | TZS 1,223 per litre |
| Wine with domestic grapes content exceeding 75% | 0 |
| Spirits | TZS 1,812 per litre |
| Cigarettes without filter containing more than 75% domestic tobacco | TZS 6,209 per 1,000 |
| Cigarettes with filter containing more than 75% domestic tobacco | TZS 14,649 per 1,000 |
| Other cigarettes not mentioned above | TZS 26,604 per 1,000 |
| Cut rag/filler | TZS 13,436 per kg |
| Satellite and cable television broadcasting | 5% |
| Airtime for mobile phones | 10% |
| Disposable plastic bags | 120% |
| Liquefied petroleum gas (LPG) | 0 |
| Motor car with cylinder capacity exceeding 1000cc but not exceeding 2000cc | 5% |
| Motor vehicle with engine size greater than 2000cc | 10% |
| Old motor vehicles (10 years or more) | 20% |
| Motor spirit (gasoline) premium | TZS 339 per litre |
| Motor spirit (gasoline) regular | TZS 339 per litre |
| Gas oil (diesel) | TZS 314 per litre |
| Jet Fuel | 0 |
| Illuminated kerosene | TZS 52 per litre |
| Other medium oil and preparation | TZS 9.32 per litre |
| Industrial diesel oil | TZS 392 per litre |
| Heavy furnace oil | TZS 80 per litre |
| Lubrication oil | TZS 500 per m3 |
| Lubrication greases | TZS 0.75 per kg |

### *Fuel levy*

Fuel levy is charged on petroleum products at a rate of TZS 200 per litre.

### *Payroll taxes*

Payroll taxes include a skills and development levy at 6% of payroll cash costs and a 20% social security contribution, of which 10% is borne by employers with the other 10% deducted from employee pay, generally.

### Stamp duty
Examples of instruments giving rise to stamp duty obligations include conveyances, leases, share transfers, and issue and transfer of debentures. The current rate is 1% of the transaction value.

### Local taxes
The local government levies a property tax based on the value of a premise. The rates vary depending on the value and location of the property. The local government is also entitled to charge a 0.3% service levy based on turnover generated in the relevant district. For agricultural produce and livestock, there is a cess tax, currently capped at 5% of the producer price.

## Branch income

The income tax liability of a person with a PE in Tanzania is calculated as if the person and the PE are independent but as if the PE is resident in Tanzania. The income of the PE is taxed at the normal income tax rate for entities, namely 30%.

The PE is also subject to a tax on ‘repatriated income’, which applies at a rate of 10% (the same rate as a company would withhold on dividends).

In certain circumstances, business activities of the head office may be attributed to the branch. Arrangements between a PE and head office generally are not recognised other than the transfer of an asset or liability between the two. Amounts derived or payments received and expenditures incurred or payments made that relate to assets held by, or liabilities owed by, the business of the PE are attributed to the PE.

## Income determination

Subject to any provision to the contrary in the Income Tax Act, income is to be calculated in accordance with generally accepted accounting principles. Corporations must apply an accrual basis of accounting.

## Deductions

In calculating taxable profit, deductions are allowed for revenue expenditures incurred wholly and exclusively in the production of income, with some statutory exceptions. For capital expenditures, there are specific tax depreciation allowances.

There are special rules with regard to the valuation of trading stock and long-term contracts and in relation to the treatment of instalment sales and finance leases.

There is ring-fencing of mining operations per licenced area. In addition, expenditures incurred for exploration activities outside a licenced area are only deductible when commercial operations commence.

### Depreciation
The categories of depreciable assets and their tax depreciation rates are set out in the table below.

Expenditures on plant and machinery are generally written off on a reducing balance basis at rates of 37.5%, 25%, or 12.5%, depending on the category of the asset. Certain plant and machinery for manufacturing, fish farming, and tourist hotels benefit from a 50% allowance in the first year, with the normal rates applying to the remaining balance in subsequent years. There is an immediate write-off of expenditures on plant and machinery used in agriculture.

Expenditures on buildings qualify for a depreciation allowance of 5% per year on a straight-line basis. For intangible assets, the write-off is over the useful life of the asset.

Apart from the immediate write-off of plant and machinery, agricultural businesses also benefit from the immediate write-off of agricultural improvement expenditures (including the costs of clearing land, excavating irrigation channels, and planting perennial crops or tree bearing crops). Buildings, structures, dams, water reservoirs, fences, and similar works of a permanent nature used in agriculture, livestock, or fish farming are written off on a straight-line basis over five years.

Mining companies are entitled to a 100% capital deduction with respect to capital expenditures on exploration and development.

### Depreciation allowances rates

| Class | Depreciable assets | Rate (%) |
|---|---|---|
| 1 | Computers and data handling equipment, together with peripheral devices; automobiles, buses, and minibuses with a seating capacity of less than 30 passengers; goods vehicles with a load capacity of less than seven tonnes; construction and earth-moving equipment. | 37.5 |
| 2 | Buses with a seating capacity of 30 or more passengers, heavy general purpose or specialised trucks, trailers, and trailer-mounted containers; railroad cars, locomotives, and equipment; vessels, barges, tugs, and similar water transportation equipment; aircraft, other self-propelling vehicles; plant and machinery (including windmills, electric generators, and distribution equipment) used in manufacturing or mining operations; specialised public utility plant and equipment; and machinery or other irrigation installations and equipment. | 25 |
| 3 | Office furniture, fixtures, and equipment; any asset not included in another class. | 12.5 |
| 4 | Natural resource exploration and production rights and assets in respect of natural resource prospecting, exploration, and development expenditure. (However, note that the Income Tax Act 2004 does provide for predecessor capital deduction provisions in the Income Tax Act 1973 to continue for the holders of mining rights.) | 20 |
| 5 | Buildings, structures, dams, water reservoirs, fences, and similar works of a permanent nature used in agriculture, livestock farming, or fishing farming. | 20 |
| 6 | Buildings, structures, and similar works of permanent nature other than those mentioned in Class 5. | 5 |
| 7 | Intangible assets other than those in Class 4. | 1 divided by the useful life of the asset in the pool and rounded down to the nearest half year |
| 8 | Plant and machinery (including windmills, electric generators, and distribution equipment) used in agriculture. | 100 |

### *Bad debts*
In order to claim relief for bad debts, it is necessary to demonstrate that all reasonable steps have been taken to pursue payment and that there is a reasonable belief that the debt claim will not be satisfied. However, financial institutions should generally be able to claim relief for provisions made in accordance with the standards established by the Bank of Tanzania.

### *Net operating losses*
There is no limit on the carry forward period for tax losses. However, there is ring-fencing of tax losses as follows:

- Losses from agricultural business can only be offset against profits derived from agricultural business.
- Foreign source losses can only be offset against foreign source profits.
- Losses on investments can only be offset against investment income.
- Foreign source losses on investments can only be offset against foreign source investment income.

In certain circumstances, tax losses may be forfeited on a change in the underlying control of an entity.

## *Group taxation*

There are no provisions for tax consolidation or group relief.

### *Transfer pricing*
With respect to transactions between related parties, there is an obligation to 'quantify, apportion, and allocate amounts' for income tax purposes on an arm's-length basis. If the Commissioner considers that a person has failed to comply with this requirement, he may make such adjustments as he thinks appropriate.

The Commissioner has the power to make counteractive adjustments to a person's tax liability, where he considers that an arrangement is a tax-avoidance arrangement.

### *Thin capitalisation*
There is a thin capitalisation restriction on the amount of deductible interest for what are termed 'exempt-controlled resident entities', where the debt: equity ratio exceeds 70:30.

### *Controlled foreign trusts and corporations*
There are provisions that relate to the treatment of unallocated income of controlled foreign trusts and corporations; however, in practice, this is more of academic interest as there is limited outward investment from Tanzania.



### *Anti-avoidance*
Other anti-avoidance provisions include the following:

- A change in the underlying control of an entity, accompanied by some change in the conduct of the business.
- Income or dividend stripping arrangements.
- Income splitting.

## Tax credits and incentives

### Agriculture, manufacturing, mining, and tourism

Tax incentives by way of generous capital deduction provisions are given for specific sectors, namely agriculture, manufacturing, mining, and tourism. *See the Deductions section for further details.*

### Export processing zones, special economic zones

There are special benefits for export processing zones (EPZ) and special economic zones (SEZ). Included in the benefits available to a person licensed to carry on business in an EPZ, as well as to SEZ investors selling in export markets, are a ten-year income tax holiday and WHT holiday, subject to a requirement to export at least 80% of production.

### Foreign tax credits

A credit is automatically given for foreign tax paid by a resident on foreign income, but such credit may not exceed the Tanzanian tax rate applicable to that income. Any unrelieved amount of foreign tax credit may be carried forward (subject to the 'change of control' provisions). An election also may be made to claim relief as an expense instead of as a credit.

## Withholding taxes

### Withholding tax rates

| Payment | Resident (%) | Non-resident (%) |
|---|---|---|
| Dividend | | |
| To a company controlling 25% or more of the voting power and holding 25% or more of the shares | 0 | 10 |
| From a Dar es Salaam Stock Exchange listed company | 5 | 5 |
| Otherwise | 10 | 10 |
| Interest | 10 | 10 |
| Rent | | |
| Land and buildings | 10 | 15 |
| Aircraft lease | 0 | 0 |
| Other | 0 | 15 |
| Royalty | 15 | 15 |
| Natural resource payment | 15 | 15 |
| Service fees | | |
| Technical services provided to mining companies | 5 | 15 |
| Other | 0 | 15 |
| Insurance premium | 0 | 5 |
| Payments to residents without a tax identification number certificate | 2 | N/A |

### Double tax treaties

Double tax treaties are in force with Canada, Denmark, Finland, India, Italy, Norway, South Africa, Sweden, and Zambia. In certain circumstances, these may reduce the WHT rates.

## *Tax administration*

While the year of income for tax purposes is the calendar year, an entity may apply to use its own accounting period rather than the calendar year.

Taxable income and deductible expenditure is quantified in TZS. The Commissioner does have the power by notice in writing to permit quantification in a foreign currency convertible to TZS.

### *Returns*

A statement of estimated tax payable, which contains an estimate of the chargeable income and the tax payable thereon, is due for submission within three months from the beginning of the accounting period. A final tax return must be furnished within six months from the end of the accounting period. WHT returns must be submitted every half year. A late filing penalty applies monthly at an amount equal to the higher of (i) TZS 100,000 or (ii) 2.5% applied to unpaid tax. If estimated tax is significantly underestimated, a penalty may also apply.

### *Payment of tax*

Instalment tax is payable in four equal instalments not later than three months, six months, nine months, and 12 months from the beginning of the accounting period. Final tax is payable on the date on which the final return is due for submission, namely six months after the end of the accounting period. WHT is due seven days after the month of deduction. Interest on late payment is charged at the Bank of Tanzania discount rate plus 5%.

# Thailand

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## Significant developments

### Privileges for sustainable investment
In April 2010, the Board of Investment (BOI) launched a new policy in regard to sustainable investment by stipulating that all areas of the country, except Bangkok, will be designated as Investment Promotion Zones until December 2012.

### Additional tax incentives for regional operating headquarters (ROH)
A new package of tax incentives available to ROH was introduced in November 2010 which gave taxpayers the right to choose whether to follow the old or the new package. However, an application to switch to the new package by an existing ROH may not be made after 14 November 2015. *For further details, see Regional operating headquarters (ROH) in the Tax credits and incentives section.*

### Tax incentives for international procurement center (IPC)
As of 5 May 2011, a 15% corporate income tax rate is granted to qualified income under the IPC, a company established in Thailand for five consecutive years. *For further details, see International procurement center (IPC) in the Tax credits and incentives section.*

### Withholding tax (WHT)
As of 13 October 2010, the following income earned by a foreign company not carrying on business in Thailand, which was previously exempt from tax, is subject to 15% WHT in respect of new investments:

- Interest on bonds/debentures issued by state enterprises.
- Difference between the redemption price and the initial sale price of bonds issued by the government, state enterprises, and specified institutions.
- Gains on the transfer of bonds issued by the government, state enterprises, and specified institutions.

## Taxes on corporate income

Corporate income tax (CIT) is generally paid at a flat rate of 30% on net taxable profits.

Thailand incorporated companies are taxed on worldwide income. A foreign incorporated company is taxed on profits arising from or in consequence of the business carried on in Thailand. A foreign company not carrying on business in Thailand is subject to a WHT on certain types of assessable income (e.g. interest, dividends, royalties, rentals, and service fees) paid from or in Thailand. The rate of WHT is generally 15%, except for dividends which is 10%, while other rates may apply under the provisions of double tax treaties.

### *Reduced rates for listed companies*

A CIT reduction to 25% and 20% respectively is given to companies listed by 31 December 2009 on the Stock Exchange of Thailand (SET) and the Market for Alternative Investment (MAI), the trading board established by the SET. The rates are generally for three years depending on the date of listing.

Listed companies other than those described above are eligible for a reduced CIT rate in the following manners:

**Companies listed on the SET**

| Net profit (THB*) | Rate (%) |
|---|---|
| 0 to 300,000,000 | 25 |
| Over 300,000,000 | 30 |

**Companies listed on the MAI**

| Net profit (THB) | Rate (%) |
|---|---|
| 0 to 20,000,000 | 20 |
| Over 20,000,000 | 30 |

*Thai baht

These rates apply for three accounting periods commencing from the accounting period beginning on or after 1 January 2008.

### *Reduced rates for companies with low paid-in capital*

Companies and juristic partnerships with paid-in capital not exceeding THB 5 million at the end of any accounting period are subject to CIT at the following reduced rates:

| Net profit (THB) | Rate (%) |
|---|---|
| 0 to 150,000 | 0 |
| 150,001 to 1,000,000 | 15 |
| 1,000,001 to 3,000,000 | 25 |
| Over 3,000,000 | 30 |

### *Reduced rates for banks*

Banks are subject to CIT at the rate of 10% with respect to profits derived from lending to non-Thai residents from foreign currency funds obtained from non-Thai sources (so-called 'out-out' business).



### *Petroleum income tax*

Taxation on income from petroleum operations is imposed on petroleum concessionaire companies by the Petroleum Income Tax Acts (PITA). Companies taxed under the PITA are exempt from taxes and duties on income imposed under the Revenue Code and under any other laws. The exemption applies so long as the company pays taxes and duties on income subject to the PITA or on dividends paid out of income subject to the PITA.

Petroleum companies are taxed at the rate of 50% of their annual net profit from petroleum operations, including profit from the transfer of their concession interests and other activities incidental to petroleum operations. Deductions are allowed for 'ordinary and necessary' business expenses, as well as depreciation on capital expenditure, petroleum royalties, and other charges. Certain types of expenses are specifically disallowed for deduction, including interest.

## *Corporate residence*

Corporate residence is determined by the place of incorporation. A company incorporated under the laws of Thailand is a resident company.

A company incorporated abroad is subject to CIT in Thailand if it is considered to be carrying on business in Thailand. The term 'carrying on business in Thailand' is broad and, subject to the provisions of double taxation treaties (DTT), includes the presence of an employee, representative, or go-between that results in a foreign corporation deriving income or gains in Thailand.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is levied at the current rate of 7% (which will be adjusted to a normal 10% rate after September 2012), except on exports, which are zero-rated, and a number of exempt goods and services (e.g. basic groceries, education, health care, interest, leasing of immovable property, and sale of real estate).

### *Specific business tax (SBT)*

SBT is collected on the gross revenue of certain businesses, not subject to VAT, at fixed rates. Commercial banking, similar financial businesses, and the sale of immovable property are taxed at 3% and life insurance at 2.5%.

The rate of SBT has been reduced to 0.01% for certain revenue derived by commercial banks and finance, securities, and credit foncier businesses as well as businesses with regular transactions similar to commercial banking.

An additional 10% of SBT is levied as municipality tax.

### *Stamp duty*

Stamp duty is levied on 28 different types of documents and instruments, including contracts for hire of work, loans, share transfers, leases of land or buildings, and insurance policies. The rate of stamp duty varies depending on the type on agreement, but ranges from THB 1 per THB 1,000 of value on most contracts and agreements to a fixed amount per instrument on most commercial and other documents. Unstamped documents are not admissible as evidence in a civil lawsuit, and the surcharge can be as high as 600% of the duties for failure to pay the stamp duty on a timely basis.

### *Customs duties*

#### Basis of taxation

Customs duties are imposed under the Customs Act and the Customs Tariff Decree. Customs duties are collected on both imports and a very limited number of exports. Classification of imports is based on the Harmonized Commodity Description and Coding System (the so-called 'Harmonized System'). Thailand has adopted the ASEAN Harmonized Tariff Nomenclature ('AHTN') 2007, which is based on the Harmonized System 2007, as its latest import tariff nomenclature.

Duties are levied on a specific or an *ad valorem* basis, whichever is the higher, and the applied *ad valorem* duties range between 0% and 80%. Exemptions from import duties are available on particular items of goods as prescribed in the Customs Tariff Decree. Preferential duty rates are available on imported goods from countries that have a preferential free trade agreement (FTA) with Thailand.

Currently, Thailand has FTAs with the following countries:

- ASEAN member states (i.e. Singapore, Vietnam, Malaysia, Indonesia, Philippines, Cambodia, Laos, Myanmar, and Brunei).
- Peru (not yet entered into force as of April 2011).
- New Zealand.
- Australia.
- India.
- Japan.

Also, as part of ASEAN, Thailand has preferential trade agreements with the following countries:

- China.
- Korea.
- Japan.
- Australia and New Zealand.
- India.

Generally, the value of imports is based on their CIF (cost, insurance, and freight), whereas exported goods are based on their FOB (free on board).

Thailand has implemented the World Trade Organization (WTO) Valuation Agreement. The primary basis for the customs value is transaction value (i.e. the price actually paid or payable for the goods when sold for export). This is subject to adjustments for certain elements which are considered to form a part of the value for customs purposes, but are not yet included in the selling price. If the declared price is evidently low or is unlikely to be the true value of such goods, Thai Customs will dispute the declared price.

### Customs incentives schemes

Various customs incentives schemes, each with its own specific conditions and duty privileges, are available in Thailand, including the following:

- Duty and tax compensation (‘Tax Coupons’).
- Duty drawback under Section 19 bis for imported raw materials used in export production.
- Duty drawback for re-export in the same state under Section 19.
- Free zones (Customs or Industrial Estate Authority of Thailand Free Zones).
- Manufacturing bonded warehouses.
- General bonded warehouses.
- BOI promotion.



## *Excise tax*

### Basis of taxation

Excise tax is imposed on the sale of a selected range of commodities, whether manufactured locally or imported. Tax rates are based on *ad valorem* or a specific rate, whichever is higher. Tax liabilities arise on locally manufactured goods when leaving the factory and at the time of importation for imported goods.

**Taxable goods and services**

- Fuel oil and petroleum products.
- Certain non-alcoholic beverages.
- Certain electrical appliances.
- Crystal glassware.
- Motor vehicles.
- Boats.
- Perfume products and cosmetics.
- Entertaining services, turf courses, and golf courses.
- Alcoholic beverages.
- Cigarettes containing tobacco.
- Woollen carpets.
- Motor bicycles.
- Batteries.
- Playing cards.
- Ozone depleting substances.

### *Local taxes*

There are three major local taxes:

**Household and land tax**

Household and land tax is levied at 12.5% of assessable economic rental income.

**Signboard tax**

Signboard tax is levied at varying rates according to size. The minimum tax is THB 200 per annum.

**Local development tax**

Local development tax is levied at rates ranging between 0.25% and 0.95% of the value of land assessed by local authorities. This tax does not apply if the property is subject to household and land tax.

### *Capital taxes*

There are no capital taxes in Thailand.

## *Branch income*

Branches of foreign corporations pay income tax at the corporate tax rate on locally earned profits only. Branch profits remitted to the foreign head office are subject to additional tax at the rate of 10%. However, this is a tax on disposition of profits abroad and is not limited to remittances. For example, a credit of profits to the head office account in the books is held to be a disposition of profits abroad even though no remittance of funds takes place.

## *Income determination*

### *Inventory valuation*

Inventory is valued at the lower of cost or market price. Any recognised method of ascertaining the cost price may be used, but a change in the method may be made only with the prior approval of the director-general of the Revenue Department. Conformity between book and tax reporting is required.

### Capital gains

There is no specific legislation governing capital gains. All capital gains earned by a Thai company are treated as ordinary revenue for tax purposes. Capital gains on the sale of investments derived from or in Thailand by a foreign company not carrying on business in Thailand are subject to a tax of 15%, withheld at source by the purchaser, unless otherwise exempt under a DTT.

As of 13 October 2010, gains earned by a foreign company not carrying on business in Thailand on sale of bonds issued by the government, state enterprises, and specified institutions are subject to a WHT of 15%.

### Dividend income

Dividends received from a Thai company by a company listed on the SET are exempt from tax. Dividends received by a non-listed company from other Thai companies are also exempt from tax, provided that the company receiving the dividends holds at least 25% of the total voting shares without any cross-shareholding. The tax exemption applies on the condition that the shares must be held for at least three months before and three months after the dividends are received.

In other cases, where one Thai company receives dividends from another Thai company, one half thereof is exempt from tax.

Dividends received from outbound investment are exempt from tax provided that the Thai company receiving the dividends holds at least 25% of the shares with voting rights of the company paying the dividends for a period of not less than six months before the date on which the dividends are received and the dividends must be derived from net profit in the foreign country taxed at a rate of not less than 15%. In the event that a 'special law' in a particular foreign country provides a reduced tax rate or exemption for the net profit, the limited company which receives the dividends is still eligible for tax exemption.

Share of profits received by a Thai company or a foreign company carrying on business in Thailand from an unincorporated joint venture carrying on business in Thailand are exempt from CIT.

### Stock dividends

Stock dividends are taxable to the recipient as ordinary income.

### Foreign income

Only Thailand incorporated companies are taxed on worldwide income. The Revenue Code does not describe how foreign income received by a Thailand-incorporated company is taxed, but the Revenue Department regards foreign branch income as taxable when earned and foreign dividend income as taxable when received. Double taxation is relieved by way of a credit against the tax chargeable in Thailand *(see Foreign tax credit in the Tax credits and incentives section)*.



## Deductions

### Depreciation, amortization, and depletion

Deductions for wear and tear and depreciation are allowed as a percentage of cost. If the rate of deduction adopted by a company under its own accounting method is lower than the statutory percentage of cost, a deduction will be allowed only at the rate adopted by the company. The straight-line basis is the method most commonly used by companies, but any generally accepted basis, such as sum-of-the-years-digits method or double declining method, is permitted. Statutory rates are as shown:

| Asset | Rate (%) |
|---|---|
| Buildings: | |
| Durable buildings | 5 |
| Temporary buildings | 100 |
| Cost of acquisition of depletable natural resources | 5 |
| Cost of acquisition of lease rights: | |
| If there is no written lease agreement or if there is a written lease agreement containing a renewal clause whereby continual renewals are permitted | 10 |
| If there is a written lease agreement containing no renewal clause or containing a renewal clause but restricting renewable periods to a definitely limited duration | Percentage rate equals 100 divided by the sum of years of the original and renewable lease periods |
| Cost of acquisition of the right in a process, formula, goodwill, trademark, business license, patent, copyright, or any other right: | |
| If the period of use is unlimited | 10 |
| If the period of use is limited | Percentage rate equals 100 divided by the number of years of use |
| Other assets not mentioned above, excluding land and inventory | 20 |

Special depreciation methods for certain assets may be applied as follows:

- Machinery and equipment for research and development (R&D) may initially be depreciated at 40% of cost with the remaining balance being depreciated at the above statutory rate of 20% per annum.
- Computer hardware and software may be depreciated within three accounting periods.
- Fixed assets, excluding vehicles, land, buildings, and intangible assets of taxpayers operating in the tourism business under the law governing Thailand tourism, which have been purchased or the ownership transferred for the taxpayer's own business use, may initially be depreciated at 60% of cost on the acquisition date. The remaining cost should then be depreciated according to the normal depreciation method, which is a maximum of 20% per annum. The initial depreciation can be used for assets acquired and ready for use from 14 October 2010 until 31 December 2011.

### Special depreciation method for small companies

Companies and juristic partnerships with fixed assets, excluding land, at a value of no more than THB 200 million and with no more than 200 employees are entitled to the following special depreciation methods in addition to those noted previously:

- Machinery and equipment may initially be depreciated at 40% of cost, and the remaining balance is then depreciated at the prescribed rate.
- Computer hardware and software may initially be depreciated at 40% of cost, and the remaining balance is then depreciated within three accounting periods.
- Factory buildings may initially be depreciated at 25% of cost, and the remaining balance is then depreciated at the prescribed rate.

### *Charitable contributions*
Deductions for allowable charitable contributions and certain other donations may not exceed 2% of net taxable profits. Deductions for educational support as approved by the Ministry of Education may be allowed at the rate of 200% of the actual expense, but not exceeding 10% of net profit before deductions of the allowable charitable contributions and certain other donations. Furthermore, deductions for the support of public recreational facilities may also be allowed at the rate 200% of the actual expense, but not exceeding 10% of net profit before deductions of the allowable charitable contributions and certain other donations after including the educational support expense.

### *Taxes*
In general, all taxes are deductible except CIT and VAT together with fines, penalties, and surcharges charged under the Revenue Code.

### *Non-deductible expenses*
There are list of non-deductible expenses, including, but not limited to, the following:

- Expenses having nature of provisions or reserves.
- Contributions to any fund (except an approved provident fund).
- Bad debt written off which is not consistent with the rules, procedures, and conditions prescribed by the Ministerial Regulations.

### *Net operating losses*
Losses may be carried forward for the following five accounting periods. Carryback of losses is not permitted. A change in control of a loss company does not impact its loss carryforward.

### *Payments to foreign affiliates*
A Thailand incorporated company may claim a deduction for royalties, management service fees, and interest charges, provided they are expended exclusively for the purpose of generating profits or for purposes of business in Thailand and are determined on an arm's-length basis.

## *Group taxation*

Group taxation is not permitted in Thailand.

### *Transfer pricing*
Thailand has no detailed transfer pricing legislation. However, transfer pricing guidelines issued by the Revenue Department define the term 'market price', detail the permitted transfer methods, describe the transfer pricing documentation requirements, and allow taxpayers to apply for advance pricing agreements (APAs) in respect of any intended related party transaction.



The transfer pricing guidelines do not have the status of legislation but are internal directives that the Revenue officials must adhere to when conducting tax audits, reviews, or investigations. The guidelines are also intended to inform taxpayers about transfer pricing practices.

The guidelines authorize the use of both transactional transfer pricing methods (e.g. the comparable uncontrolled price, the resale price, and the cost plus methods) as well as profit based methods, in order to determine the market price of a transaction. No one method is preferred over another, and there is no hierarchy of acceptable methods. Although the Revenue Department would generally accept a taxpayer's chosen method, it retains the right to select an alternative method if it deems it to be more appropriate.

### *Thin capitalisation*

Under the tax law, there are no thin capitalisation rules or prescribed debt to equity rules in Thailand.

## *Tax credits and incentives*

The Board of Investment (BOI), by virtue of the Investment Promotion Act, provides tax incentives to certain activities within the following categories:

- Agriculture and agricultural products.
- Mining, ceramics, and basis metals.
- Light industry.
- Metal products, machinery, and transport equipment.
- Electronic industry and electrical appliance.
- Chemicals, paper, and plastics.
- Service and public utilities.

The tax incentives available include the following:

- Exemption from or reductions of import duties on imported machinery.
- Exemption from import duties on raw materials and components imported for manufacturing for export.
- A reduction of up to 90% of import duties on raw or essential materials imported for manufacturing for domestic sale.
- Exemption from CIT equal to the investment, excluding the cost of land and working capital, for up to eight years depending on the promoted activity and location.
- Exclusion of dividends derived from promoted enterprises from taxable income during the period of exemption from CIT.

Additional incentives for enterprises located in an industrial estate or promotion zone include the following:

- Reduction of 50% of CIT for five years after the end of the tax holiday.
- Double deduction from taxable income of the cost of transportation, electricity, and water supply.

### *Privileges for sustainable investment*

In April 2010, the BOI launched a new policy in regard to sustainable investment by stipulating that all areas of the country, except Bangkok, will be designated as Investment Promotion Zones until December 2012. The BOI also provides special privileges to target industries, which have been classified in three categories as follows:

- Activities related to energy conservation and alternative energy.
- Activities related to eco-friendly materials and products.
- High-technology businesses.

Any activity which is classified under the above categories will obtain special privileges as a priority activity, e.g. CIT exemption for a period of eight years with no limit on the amount, import duty exemption for the import of machinery, 50% reduction in the rate of CIT on net profit for five years after the end of the tax holiday, etc.

Applications for the above measures must be submitted before 31 December 2012.

### *Special development zone*
A special development zone has been established in five provinces in the far south of Thailand in which a company or juristic partnership located therein will be subject to CIT at the rate of 3% for the revenue earned from the manufacture or sale of goods or provision of services from the accounting period that begins on or after 1 January 2010, until the accounting period that ends on or after 31 December 2012.

### *Regional operating headquarters (ROH)*
ROH means a company organised under the Thai law providing administrative, technical assistance, or supporting services to its domestic or overseas affiliated enterprises or branches in at least three countries other than Thailand with a paid-in capital of at least THB 10 million on the last day of any accounting period.

Tax incentives available to ROH are under two packages, known as the old and the new package, either of which taxpayers may elect to follow. However, the applications to obtain the privilege under the new package have to be made before 14 November 2015.

The following corporate tax incentives are available under the old package:

- 10% CIT on income from affiliated enterprises and branches for services rendered, including administrative services, technical assistance, management, R&D, or training.
- 10% CIT on interest income received as a result of re-lending to affiliated enterprises or branches funds borrowed by the ROH.
- 10% CIT on royalty income derived from affiliated enterprises and branches and which is generated from R&D work performed in Thailand.
- CIT exemption on dividends received from domestic and overseas affiliated enterprises and branches.

The corporate tax incentives available under the new package are as follows:

- In the case where service fees and royalties received by the ROH from associated enterprises in foreign countries amount to at least 50% of the total income of the ROH (ROH income plus non-ROH income):
  - CIT exemption for ten years on service income derived from foreign branches or associated enterprises of the ROH *(see Note below)*.
  - 10% CIT for ten years on service income derived from domestic branches or associated enterprises of the ROH and on qualified royalties and qualified interest income *(see Note below)*.
  - CIT exemption for ten years on dividends received by ROH from associated enterprises *(see Note below)*.
  - WHT exemption on dividends received by foreign corporate shareholders not carrying on business in Thailand from the qualified ROH profit.
- In the case where service fees and royalties received by the ROH from associated enterprises in foreign countries amount to less than 50% of the total income of the ROH (ROH income plus non-ROH income):
  - CIT exemption for ten years on service income derived from foreign branches or associated enterprises of the ROH *(see Note below)*.

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- 10% CIT for ten years on service income derived from domestic branches or associated enterprises of the ROH *(see Note below)*.

Note: The corporate tax benefits will be extended to 15 years provided that as at the end of the tenth fiscal year, the accumulated business spending paid to recipients in Thailand for ten fiscal periods has exceeded THB 150 million.

### *International procurement center (IPC)*

The IPC will be subject to CIT on its net profit from qualified income at the rate of 15% for five consecutive accounting periods. IPC refers to a company established under Thai law carrying on the business of procuring and selling goods, raw materials, and parts to affiliated companies.

Qualified income includes:

- Income from procuring and selling goods outside Thailand to affiliated companies situated abroad whereby the goods must not be brought into Thailand.
- Income from procuring parts and raw materials either in Thailand or abroad for sale to affiliated companies situated abroad for manufacturing goods outside Thailand by the affiliates.

Applications to obtain the privilege must be submitted within two years from 6 May 2011.

### *Foreign tax credit*

A Thai company can use foreign tax paid on business income or dividends as a credit against its CIT liability. However, the credit cannot exceed the amount of Thai tax on the income.

## *Withholding taxes*

### *WHT rate schedule*

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Resident corporations | 0/10 (1) | 0/1 (2) | 3 |
| Resident individuals | 10 | 15 | Progressive rate (3) |
| | | | |
| Non-resident corporations and individuals: | | | |
| Non-treaty | 10 | 15 | 15 |
| | | | |
| Treaty: | | | |
| Armenia | 10 | 10/15 (4) | 15 |
| Australia | 10 | 10/15 (4) | 15 |
| Austria | 10 | 10/15 (4) | 15 |
| Bahrain | 10 | 10/15 (4) | 15 |
| Bangladesh | 10 | 10/15 (4) | 15 |
| Belgium | 10 | 10/15 (4) | 5/15 (9) |
| Bulgaria | 10 | 10/15 (4) | 5/15 (5) |
| Canada | 10 | 10/15 (4) | 5/15 (6) |
| Chile | 10 | 10/15 (4) | 10/15 (27) |
| China | 10 | 10/15 (4) | 15 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Cyprus | 10 | 10/15 (23) | 5/10/15 (7) |
| Czech Republic | 10 | 10/15 (4) | 5/10/15 (8) |
| Denmark | 10 | 10/15 (4) | 5/15 (9) |
| Finland | 10 | 10/15 (4) | 15 |
| France | 10 | 3/10/15 (10) | 0/5/15 (11) |
| Germany | 10 | 10/15 (4) | 5/15 (9) |
| Hong Kong | 10 | 10/15 (12) | 5/10/15 (13) |
| Hungary | 10 | 10/15 (4) | 15 |
| India | 10 | 10/15 (4) | 15 |
| Indonesia | 10 | 10/15 (4) | 15 |
| Israel | 10 | 10/15 (4) | 5/15 (14) |
| Italy | 10 | 10/15 (4) | 5/15 (9) |
| Japan | 10 | 10/15 (4) | 15 |
| Korea, Republic of | 10 | 10/15 (24) | 5/10/15 (25) |
| Kuwait | 10 | 10/15 (4) | 15 |
| Laos | 10 | 10/15 (4) | 15 |
| Luxembourg | 10 | 10/15 (4) | 15 |
| Malaysia | 10 | 10/15 (4) | 15 |
| Mauritius | 10 | 10/15 (4) | 5/15 (5) |
| Nepal | 10 | 10/15 (4) | 15 |
| Netherlands | 10 | 10/15 (4) | 5/15 (9) |
| New Zealand | 10 | 10/15 (24) | 10/15 (15) |
| Norway | 10 | 10/15 (4) | 5/10/15 (16) |
| Oman | 10 | 10/15 (17) | 15 |
| Pakistan | 10 | 10/15 (4) | 0/10/15 (18) |
| Philippines | 10 | 10/15 (28) | 15 |
| Poland | 10 | 10/15 (4) | 5/15 (19) |
| Romania | 10 | 10/15 (4) | 15 |
| Russia | 10 | 10/15 (26) | 15 |
| Seychelles | 10 | 10/15 (4) | 15 |
| Singapore | 10 | 10/15 (4) | 15 |
| Slovenia | 10 | 10/15 (4) | 10/15 (20) |
| South Africa | 10 | 10/15 (4) | 15 |
| Spain | 10 | 10/15 (4) | 5/8/15 (21) |
| Sri Lanka | 10 | 10/15 (4) | 15 |
| Sweden | 10 | 10/15 (4) | 15 |
| Switzerland | 10 | 10/15 (4) | 5/10/15 (8) |
| Turkey | 10 | 10/15 (4) | 15 |
| Ukraine | 10 | 10/15 (4) | 15 |
| United Arab Emirates | 10 | 10/15 (4) | 15 |
| United Kingdom | 10 | 10/15 (4) | 5/15 (9) |
| United States | 10 | 10/15 (12) | 5/8/15 (22) |
| Uzbekistan | 10 | 10/15 (4) | 15 |
| Vietnam | 10 | 10/15 (4) | 15 |

# Thailand

Notes

1. The zero-rate applies to a recipient company listed on the SET.
2. The 1% rate applies to interest paid to all resident corporations other than banks or finance companies, except where interest arises from bonds or debentures.
3. The progressive rate is in accordance with the personal income tax schedule.
4. The 10% rate applies to interest paid to a recipient that is a bank or financial institution (including an insurance company).
5. The 5% rate applies to royalties paid for the use of any copyright of literary, artistic, or scientific work excluding cinematograph films and films, tapes or discs for radio, or television broadcasting.
6. The 5% rate applies to royalties paid for the production or reproduction of any literary, dramatic, musical, or artistic work excluding royalties with respect to motion picture films and works on film or videotape for use in connection with television.
7. The 5% rate applies to royalties paid for the use of any copyright of literary, dramatic, musical, artistic, or scientific work including software, cinematograph films or films or tapes used for radio or television broadcasting; and the 10% rate applies to royalties paid for the use of industrial, commercial, or scientific equipment or for information concerning industrial, commercial, or scientific experience.
8. The 5% rate applies to royalties paid for the alienation or the use of any copyright of literary, artistic, or scientific work excluding cinematograph films or films or tapes used for radio or television broadcasting, and the 10% rate for the alienation of any patent, trademark, design, or model, plan, secret formula, or process.
9. The 5% rate applies to royalties paid for the use of any copyright of literary, artistic, or scientific work.
10. The 3% rate applies to interest paid on loans or credits granted for four years or more with the participation of a financing public institution to a statutory body or to an enterprise in relation to the sale of any equipment or to the survey, the installation, or the supply of industrial, commercial, or scientific premises and of public works. The 10% rate applies to interest paid to any financial institution.
11. The zero-rate applies to royalties paid to a contracting state or state-owned company with respect to films or tapes, and the 5% rate to royalties for the alienation or the use of any copyright of literary, artistic, or scientific work.
12. The 10% rate applies to (a) interest paid to a bank or financial institution (including an insurance company) and (b) interest paid with respect to indebtedness arising as a consequence of a sale on credit of any equipment, merchandise, or services, except where the sale was between persons not dealing with each other at arm's length.
13. The 5% rate applies to royalties paid for the use or the right to use any copyright of literary, artistic, or scientific work and the 10% rate for the use or the right to use any patent, trademark, design, or model, plan, secret formula, or process.
14. The 5% rate applies to royalties paid for the use of any copyright of literary, artistic, or scientific work excluding cinematograph films or films, tapes used for radio, or television broadcasting.
15. The 10% rate applies to royalties paid for the use of any copyright; or the use of, or the right to use, any industrial, scientific, or commercial equipment; or the use of, or the right to use, any motion picture film, or film or videotape or any other recording for use in connection with television, or tape or any other recording for use in connection with radio broadcasting; or the reception of, or the right to receive, visual images or sounds, or both, transmitted to the public by satellite or, cable, optic fibre, or similar technology; or the use in connection with television or radio broadcasting, or the right to use in connection with television or radio broadcasting, visual images, or sounds, or both, transmitted by satellite or cable, optic fibre, or similar technology.
16. The 5% rate applies to royalties paid for the use of any copyright of literary, artistic, or scientific work, and the 10% rate applies to royalties paid for the use or the right to use industrial, commercial, or scientific equipment.
17. The 10% rate applies to (a) interest paid to a bank or financial institution (including an insurance company) and (b) interest from a loan or debt claim that is guaranteed by the government.
18. The zero-rate applies to royalties paid to a contracting state or a state-owned company with respect to films or tapes, and the 10% rate applies to royalties paid for the alienation or the use of any copyright of literary, artistic, or scientific work.
19. The 5% rate applies to royalties paid for the alienation or the use or the right to use any copyright of literary, artistic, or scientific work excluding cinematograph films or tapes used for television or broadcasting.
20. The 10% rate applies to royalties paid for the use of, or the right to use, any copyright of literary or artistic work including motion pictures, live broadcasting, film, tape, or other means of the use or reproduction in connection with radio and television broadcasting, and for the use of, or the right to use industrial, commercial, or scientific equipment.
21. The 5% rate applies to royalties paid for the use of any copyright of literary, dramatic, musical, artistic, or scientific work excluding cinematograph films or films or tapes used for radio or television broadcasting. The 8% rate applies to royalties in consideration of financial leasing for the use of, or the right to use, industrial, commercial, or scientific equipment.
22. The 5% rate applies to royalties paid for the use of any copyright of literary, artistic, or scientific work including software, motion pictures, and works on film, tape, or other means of reproduction for use in connection with radio or television broadcasting. The 8% rate applies to royalties paid for the use of industrial, commercial, or scientific equipment.

23. The 10% rate applies to interest paid (a) to a recipient that is a bank or financial institution (including an insurance company); (b) in connection with the sale on credit of any industrial, commercial, or scientific equipment; or (c) in connection with the sale on credit of any merchandise by one enterprise to another enterprise.
24. The 10% rate applies to interest paid (a) to a recipient that is a bank or financial institution (including an insurance company); or (b) with respect to indebtedness arising as a consequence of a sale on credit of any equipment, merchandise or services, except where the sale was between persons not dealing with each other at arm's length.
25. The 5% rate applies to royalties paid for the use of or the right to use any copyright of literary, artistic, or scientific work including software, and motion pictures and works on film, tape, or other means of reproduction for use in connection with radio or television broadcasting and the 10% rate for the use of or the right to use any patent, trademark, design, or model, plan, secret formula, or process.
26. The 10% rate applies to interest paid to the following recipients (a) in the case of a resident of Russia, any institution having a license to carry on banking operations; and (b) in the case of a resident of Thailand, any financial institution (including an insurance company).
27. The 10% rate applies to royalties paid for the use of, or the right to use, any copyright of literary, artistic, or scientific work, or for the use of, or the right to use, industrial, commercial, or scientific equipment.
28. In case of interest arising in Thailand, the 10% rate applies to interest paid to a Philippines financial institution (including an insurance company). In the case of interest arising in the Philippines, the 10% rate applies in respect of public issues of bonds, debentures, or similar obligations.

## *Tax administration*

### *Returns*

The Thai system is one of self-assessment. A company prepares and files its tax returns by the due dates and at the same time pays the taxes calculated to be due.

The tax year for a company is its accounting period, which must be of 12 months' duration. However, it may be less than 12 months in the case of the first accounting period after incorporation, the accounting period of dissolution, or after approval for a change in the accounting period has been received from the Revenue Department and the Business Development Department.

### *Payment of tax*

CIT is paid twice in each year. A half-year return must be filed within two months after the end of the first six months of an accounting period. The tax to be paid is computed on one-half of the estimated profit for the full accounting period, except for listed companies, banks, certain other financial institutions, and other companies under prescribed conditions where the tax is based on the actual net profit for the first six months. The balance of the tax due is payable within 150 days from the closing date of the accounting period, along with the annual tax return. Credit is given for the amount of tax paid at the half-year.

# Turkey

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## Significant developments

### Draft Turkish commercial code (TCC) adopted

The draft TCC, which will be effective as of 1 July 2012, was adopted on 12 January 2011 by the General Assembly of the Turkish Parliament. The TCC brings radical changes into the world of business and the economy in commercial life and brings the following changes that are hereto expressed in general terms:

- Corporate governance is actually a codex that should be applied to all enterprises in order to inspire investors with confidence and ensure sustainable development. The corporate governance approach of TCC has been based on four pillars: (i) Full transparency, (ii) Fairness, (iii) Accountability, and (iv) Responsibility.
- In the TCC, every capital stock company has been obligated to create a website, and if the company already has a website, to allocate a part thereof for information society services.
- A group of companies, which is created for the specific purpose of managing more than one capital stock company according to predetermined and concrete policies within the context of controlling relationships, has been regulated for the first time in Turkish law by the TCC.
- The TCC has regulated the structural changes in companies (i.e. division, merger, and conversion). Most of these provisions relate to protecting the partners, the partnership creditors, and the employees and securing their rights and credits.

The TCC also offers a fundamental system change with a reformist understanding and a contemporary evolution in the auditing of capital stock companies. This change is of such a scope and characteristic that it will establish trust in national and international markets and create a new perspective for Turkey. The new audit will be conducted by an independent auditor in compliance with International Auditing Standards (IAS).

### New code of obligations adopted

The Turkish code of obligations has been adopted as of 11 January 2011. However, promulgation of this new code has been postponed until 1 July 2012. The new code will supersede the former one, which has been in application for more than 80 years.

The most pertinent innovations commonly encountered in commercial life introduced by the new code are described as follows:

- Formation of agreements: One of the most significant amendments contained in the new code relates to the 'written form requirement' presented under Articles 14 and 15. Pursuant to the new articles, agreements can be executed with an electronic signature. According to Article 14 of the new code, in line with the law on electronic signature No. 5070, secure electronic signatures or confirmed fax and any other

communication instruments, which are able to be sent and stored, may be valid and binding.
- Contractual rate of interest and default interest: The new code creates significant changes in favor of the debtor on the contractual rate of interest and the calculation of default rates. High interest rates that are determined by the creditors are prohibited by the new amendments. One of the most important innovations introduced by the new code is that the percentage of the interest and the default interest may not exceed the fixed percentages.
- Risk liability: Under Article 70 of the new code, if damage occurs due to the activities of a significantly dangerous enterprise, the owner of the enterprise shall be held liable together with the operator, if any. Therefore, even if permissions and licenses required for activities of such enterprise are dully obtained, persons who are in charge of the operating activities of the dangerous enterprise will be liable for ordinary risks which may arise from typical damage.
- Guarantee agreements: Pursuant to Article 383 of the new code, a guarantee will not be valid unless it has been executed in writing and unless the maximum amount under the responsibility of the guarantor and the date of the guarantee is clearly stated. Nevertheless, the maximum amount under the responsibility of the guarantor and the date of guarantee may be determined by the handwriting of the guarantor. Amendments adopted after the execution of a guarantee agreement that raise the responsibility of the guarantor will not be valid unless such amendments were made in compliance with the execution requirements of the guarantee.

## *Taxes on corporate income*

Corporations are liable for corporate income tax (CIT) at a rate of 20% on net profits generated, as adjusted for exemptions and deductions and including prior-year losses carried forward, to a limited extent.

According to Turkish tax legislation, income taxation differs significantly based on the taxpayer's place of residence. Resident entities are subject to tax on their worldwide income, whereas non-resident entities are taxed solely on the income derived from activities in Turkey.

## *Corporate residence*

If both the legal and the business headquarters of a company are located outside Turkey, the company is regarded as a non-resident entity for Turkish tax purposes. If one of these headquarters is located within Turkey, the company is regarded as a resident entity for Turkish tax purposes.



Note that there is no distinction between CIT and value-added tax (VAT) registration in Turkey. Therefore, corporations or PEs are liable for all taxes (e.g. CIT, VAT, withholding tax, stamp tax) once they are registered for tax purposes in Turkey.

### *Permanent establishment (PE)*

Unlike the provisions of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital, there is no minimum period of presence in Turkey before a presence is regarded under the Turkish tax legislation as a PE. In this regard, we believe that the PE evaluation should be made for each case depending on the merit of the cases both from a local legislation perspective and from a treaty (if applicable) perspective.

## Other taxes

### Value-added tax (VAT)

Deliveries of goods and services are subject to VAT at rates varying from 1% to 18%. The general rate is 18%. VAT payable on local purchases and on imports is regarded as 'input VAT', and VAT calculated and collected on sales is considered 'output VAT'. Input VAT is offset against output VAT in the VAT return filed at the related tax office. If output VAT is in excess of input VAT, the excess amount is paid to the related tax office. Conversely, if input VAT exceeds output VAT, the balance is carried forward to the following months to be offset against future output VAT. With the exception of a few situations such as exportation and sales to an investment incentive holder, there is no cash refund to recover excess input VAT.

Turkish VAT principles contain a 'reverse-charge VAT mechanism', which requires the calculation of VAT by resident entities on payments to persons in foreign countries. Under this mechanism, VAT is calculated and paid to the related tax office by the resident entity. The resident entity treats this VAT as input VAT and offsets it in the same month. This VAT does not create a tax burden for the resident or non-resident entity, except for its cash flow effect on the former if there is insufficient output VAT to offset the input VAT.

### Banking and insurance transactions tax (BITT)

The transactions being performed by licensed banks and insurance companies are generally exempt from VAT but are subject to BITT at a rate of 5%, which is due on the gains of such corporations from their transactions.

The purchase of goods and services by banks and insurance companies are subject to VAT, but this is considered an expense or cost item. Therefore, it is not recoverable (i.e. for VAT purposes by offsetting against the output VAT) in the hands of these corporations.

### Property taxes

Buildings and land owned in Turkey are subject to real estate tax at different rates.

### Stamp tax

Stamp tax applies to a wide range of documents, including but not limited to agreements, financial statements, and payrolls. Stamp tax is levied as a percentage of the value stated on the agreements at rates varying between 0.165% and 0.825%.

Salary payments are subject to stamp tax at a rate of 0.66% over the gross amounts, whereas a lump-sum stamp tax is calculated for certain types of documents such as the printed copies of the financial statements.

### Special consumption tax

There are four main product groups that are subject to special consumption tax:

- Petroleum products, natural gas, lubricating oil, solvents, and derivatives of solvents.
- Automobiles and other vehicles, motorcycles, planes, helicopters, yachts.
- Tobacco and tobacco products, alcoholic beverages.
- Luxury products.

Unlike VAT, which is applied on each delivery, special consumption tax is charged only once (except for some activities such as production).

### *Resource utilisation support fund (RUSF)*
Foreign loans (including trade payables) obtained by Turkish resident individuals or legal entities (except for banks or financial institutions) are subject to RUSF at the following rates:

- 3% over the principal or the interest amount (depends on the currency denomination and on the maturity).
- 0% in case of locally obtained loans.

### *Customs and foreign trade*
PwC Turkey's customs and foreign trade specialist team would be pleased to assist in determination of customs duties and in providing extensive information regarding the local excise regime.

## *Branch income*

Branches are taxed solely on the income derived from activities in Turkey since they are regarded as non-resident entities for Turkish tax purposes. Branch profits are subject to Turkish CIT at the rate of 20%.

The branch profit transferred to headquarters (i.e. upstream income repatriation) is subject to dividend WHT at a rate of 15%, which might be reduced if there is a bilateral tax treaty between Turkey and the country of which the principal is a resident for income tax purposes. *See the Withholding taxes section for a list of countries with which Turkey has an applicable tax treaty.*

## *Income determination*

### *Capital gains*
No separate rules exist with respect to capital gains taxation in Turkey. Capital gains and losses are included in the determination of taxable corporate income.

*See Capital gains exemption in the Tax credits and incentives section for information about an incentive that can reduce the effective CIT rate on capital gains in certain instances.*

### *Dividend income*
In dividend distribution's between Turkish resident companies, the dividend payer is exempt from WHT and the recipient is exempt from CIT.

### *Foreign income*
In principle, foreign-sourced income is taxable in Turkey. However, foreign-sourced dividend income may also be subject to a participation exemption, if certain conditions are fulfilled. A participation exemption for capital gains generated from a foreign subsidiary may also be available in Turkey, under certain conditions.

Other foreign-sourced income, such as royalties and interest, is fully taxable in Turkey. Partial relief from taxation is granted insofar as the foreign tax paid does not exceed the rate of tax payable for the same income in Turkey.

Although undistributed income of foreign subsidiaries should not be taxable in Turkey, controlled foreign company (CFC) rules should also be taken into consideration in this respect. *See CFC rules in the Group taxation section for more information.*

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## Deductions

Turkish CIT legislation allows a deduction for all the "ordinary and necessary expenses paid or incurred for the generation and sustenance of income during the taxable year in carrying on any trade or business".

The general principle for tax deductibility is that the payment should be a necessary business expense and it should be properly documented in accordance with the relevant provisions of the Turkish transfer pricing regulations and those in the local tax procedural law.

### Depreciation and amortisation

Fixed assets are subject to depreciation at rates determined by the Turkish Ministry of Finance, based on their useful life.

Depreciation can be calculated by applying either the straight-line or declining-balance method, at the taxpayer's discretion. The taxpayer may also change the option from declining-balance to straight-line (but not vice versa) at any time during the life of the asset. The applicable rate for the declining-balance method is twice the rate of the straight-line method, subject to certain limitations. Furthermore, in special cases, the tax authorities may determine higher depreciation rates.

Intangible assets are amortised by the straight-line method over their estimated useful lives, if objectively determinable.

Profits or losses on disposal of fixed assets (i.e. the difference between the proceeds and the written-down values) are included in taxable income in the year of disposal. If the renewal of disposed-of assets is considered necessary by the owners of the business concern, the profit accrued may be retained for a certain amount of time. After the purchase of new fixed assets, the profits may be offset against the depreciation of the new assets.

### Bad debts

Bad and doubtful accounts receivable are deductible under certain conditions. Amounts of the receivables collected afterwards are added to the profits of the year in which they are collected.

### Pensions and employee termination benefits

Payments for pensions and employee termination benefits are deductible for CIT purposes under certain conditions and are not subject to WHT beyond a certain limit.

### Taxes

Essentially, the CIT itself and VAT are, subject to certain exceptions, not deductible for CIT purposes.

Fees and duties paid in relation to assets of the company are, in principle, deductible in determining taxable corporate income.

### Net operating losses

Corporate losses may be carried forward for five years. Losses cannot be carried back.

### *Payments to foreign affiliates*
Charges for royalties and interest by foreign affiliates may be deductible for CIT purposes, provided that transfer pricing and thin capitalisation rules are followed *(see the Group taxation section for more information)*.

## *Group taxation*

Consolidation of the accounts of group companies for tax purposes is not allowed in Turkey since each company is regarded as a separate taxpayer.

### *Transfer pricing*
The new corporate income tax law includes considerable amendments to transfer pricing regulations, using the OECD's guidelines as a basis. If a taxpayer enters into transactions regarding the sale or purchase of goods and services with related parties in which prices are not set in accordance with the arm's-length principle, the related profits are considered to have been distributed in a disguised manner through transfer pricing. Such disguised profit distribution through transfer pricing is not accepted as deductible for CIT purposes. The methods prescribed in the law are the traditional transaction methods described in the OECD's transfer pricing guidelines.

### *Thin capitalisation*
According to local thin capitalisation regulation, if the ratio of the borrowings from shareholders or from persons related to the shareholders exceeds triple the shareholders' equity of the borrower company at any time within the relevant year, the exceeding portion of the borrowing will be considered thin capital and the corresponding interest will not be deductible. Accordingly, the ratio of loans received from related parties to shareholders' equity must be no more than three to one in order to eliminate Turkish thin capitalisation issues.

### *Controlled foreign company (CFC) rules*
A CFC is a company established abroad with at least 50% of the organisation controlled directly or indirectly by tax-resident companies and real persons by means of separate or joint participation in the capital or dividends voting rights. A CFC also must meet certain conditions (e.g. 25% or more of its gross revenue must be comprised of passive income), and it must be subject to an effective income tax rate lower than 10% for its commercial profit in its home country.

The CFC's profit is included in the CIT base of the controlling resident corporation at the rate of the shares controlled, irrespective of whether it is distributed.



## *Tax credits and incentives*

### *Participation exemption for dividends*
There is an unconditional CIT and dividend WHT exemption for dividend income between Turkish companies. If a Turkish company has a shareholding in a foreign company, this dividend income is exempt from CIT, under certain conditions.

### *Exemption for income from foreign construction and repair activities*
The profit from construction and repair activities carried out by Turkish corporations in foreign countries may be exempt from CIT in Turkey under the Turkish CIT law. It should be noted that if loss occurs from these activities, it is not possible to deduct this loss amount from the income generated through domestic activities since deduction

of a loss relating to foreign activities that are exempt from CIT in Turkey is not allowed for deduction.

### *Capital gains exemption*
For capital gains generated from the sale of shares in a Turkish company to another Turkish company, a 75% CIT exemption is applicable under certain conditions. This partial exemption may also be applicable for the capital gains derived from the alienation of real estate investments under certain conditions.

In the event a foreign subsidiary is sold by a Turkish company, a CIT exemption at the rate of 100% is applicable under certain conditions.

### *Investment incentives*
The Turkish government provides investment incentives (state aids) to eliminate inter-regional economic imbalance, facilitate a larger capital contribution by public and foreign investors to the capital build-up of the country, and support activities that have a positive effect on employment. Generally speaking, state aid can be classified as either a tax or a non-tax incentive.

The principal prerequisite for benefiting from state aid, except investment allowance, is to obtain an Investment Incentive Certificate (IIC). The IIC is a document granted to investors for their investments by the Undersecretariat for the Treasury. It allows utilisation of the said benefits. The import of machinery and equipment (excluding raw materials, intermediate, and operating products) is exempt from customs duty and RUSF payments. In addition, a VAT exemption is also applicable on the importation of eligible machinery and equipment.

According to investment incentive legislation, in order to obtain an IIC, the minimum amount of total investment should be at least 1 million Turkish liras (TRY).

The advantages of an IIC can be summarised as exemption from customs duty, RUSF, and VAT.

From an income tax perspective, the legislation related to investment incentives has changed substantially. There are six main components of the new investment regulation:

- Reduced CIT rate.
- VAT exemption.
- Exemption for social security premium (employer's portion).
- Customs duty exemption.
- Interest support.
- Allocation of land for investments.

### *Free trade zone*
Free trade zones are special sites that lie geographically within the country but are deemed to be outside the customs territory. In these regions, the normal regulations related to foreign trade and other financial and economic areas are either inapplicable, partly applicable, or superseded by new regulations.

In general, activities such as manufacturing, storage, packing, general trading, banking, insurance, and trade may be performed in Turkish free trade zones. Goods moving between Turkey and the zones are treated, for all purposes, as exports or imports. However, operations within the zones are subject to the supervision of the zone management (and customs authorities), to whom regular activity reports must be submitted. Consequently, there is a requirement for zone users to maintain full accounting records (in Turkish) with respect to their activities. These accounting requirements extend to inventory records. Customs duty is levied on any unexplained inventory losses as though the goods had been imported into the country.

The right to operate in a free zone is conferred by an operating licence obtained from the Undersecretariat for Foreign Trade, which reviews the application for conformity with the objectives and types of activity specified by the Economic Affairs Coordination Council.

### *Portfolio investment income*

In line with the amendments in the Turkish income tax law, being effective 1 January 2006, certain investment income (e.g. capital gains on listed equities acquired after 1 January 2006 and interest and capital gains from domestic government bonds or treasury bills issued after 1 January 2006), derived by non-resident corporations without having a PE in Turkey and by non-resident individuals, is currently subject to WHT at source.

The following investors will qualify for WHT at a rate of 0%:

- Turkish resident capital corporations (limited liability companies, joint stock companies, and comandite companies whose capital is divided into shares).
- Non-resident corporations which have the same characteristics as Turkish capital corporations.
- Turkish investment funds (regulated in accordance with the Capital Markets Board or CMB).
- Non-resident investment funds similar to Turkish investment funds.
- Those non-residents similar to Turkish investment funds and trusts which engage in investment in securities and other capital markets instruments as their only business in Turkey, to derive income and capital gains from these instruments, and to exert the rights attached to these instruments.

WHT is applied at a rate of 10% for both resident and non-resident individuals and for all other entities which are not qualified for 0% WHT (i.e. those who are not listed above).

The withholding will be applied by local intermediary banks, brokerage houses, or local custodian banks, instead of the conventional self-declaration mechanism, and this withholding would be the final taxation in Turkey both for non-residents and Turkish individuals.



### *Research and development (R&D) activities*

In the last decade, the Turkish Parliament has enacted several regulations to provide incentives for R&D activities in Turkey. The three primary R&D incentives include significant advantages granted to investors planning R&D activities in science, software, and technology in special zones known as 'techno-parks', cash subsidies from the Scientific and Technological Research Council of Turkey (TUBITAK), and corporate tax deductions.

One of the objectives of the special R&D law, which was enacted in 2008, is to attract foreign investors with significant R&D activities abroad to invest in Turkey, by enabling non-resident companies with a subsidiary or branch in Turkey to benefit from R&D tax incentives. The main incentives introduced by this R&D law are listed as follows:

### R&D deduction
All eligible innovation and R&D expenditures made in technology centres or R&D centres, which must employ at least 50 full-time equivalent R&D personnel, or R&D and innovation projects supported by foundations established by law or international funds can be deducted from the CIT base at a rate of 100%.The same expenditures can also be capitalised and expensed through amortisation over five years in the case of successful projects, whereas the R&D expenditure on failed projects can be expensed immediately.

Companies with separate R&D centres employing more than 500 R&D personnel can, in addition to the aforementioned deduction, deduct half of any increase in R&D expenditures over similar money spent in the previous period.

Any unutilised R&D deduction can be carried forward for an unlimited period of time, indexed to the revaluation rate, which is an approximation of the inflation rate.

### Income WHT exemption on salaries
80% of the salary income of eligible R&D and support personnel is exempt from income WHT. However, this rate is increased to 90% for personnel with a doctorate degree.

### Support for the contributions to the Turkish social security institution
The Ministry of Finance will pay half the employer portion of social security premiums for R&D and support personnel for five years.

### Stamp tax exemption
Documents prepared in relation to R&D activities are exempt from stamp tax.

### *Foreign tax credit*
A partial relief from income taxation is granted for the foreign tax paid that does not exceed the rate of tax payable for the same income in Turkey.

## *Withholding taxes*

There is no WHT on payments to resident corporations by other resident corporations, except for a 3% WHT on progress payments to contractors, both domestic and foreign, within the scope of construction work spanning more than one calendar year.

The local WHT rates are as follows:

| Income derived by non-resident individual or corporation not constituting PE in Turkey | WHT (%) |
|---|---|
| Rental from immovable assets | 20 |
| Leasing of goods (within the scope of the conditions regulated under Turkish Financial Leasing Law No. 3226) | 1 |
| Royalties (e.g. on patents, copyrights, license) | 20 |
| Professional services | 20 |
| Petroleum services | 5 |
| Interest on loan arrangements | 10 |
| Interest on time deposits | 15 |
| Interest income derived from time deposits | 15 |
| Reverse-repo income | 15 |
| Wages and salaries | 15 to 35 |

| Income derived by non-resident individual or corporation not constituting PE in Turkey | WHT (%) |
|---|---|
| Capital gains from listed equities of securities investment trusts purchased after 1 January 2006 | 0 |
| **Income derived by resident capital companies*** | **WHT (%)** |
| Capital gains on Treasury bills and domestic government bonds issued after 1 January 2006 | 0 |
| Capital gains from listed equities purchased after 1 January 2006 (excluding those purchased by securities investment trusts after 1 January 2006) | 0 |
| **Income derived by other resident entities and individuals** | **WHT (%)** |
| Capital gains on Treasury bills and domestic government bonds issued after 1 January 2006 | 10 |
| Capital gains from listed equities purchased after 1 January 2006 (excluding those purchased by securities investment trusts after 1 January 2006) | 0 |
| **Income derived by Turkish securities investment funds and securities investment trusts** | **WHT (%)** |
| Capital gains from domestic government bonds issued after 1 January 2006 | 0** |
| Interest from domestic government bonds issued after 1 January 2006 | 0** |
| Capital gains from listed equities purchased after 1 January 2006 | 0** |

*Capital companies refers to limited liability companies (LLCs), joint stock companies (JSCs), and comandite companies, whose capital is divided into shares, and Turkish investment funds (regulated in accordance with the Turkish Capital Markets Board's legislations)

**Final WHT at source

Please refer to the following tables for local WHT on interest, royalties, and dividends, respectively.

### *Turkish WHT on interest and royalties*

| Recipient | WHT on interest (%) | WHT on royalties (%) |
|---|---|---|
| Albania | 10 | 10 |
| Algeria | 10 | 10 |
| Austria | 5/10/ 15 (1, 2, 15) | 10 (2) |
| Azerbaijan | 10 | 10 |
| Bahrain | 10 | 10 |
| Bangladesh | 10 | 10 |
| Belarus | 10 | 10 |
| Belgium | 15 (1) | 10 |
| Bosnia-Herzegovina | 10 | 10 |
| Bulgaria | 10 | 10 |
| China (People's Republic of) | 10 | 10 |
| Croatia | 10 | 10 |
| Czech Republic | 10 | 10 |
| Denmark | 15 (1) | 10 |
| Egypt | 10 | 10 |
| Estonia | 10 | 5/10 (12) |
| Ethiopia | 10 | 10 |
| Finland | 15 (1) | 10 |
| France | 15 (1) | 10 |
| Georgia | 10 | 10 |

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| Recipient | WHT on interest (%) | WHT on royalties (%) |
|---|---|---|
| Germany | 15 (1, 14) | 10 (14) |
| Greece | 12 (1) | 10 |
| Hungary | 10 | 10 |
| India | 10/15 (1, 6) | 15 |
| Indonesia | 10 | 10 |
| Iran | 10 | 10 |
| Ireland | 10/15 (1, 17) | 10 |
| Israel | 10 | 10 |
| Italy | 15 (1) | 10 |
| Japan | 10/15 (1, 5) | 10 |
| Jordan | 10 | 12 |
| Kazakhstan | 10 | 10 |
| Korea, Republic of | 10/15 (1, 3) | 10 |
| Kuwait | 10 | 10 |
| Kyrgyzstan | 10 | 10 |
| Latvia | 10 | 5/10 (12) |
| Lebanon | 10 | 10 |
| Lithuania | 10 | 5/10 (12) |
| Luxembourg | 10/15 (1, 4) | 10 |
| Macedonia | 10 | 10 |
| Malaysia | 15 (1) | 10 |
| Moldova | 10 | 10 |
| Mongolia | 10 | 10 |
| Morocco | 10 | 10 |
| Netherlands, The | 10/15 (1, 4) | 10 |
| Northern Cyprus, Turkish Republic of | 10 | 10 |
| Norway | 15 (1) | 10 |
| Oman | 10 (18) | 10 |
| Pakistan | 10 | 10 |
| Poland | 10 | 10 |
| Portugal | 10/15 (1, 4) | 10 |
| Qatar | 10 | 10 |
| Romania | 10 | 10 |
| Russia | 10 | 10 |
| Saudi Arabia | 10 (16) | 10 |
| Serbia-Montenegro | 10 | 10 |
| Singapore | 7.5/10 (8) | 10 |
| Slovakia | 10 | 10 |
| Slovenia | 10 | 10 |
| South Africa | 10 | 10 |
| Spain | 10/15 (1, 9) | 10 |
| Sudan | 10 | 10 |
| Sweden | 15 (1) | 10 |
| Syria | 10 | 10/15 (13) |
| Tajikistan | 10 | 10 |
| Thailand | 10/15 (1, 10) | 15 |

| Recipient | WHT on interest (%) | WHT on royalties (%) |
|---|---|---|
| Tunisia | 10 | 10 |
| Turkmenistan | 10 | 10 |
| Ukraine | 10 | 10 |
| United Arab Emirates (UAE) | 10 | 10 |
| United Kingdom | 15 (1) | 10 |
| United States (US) | 10/15 (1, 7) | 5/10 (11) |
| Uzbekistan | 10 | 10 |
| Yemen | 10 (18) | 10 |

Notes

1. The local rate of 10% will be applied in the event a higher rate is stipulated in the agreement.
2. Provisions for WHT at source are effective for amounts paid or credited on or after 1 January 2010.
3. A rate of 10% if the loan or other debt claim is for a period exceeding two years; 15% in all other cases (1).
4. A rate of 10% if the loan is taken for a period exceeding two years; 15% in all other cases (1).
5. A rate of 10% if the loan/credit is taken from a financial institution; 15% in all other cases (1).
6. A rate of 10% if the loan is taken from a bank or a financial institution; 15% in all other cases (1).
7. A rate of 10% if the credit/loan is taken from a bank, financial or savings institution, insurance company; 15% in all other cases (1).
8. A rate of 7.5% if the loan is taken from a financial institution; 10% in all other cases.
9. A rate of 10% if the interest is the result of a loan provided/given by a bank or if the interest is paid in return for an article of merchandise, or equipment given to the contracting state on credit; 15% in all other cases (1).
10. A rate of 10% if the loan is taken from a financial institution, including insurance companies; 15% in all other cases (1).
11. A rate of 10% for the use of, the right to use, or the sale (contingent on the productivity, use, or disposition) of any copyright of literary, artistic, or scientific work, including royalties in respect of motion pictures and works on film, tape, or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula, or process, or for information concerning, industrial, commercial, or scientific experience; 5% for the use of or the right to use industrial, commercial, or scientific equipment.
12. A rate of 5% for the use of industrial, commercial, or scientific equipment; 10% in all other cases.
13. A rate of 15% for patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial, or scientific experience; 10% for the use of or the right to use any copyright of literary, artistic, or scientific work including cinematographic films and recordings for radio and television.
14. The treaty has been terminated by Germany. The termination is applied for the periods following 1 January 2011.
15. A rate of 5% in respect of a loan or credit made, guaranteed, or insured for the purposes of promoting export by the Oesterreichische Kontrollbank AG or a similar Turkish public entity the objective of which is to promote the export; 10% if the interest is derived by a bank; 15% in all other cases (1).
16. If the beneficial owner of the 'income from debt claims' is a resident of Saudi Arabia, the tax so charged shall not exceed 10% of the gross amount of income.
17. A rate of 10% in respect of a loan or other debt claim for a period exceeding two years or if the interest is received by a financial institution; 15% in all other cases (1).
18. Interest arising in one of the contracting states and paid to the Government of Republic of Turkey or the Central Bank of Turkey shall be exempt from income taxes in the contracting state. Similarly, interest arising in the Republic of Turkey and paid to the Government or the Central Bank of the other contracting state shall be exempt from income taxes in Turkey.



### *Turkish WHT on dividends*

Dividend distributions to individuals and to non-resident persons who are shareholders are subject to WHT at a local rate of 15%. This rate might be reduced for non-resident shareholders in the presence of a tax treaty. Please note that dividend distributions to resident entities and branches of non-resident entities are not subject to WHT.

| Recipient | Shareholding interest (%) | WHT rate (%) |
|---|---|---|
| Albania | If greater than / equal to 25 | 5 |
| | In all other cases | 15 |
| Algeria | | 12 |

| Recipient | Shareholding interest (%) | WHT rate (%) |
|---|---|---|
| Austria | If greater than / equal to 25 | 5 (2, 7) |
| | In all other cases | 15 (2, 7) |
| Azerbaijan | | 12 |
| Bahrain | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Bangladesh | | 10 |
| Belarus | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Belgium | If greater than / equal to 10 | 15 (2) |
| | In all other cases | 20 (1, 2) |
| Bosnia-Herzegovina | If greater than / equal to 25 | 5 |
| | In all other cases | 15 |
| Bulgaria | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| China (People's Republic of) | | 10 |
| Croatia | | 10 |
| Czech Republic | | 10 |
| Denmark | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| Egypt | If greater than / equal to 25 | 5 |
| | In all other cases | 15 |
| Estonia | | 10 |
| Ethiopia | | 10 |
| Finland | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| France | If greater than / equal to 10 | 15 |
| | In all other cases | 20 (1) |
| Georgia | | 10 |
| Germany | If greater than / equal to 10 | 15 (6) |
| | In all other cases | 20 (1, 6) |
| Greece | | 15 |
| Hungary | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| India | | 15 |
| Indonesia | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Iran | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| Ireland | If greater than / equal to 25 | 5/10 (2, 9) |
| | In all other cases | 15 (2) |
| Israel | | 10 |
| Italy | | 15 |
| Japan | If greater than / equal to 25 | 10 (4) |
| | In all other cases | 15 |
| Jordan | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |

| Recipient | Shareholding interest (%) | WHT rate (%) |
|---|---|---|
| Kazakhstan | | 10 |
| Korea, Republic of | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| Kuwait | | 10 |
| Kyrgyzstan | | 10 |
| Latvia | | 10 |
| Lebanon | If greater than / equal to 15 | 10 |
| | In all other cases | 15 |
| Lithuania | | 10 |
| Luxembourg | If greater than / equal to 25 | 10 |
| | In all other cases | 20 (1) |
| Macedonia | If greater than / equal to 25 | 5 |
| | In all other cases | 10 |
| Malaysia | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Moldova | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Mongolia | | 10 |
| Morocco | If greater than / equal to 25 | 7 |
| | In all other cases | 10 |
| Netherlands, The | If greater than / equal to 25 | 15 (2) |
| | In all other cases | 20 (1, 2) |
| Northern Cyprus, Turkish Republic of | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| Norway | If greater than / equal to 25 | 25 (1) |
| | In all other cases | 30 (1) |
| Oman | If greater than / equal to 15 | 10 |
| | In all other cases | 15 |
| Pakistan | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Poland | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Portugal | If greater than / equal to 25 | 5 |
| | In all other cases | 15 |
| Qatar | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Romania | | 15 |
| Russia | | 10 |
| Saudi Arabia | If greater than / equal to 20 | 5 (8) |
| | In all other cases | 10 |
| Serbia-Montenegro | If greater than / equal to 25 | 5 |
| | In all other cases | 15 |
| Singapore | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Slovakia | If greater than / equal to 25 | 5 |
| | In all other cases | 10 |

# Turkey

| Recipient | Shareholding interest (%) | WHT rate (%) |
|---|---|---|
| Slovenia | | 10 |
| South Africa | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Spain | If greater than / equal to 25 | 5 (5) |
| | In all other cases | 15 |
| Sudan | | 10 |
| Sweden | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| Syria | | 10 |
| Tajikistan | | 10 |
| Thailand | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| Tunisia | If greater than / equal to 25 | 12 |
| | In all other cases | 15 |
| Turkmenistan | | 10 |
| Ukraine | If greater than / equal to 25 | 10 |
| | In all other cases | 15 |
| United Arab Emirates (UAE) | If greater than / equal to 25 | 10 (3) |
| | In all other cases | 12 |
| United Kingdom | If greater than / equal to 25 | 15 |
| | In all other cases | 20 (1) |
| United States (US) | If greater than / equal to 10 | 15 |
| | In all other cases | 20 (1) |
| Uzbekistan | | 10 |
| Yemen | | 10 |

Notes

1. The local rate is 15% for dividends. Unless a lower rate is stated in the Agreement, the local rate is applied.
2. As per the provisions of the protocol amending the agreement, the rate may be (partially or wholly) reduced;
    - For the Netherlands: to 10%, as long as, under the provisions of the Netherlands Company Tax Act and to the future amendments thereto, a company which is a resident of the Netherlands is not charged tax with respect to dividends the company receives from a company which is a resident of Turkey.
    - For Belgium: to 10%, as long as, under the provisions of the Belgian laws and of the future amendments thereto, a company which is a resident of Belgium is not charged tax with respect to dividends the company receives from a company which is a resident of Turkey.
    - For Austria: to 5%, if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends, provided that such dividends are exempt from tax in Austria.
    - For Ireland: to 5%, where the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the voting power of the company paying the dividends. 15% in all other cases.
3. Subject to 5% of the gross amount of the dividends if the recipient is the government, or a public institution which is wholly owned by the government or its political subdivisions, or local authorities of the UAE.
4. The tax rate shall be 15% where the amount of the Turkish tax imposed on the income of the company paying dividends is less than 40% of such income derived in the accounting period ending immediately before the date when such dividends become payable.
5. The income should be subject to full corporate taxation in the hands of the Turkish tax-resident subsidiary.
6. The treaty has been terminated by Germany. The termination is applied for the periods following 1 January 2011.
7. The provisions for WHT at source are effective for amounts paid or credited on or after 1 January 2010.

8. If the beneficial owner of the dividends is a resident of Saudi Arabia, the tax so charged shall not exceed 5% of the gross amount of the dividends provided: (i) the beneficial owner is a company (other than a partnership) which holds directly at least 20% of the capital of the Turkish company paying the dividends or (ii) the beneficial owner is a central bank or an entity which is wholly owned by the government.
9. In case of Turkey, the tax rate shall not exceed 5%, to the extent that they are paid out of profits that have been subject to full rate of CIT in Turkey (i.e. without benefiting from tax exemption).

### *Anti-tax haven provisions*

According to the new law, all sorts of payments made to corporations (including branches of resident corporations) that are established or operational in countries that are regarded by the Turkish Council of Ministers to undermine fair tax competition (through taxation or other practices) may be subject to taxation in Turkey through withholding at a rate of 30%.

In the meantime, the Turkish Council of Ministers has not yet determined which countries receiving payments are considered 'tax havens'.

## *Tax administration*

A self-assessment system is used in Turkey.

All Turkish taxes are imposed under laws drafted by or with the involvement of the Turkish Ministry of Finance and are promulgated by the Turkish Parliament. The central government, acting through the Ministry of Finance, imposes most of them, although local authorities have certain rights over some minor transaction charges. Tax procedures are governed by the Turkish tax procedural law.

### *Returns*

In principle, residents and non-resident entities having a PE in Turkey are obliged to be registered for all taxes in Turkey (e.g. CIT, VAT, WHT, stamp tax) and file annual CIT returns.

The last date of submission of the CIT return is the 25th day of the fourth month following the fiscal year-end. This date would be 25 April if CIT returns are filed on a calendar-year basis. Note that a different fiscal year is also allowed.

### *Payment of tax*

Taxable income is declared on a quarterly-basis as advance tax on the 14th day of the second month following each quarter, and corresponding tax is payable on the 17th day of the same period. Advance CIT paid is offset against the final (i.e. fiscal year-end) CIT calculated in the annual CIT return.

The last date of payment of CIT is the 30th day of the fourth month following the fiscal year-end.

### *Corporate income tax certification*

In Turkey, a special kind of tax audit arises called 'corporate income tax certification'. It is regulated under the provisions of the relevant professional law No. 3568 and is a well-recognized territory-specific service, which is very common for all foreign investors having entities established and tax registered in Turkey.

Under this service, a licensed tax auditor (i.e., a sworn-in financial advisor) audits the accounts of a taxpayer from a tax perspective and certifies the accuracy of the CIT return.

This tax certification service is utilised by the majority of business entities in Turkey because such a process helps identify and take corrective measures against erroneous actions that may otherwise be detected only upon a tax investigation by the Ministry of Finance.

## *Other issues*

### *For up-to-date information*

For up-to-date information on the most recent and significant developments in Turkish tax regulations, please refer to the tax bulletins added to our tax portal, Vergi Portali, which can be accessed at Vergiportali.com.

# Turkmenistan

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## Significant developments

A new law on accounting and financial reporting establishes a basis for the government's plan to transition into the international accounting and auditing standards by 2014. Banking institutions are already required to prepare financial reporting according to International Financial Reporting Standards (IFRS) as of 1 January 2011. All other organisations and entities are required to implement phased transition into the new standards as of 1 January 2013. Such developments should improve transparency and enable Turkmenistan to attract more foreign direct investments.

## Taxes on corporate income

Residents of Turkmenistan are subject to corporate income tax (CIT) on worldwide income; non-residents are subject to CIT only in respect of their Turkmenistan-sourced income. The CIT base is determined as gross income less allowable deductions.

Branches of foreign legal entities are subject to a 20% CIT, whereas Turkmen legal entities are subject to an 8% CIT.

Companies involved in oil and gas operations are subject to a 20% CIT, irrespective of the legal status/ownership structure.

### Special purpose duty for improvement of urban and rural territories

A special duty aimed at improving urban and rural territories is imposed on registered entities (e.g. legal entities and branches). The duty applies at 1% of the taxable base for CIT purposes. Generally, contractors and subcontractors operating under the umbrella of the petroleum law may be exempt from this duty.

### Contributions to Agriculture Development and Ashgabat City Development Funds

The contributions to the Agriculture Development Fund and Ashgabat City Development Fund are outside of the general tax legislation (tax code) and are provided for by specific decrees. Permanent establishments (PEs)/branches of foreign legal entities are subject to these contributions on the same terms as local legal entities.

Contribution to the Ashgabat City Development Fund only applies to entities located in Ashgabat City.

The base for the contributions is comprised of the accounting income. The contribution rate for the Agriculture Development Fund is 3%, and the contribution rate for the Ashgabat City Development Fund is 0.5%.

Generally, contractors and subcontractors operating under the umbrella of the petroleum law may be exempt from these contributions.

## Corporate residence

Legal entities are treated as residents for CIT purposes if they are established in accordance with Turkmenistan law or their place of effective management is located in Turkmenistan.

### Permanent establishment (PE)

The general definition of a PE under domestic legislation is similar to the one per the Organisation for Economic Co-operation and Development (OECD) model convention. A PE is a permanent place of the foreign legal entity in Turkmenistan, through which it, fully or partially, conducts entrepreneurial (commercial) activity, including that through an authorised person.

## Other taxes

### Value-added tax (VAT)

VAT is generally payable at the rate of 15%. A zero-rate applies to exports of goods (except for oil and gas) and international transport services. Generally, contractors operating under the umbrella of the petroleum law may be exempt from this tax.

The tax base is sales turnover including excise tax. If a sale is made by state-fixed prices, then the tax base is the respective sales turnover including VAT and excise tax. The amount of input VAT incurred may be offset against the amount of output VAT. The amount of input VAT related to capital expenditures should be capitalised.

### Customs duties

The import of certain goods into Turkmenistan is subject to customs duties. The taxable base is determined as the customs value of imported goods. Although the list of items that are subject to customs duty is relatively limited (i.e. around 50 items) the rates of customs duties may vary from 5% (e.g. products from cement) to 100% (e.g. carbonic acid) depending on the type of imported goods. In most cases, the customs duty is set on an *ad valorem* basis. There is also a customs clearance fee of 0.2% from the customs value of imported goods.

### Excise taxes

Excise tax is paid on goods or products that are considered in the list of excised goods or products. Normally, excised goods consist of alcoholic beverages, tobacco products, and automobiles. Excise rates vary based on the type of goods as well as by domestic production or import.

### Property tax

Property tax in Turkmenistan generally applies at the rate of 1% on the average annual net book value of fixed assets and average annual value of tangible assets used for business purposes and located in Turkmenistan. Generally, contractors and subcontractors operating under the umbrella of the petroleum law may be exempt from this tax.

### *Subsurface-use tax*
Subsurface-use taxpayers are legal entities and individual entrepreneurs extracting natural resources and using land or subsoil waters for the extraction of chemical products. This tax does not normally apply to contractors and subcontractors operating under the umbrella of the petroleum law.

Taxable operations include the sale of natural resources extracted by taxpayers and utilisation of natural resources for consumption. Tax rates vary depending on the goods being extracted. Natural or associated gas extraction is taxed at 22%, and crude oil extraction is taxed at 10%. Tax rates for other mineral resources vary depending on profitability (internal rate of return).

### *Social security payments*
Social security is payable by employers at 20% of the total remuneration provided to local employees. Income paid to expatriate employees should not be subject to the social security contribution.

### *Advertising levy*
An advertising levy is imposed on the amount of expenses on commercial advertising and is to be paid quarterly at the rate of 3% to 5% depending on the location of the payer within Turkmenistan. Generally, contractors operating under the umbrella of the petroleum law may be exempt from this levy.

### *Transfer taxes*
There are no transfer taxes in Turkmenistan.

### *Stamp taxes*
Although state duties of various amounts set forth by the government may apply to certain actions (e.g. branch registration), there is no unified stamp tax/duty mechanism as normally practiced in other countries.

## *Branch income*

Branches pay CIT at the rate of 20%. Technically, branches are also subject to 15% dividend tax on repatriation of income to the head office. However, if the head office collects the income from its clients directly to its bank account abroad, the mechanism of collecting the dividend tax is unclear.

Branches are taxed on profits received from activities in Turkmenistan. The gross income is reduced for expenses incurred (both inside and outside of Turkmenistan) in relation to the activities in Turkmenistan. The procedure for determining the taxable base for branches is generally similar to the one for Turkmen legal entities.



Branches subject to the standard tax regime also pay and file returns with respect to the other taxes described in this summary.

## *Income determination*

### *Inventory valuation*
Inventory is valued at cost, including costs relating to its acquisition. The law permits the use of the weighted average, first in first out (FIFO), and last in first out (LIFO) methods for tax purposes.

### *Capital gains*
Capital gains are taxable as normal business income in Turkmenistan.

### *Dividend income*
The tax code provides for relief from economic double taxation of inter-corporate dividends.

### *Foreign income*
A resident company is subject to tax on its worldwide income (including capital gains). There are no provisions for tax deferrals in Turkmenistan tax legislation.

## *Deductions*

In general, taxpayers may deduct expenses paid or accrued during the year in connection with their business and aimed at income generation. All expenses must be substantiated by documentary proof.

The deduction of certain expenses is subject to specific ceilings. Such expenses include representation expenses, which are deductible at up to 1% of gross income. Furthermore, deductible norms for business travel expenses are established periodically by the government.

### *Depreciation*
Tax depreciation is based on accounting depreciation. Depreciation is accrued based on the straight-line method. Accelerated depreciation is also allowed based on specific consent of the Ministry of Finance. The Turkmenistan accounting legislation provides a comprehensive itemised list of depreciation norms which includes more than 200 items.

Generally, for the purposes of CIT, depreciation accrued is deductible. Fixed assets acquired free of charge as well as assets of non-commercial legal entities, budget organisations, and public associations should be excluded from depreciable assets for CIT purposes, even if they are used for generating income.

Fixed assets provided under operational lease shall be depreciated by the lessor. Fixed assets provided under financial lease shall be depreciated by the lessee.

### *Goodwill*
There are no provisions for goodwill in Turkmenistan tax legislation.

### *Repair and maintenance expenses*
Deductible expenditures for the repair of fixed assets shall be comprised of the cost of spare parts and consumable materials used for repair, remuneration of employees carrying out the repairs, and other expenditures associated with such repairs, including payments to third parties for the purpose of such repairs.

### *Research and development (R&D) expenses*
R&D costs (including those that produced no positive result) shall be subject to deduction from gross revenue, except for costs associated with the purchase of fixed assets, their installation, and other costs of a capital nature.

### *Bad debts*
The Tax Code permits a taxpayer to include provisions for uncollectable debts as well as losses incurred as a result of expiration of the collection period for accounts receivable.

### Charitable contributions
There are no specific restrictions on deductibility of charitable contributions. However, they may be disallowed under the general restriction of non-business related deductions.

### Taxes
For CIT purposes, the following taxes are deductible: property tax; subsurface-use tax; levies established by the tax code (except the special-purpose duty for the improvement of urban and rural territories); accrued amounts of VAT in selling goods, performing work, and rendering of services; and amounts of excise tax included in the price of sold excisable goods by manufacturers of such goods.

### Net operating losses
Loss is defined as excess of allowable deductions over gross revenue. Losses shall be carried forward and deducted in subsequent tax (reporting) periods, but not for more than three years. Losses cannot be carried back.

### Payments to foreign affiliates
Administrative and management expenses incurred by the head office of a branch in Turkmenistan are not deductible at the branch level.

## Group taxation

There is no group taxation in Turkmenistan.

### Transfer pricing
The Turkmenistan Tax Code contains provisions concerning state supervision of transfer pricing. According to these rules, the tax authorities monitor and control transfer-pricing of certain types of transactions, including transactions between related parties, foreign trade operations, and transactions where the tax authorities during tax audits perceive considerable deviation from the market price (i.e. more than 20%).

### Thin capitalisation
There are no provisions for thin capitalisation in Turkmenistan tax legislation.

## Tax credits and incentives

Tax and investment incentives may be negotiated on a case-by-case basis. The President has often issued special decrees granting taxation exemptions and other privileges to specific investors. However, since adopting a new edition of the tax code in 2004, such practice has been significantly reduced.



### Foreign tax credit
There are no provisions for foreign tax credits in Turkmenistan tax legislation.

## Withholding taxes

Turkmenistan-source income generated by a foreign legal entity that has no PE in Turkmenistan generally is subject to withholding tax (WHT) at the source of payment at 15% (6% for income from the lease of sea vessels and aircrafts).

Relief may be available for WHT if a foreign entity is a resident of a country that has a valid double tax treaty (DTT) with Turkmenistan and if the foreign entity complies with certain administrative procedures.

Currently, Turkmenistan has only a few DTTs in force. Turkmenistan is a successor to a number of DTTs concluded by the USSR, while some treaties were concluded and ratified by the government of Turkmenistan. The countries listed below are considered to have valid tax treaties with Turkmenistan:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Austria* | 0 | 0 | 0 |
| Armenia | 5/15 | 10 | 10 |
| Belarus | 15 | 10 | 15 |
| Belgium* | 15 | 15 | 0 |
| China | 5/10 | 10 | 10 |
| France* | 15 | 0/10 | 0 |
| Great Britain* | 0 | 0 | 0 |
| Germany* | 15 | 5 | 0 |
| Georgia | 10 | 10 | 10 |
| India | 10 | 10 | 10 |
| Iran | 10 | 10 | 5 |
| Japan* | 10 | 15 | 10 |
| Kazakhstan | 10 | 10 | 10 |
| Malaysia | 10 | 10 | 10 |
| Pakistan | 10 | 10 | 10 |
| Romania | 10 | 10 | 15 |
| Russia | 10 | 5 | 5 |
| Slovakia | 10 | 10 | 10 |
| Tajikistan | 10 | 10 | 10 |
| Turkey | 10 | 10 | 10 |
| Ukraine | 10 | 10 | 10 |
| United States* | 0 | 15 | 0 |
| Uzbekistan | 10 | 10 | 10 |

* USSR treaties honoured by Turkmenistan.

## *Tax administration*

### *Returns*

Reports are generally filed quarterly within the month following the reporting quarter. Annual declaration of branches of foreign legal entities is due by 15 March of the year following the reporting one.

Tax agents must file WHT reports not later than the 20th day of the month following the one when the respective tax liability occurred.

### *Payment of tax*

Advance payments under the standard tax regime are made before the 13th and 28th days of each month (unless agreed otherwise with tax authorities). Final payments upon results of the first quarter, first half-year, nine months, and tax year are made within five days from the reporting deadlines. Under the petroleum law tax regime, the CIT is reported and paid once annually based on dates indicated as per the Product Share Agreement (PSA).

# Uganda

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## Significant developments

### Significant changes in 2010

Following the reading of the national budget in June 2010, a few amendments were made to the Income Tax Act, the Value-added Tax (VAT) Act, and the Finance Act. The key notable amendments included the following:

- Exemption of the following items from VAT:
  - Computer software and software licences. Previously, only computer software was exempt from VAT and not software licences. After dialogue between the government and various stakeholders who incur significant costs in respect of software licences, the above amendment was introduced.
  - Biodegradable packaging materials.
- A capital gain derived from sale of shares in a private limited company is subject to tax even though such a gain is not included in a person's business income. This implies that gains derived by individuals on sale of private shares in a limited company are subject to tax.
- Various changes were made to the provisions for taxation of petroleum operations. However, these may be subject to change in 2011.

## Taxes on corporate income

The income tax rate applicable to the chargeable income of companies is 30%, with the exception of:

- Mining companies.
- Non-resident air transport, shipping, and some telecommunication services.
- Resident companies whose turnover is less than 50 million shillings (UGX).

Chargeable income is gross income for the year less the total deductions allowed under the Income Tax Act (ITA). A resident company is taxed on its income from all geographical sources. A non-resident company is only subject to Uganda income tax on income derived from sources in Uganda.

### Mining companies

The income tax rate applicable to mining companies is calculated according to the following specified formula:

> Annual tax rate = 70 minus (1500/x), where x is the ratio of the company's chargeable income to the gross revenue for the year.

Note that the derived tax rate is subject to a minimum tax rate of 25% and a maximum tax rate of 45%.

### *Non-resident air transport, shipping, and some telecommunications services*

Non-resident ship operators, charterers, and air transport operators who derive income from carriage of passengers who embark, or cargo or mail which is embarked, in Uganda, as well as road transport operators who derive income from carriage of cargo or mail which is embarked in Uganda, are taxed at the rate of 2%.

A non-resident person who carries on the business of transmitting messages by cable, radio, optical fibre, or satellite communication and derives income through transmission of such messages by apparatus established in Uganda, whether or not such messages originated from Uganda, is taxed on one's gross income at a rate of 5%. Similarly, a non-resident person who derives income from providing direct-to-home pay television services to subscribers in Uganda is taxed on one's gross income at a rate of 5%.

### *Resident companies with turnover of less than UGX 50 million*

A rate of 1% of turnover is used to determine income tax payable by a resident company whose turnover is between UGX 20 million and UGX 50 million (approximately between USD 10,000 and USD 25,000), subject to certain thresholds.

However, on application to the Commissioner, a resident company with a turnover of less than UGX 50 million may be taxed at 30%.

This category excludes professionals, public entertainment services, public utility services, or construction services.

## *Corporate residence*

A company is resident in Uganda for a year of income if it meets one of the following criteria:

- Is incorporated or formed under the laws of Uganda.
- Has its management and control exercised in Uganda at any time during the year of income.
- Undertakes the majority of its operations in Uganda during a year of income.

### *Permanent establishment (PE)*

A PE (branch) means a place where a person carries on business, and includes:

- A place where a person is carrying on business through an agent, other than a general agent of independent status acting in the ordinary course of business as such.
- A place where a person has, is using, or is installing substantial equipment or substantial machinery.
- A place where a person is engaged in a construction, assembly, or installation project for 90 days or more, including a place where a person is conducting supervisory activities in relation to such a project.

## Other taxes

### Value-added tax (VAT)

VAT is governed by the VAT Act and administered by the Uganda Revenue Authority (URA). VAT is charged at the rate of 18% on the supply of most goods and services in the course of business in Uganda. Specified goods and services, as well as exports outside of Uganda, attract a zero-rate of tax.

Some supplies are exempt from VAT, the main categories being government subsidies, the supply of unprocessed foodstuffs, agricultural products and livestock, financial services, insurance services, unimproved land, leases and sale of certain residential properties, betting and gaming, education, medical and health services, social welfare services, pesticides, petroleum products subject to excise duty, machinery for processing agricultural or dairy products, accommodation in hotels outside specified areas, computers, computer accessories, software, and biodegradable packaging materials. The supply of specialised vehicles, plants, and machinery; engineering designs; feasibility studies; consultancy services; and civil works related to hydro-power, road and bridge construction, public water works, agriculture, education, and health sectors is also exempt.

Zero-rating is preferable to exemption because the VAT on costs incurred in making a zero-rated supply can be recovered while that incurred in making an exempt supply cannot be recovered.

The zero-rated supplies include the supply of goods and services exported from Uganda; the supply of drugs and medicines; the supply of seeds, fertilisers, pesticides and hoes; the supply of machinery, tools, and implements suitable for use only in agriculture; the supply of milk, including milk treated in any way to preserve it; and the supply of leased aircraft, aircraft engines, spare engines, spare parts for aircraft, and aircraft maintenance equipment.

The annual threshold for VAT registration is UGX 50 million (approximately USD 25,000). Persons who make supplies that are VATable and whose turnover exceeds UGX 50 million are required to register for VAT with the URA. VAT registered persons are required to:

- Charge VAT whenever they make supplies that are VATable.
- File monthly returns before the 15th day of the month following the reporting onth.

### Credit for input tax

A person making exempt, zero-rated, and standard supplies can recover all the input VAT if the exempt supplies are less than 5% of the total supplies. However, if the exempt supplies are more than 5% but less than 95%, the person is required to recover only a portion of the VAT input tax corresponding to the percentage of the taxable supplies. If the exempt supplies exceed 95%, the person cannot recover any input VAT.

### Imported services

The VAT Act defines a supply of service to mean any supply which is not a supply of goods or money, including the performance of services for another person.

An imported service is one provided by a person normally resident outside Uganda who is not required to register for VAT in Uganda. According to regulation 14 of the VAT Regulations 1996, any person who imports a service into the country must account for VAT on such a service. The Regulations require the person importing the service to account for the VAT at the time when performance of the service is completed, or when payment for the service is made, or when the invoice is received from the foreign supplier, whichever is earliest.

The tax on such imported services is supposed to be computed at the rate of 18% of the cost of the service. VAT registered companies are required to prepare self-billed tax invoices to account for the input VAT. Further, if the importer of the services is not registered for VAT, the importer is required to calculate and pay the VAT to URA.

Although there is no effect on the cash flow position, preparation of a self-billed tax invoice is important as it is a requirement by law. Failure to do so is tantamount to lack of compliance with the law, and a penalty of 2% per month compounded may apply.

### *Stamp taxes*
Stamp duty is charged on a number of transactions at varying rates. Stamp duty is charged at 1% of the total value for a number of instruments, including hire purchase agreements, composition deeds, leases, exchange of property, conveyance, transfers, share warrants, gifts, and agreement relating to deposit of title deeds.

Stamp duty of 0.5% is incurred on formation of a company, capital-raising activities such as increase of share capital, debentures, equitable mortgages, and mortgage deeds.

Stamp duty of 1% applies on transfer of shares.

No stamp duty is charged on the increase of share capital where it is in fulfilment of a condition precedent for acquiring loan funds for a development project or where it is made on becoming public through the stock exchange.

Stamp duty of UGX 5,000 is also charged in a number of various other instruments.

### *Customs duties*
Many goods imported into Uganda are subject to customs duties. However, exemptions are available to various classes of plant and machinery imported into Uganda. The rates of duty are provided by the East African Community common external tariff code. Certain products imported from the East African Community and the Common Market for Eastern and Southern Africa (COMESA) region enjoys special custom duty rates. Imported items are classified according to the nomenclature established under the international convention on the harmonised commodity description and coding system. Duty's range from 0% to 60% depending on the item imported.

### *Excise taxes*
Excise duties are imposed on goods considered luxuriant. Examples include locally manufactured soft drinks, cigarettes, alcoholic drinks, and spirits. A schedule of some of the rates is provided below:



| Goods | Excise tax |
|---|---|
| Cigarettes | Between UGX 20,000 and UGX 50,000 per 1,000 sticks subject to the type of cigarette |
| Cigars and other smoking tobacco | 150% |
| Beer made from malt | 60% |
| Beer made from local raw material | 20% |
| Beer produced from barley grown and malted in Uganda | 40% |

| Goods | Excise tax |
|---|---|
| Spirits | 60% |
| Wine produced from local raw materials | 20% |
| Other wine | 70% |
| Air time | 12% |
| Fuel and oils | Between UGX 200 and UGX 720 per litre depending on the type of fuel/oil |

### *Property taxes*

Property taxes are administered by the local authorities. They are based on the value of the property as assessed by the local authorities.

### *Turnover taxes*

Every promoter of gaming and pools promoted within Uganda and every principal agent of a promoter of gaming and pools promoted outside Uganda is liable to tax at 15% of the total amount of money received or the total amount of bets.

A tax of 5% is charged on gross income earned by non-resident persons carrying on the business of transmitting messages by cable, radio, optical fibre, satellite, or provision of direct to home pay television services to subscribers in Uganda.

### *Environmental taxes*

Environmental levies are charged on every person who imports motor vehicles that are eight years old or older. Levies are also imposed on the importation of used household appliances. The levy on motor vehicles is 20% of the value of the vehicle as determined for customs duty purposes. Levies on electrical appliances range from UGX 20,000 to UGX 50,000 per item depending on the nature of the item.

## *Branch income*

Tax is imposed on the income of a non-resident company derived from running a branch in Uganda. The chargeable income of a branch in Uganda is taxed at the corporation tax rate of 30% after deduction of allowable expenses.

In addition to corporation tax, branches are subject to extra tax at a rate of 15% on any repatriated income for a year of income. The repatriated income is calculated using the A+(B-C)-D approach. Where A is the net assets at the beginning of the year, B is the net profit for the year, C is the tax charge for the year, and D is the net assets at the end of the year.

## *Income determination*

In arriving at chargeable income (taxable income) one has to go through the process of adjusting profits by taking into account deductions allowed and deductions not allowed.

### *Inventory valuation*

A taxpayer is allowed a deduction for the cost of trading stock disposed of during the year, which is determined by adding to the opening value of the trading stock the cost of trading stock acquired during the year and subtracting the closing value of stock. The opening value of the stock is the closing value for the previous year or, where the taxpayer commenced business during the year, the market value at the time of commencement of the business of the trading stock acquired prior to commencement. The closing stock valuation method is the lower of cost or market value. Trading stock is allowed to be valued using either the absorption costing or prime cost method. Stock valuation method once chosen may not be changed but only with written permission of the Commissioner.

### *Capital gains*
Capital gains are included in and taxed together with the business income at a rate of 30%. There is no separate capital gains tax. Capital gains arise on disposal of non-depreciable business assets as well as sale of shares.

### *Dividend income*
The general rule is that dividend income is taxable as part of business income at a rate of 30%. Dividend income is also subject to withholding tax (WHT) at the rate of 15%. The WHT paid in respect of the dividend income is creditable where the income is subject to the corporation tax rate of 30%. The WHT rate for dividend payments to resident persons is 15%. For dividends paid out by companies listed on the stock exchange to individuals, the rate is 10%.

Dividend income is exempt from tax if the recipient company directly or indirectly controls the paying company through ownership of 25% or more of the voting power of the paying company.

### *Interest income*
The general rule is that interest income is taxable as part of business income at a rate of 30%. Interest income is also subject to WHT at the rate of 15%. The WHT paid in respect of the interest income is creditable where the income is subject to the corporation tax rate of 30%. However, interest income earned by financial institutions with respect to agricultural loans is not subject to tax. Also, interest income earned by financial institutions with respect to government securities is subject to tax at 15% as a final tax.

### *Rental income*
Rental income for companies is included in gross income and taxed at the 30% corporate tax rate.

### *Foreign income*
Foreign income is taxable on resident recipients, and tax suffered in the country where it is sourced (if any) is creditable subject to the provisions of any double taxation agreements. This credit is limited to the amount of Ugandan tax payable on that income.



## *Deductions*

### *Deductibility of expenses*
The ITA sets out the following conditions for deductibility of an expense:

- There must be an expenditure or loss.
- The expenditure or loss must be incurred by a person during the year of income.
- The expenditure must be incurred in the production of income included in gross income.

No deduction is allowed for the following expenditures:

- Any expenditure or loss of a domestic or private nature.
- Any expenditure or loss of a capital nature.
- Any expenditure or loss recoverable under insurance contract or indemnity.
- Income tax payable in Uganda or in a foreign country.
- Any fine or similar penalty paid to a government or its sub-division for breach of any law.
- Any contribution or similar payment made to a retirement fund by the employee or for the benefit of any other person (e.g. National Social Security Fund (NSSF) contributions).
- Any premium or similar payment made in respect of a life insurance policy for the life of the person paying the premium or on the life of some other person.
- Any income appropriated to a reserve fund or capitalised in any way.
- The amount of pension paid to any person.

### *Accrued expenses*
A taxpayer who is accounting for tax purposes on an accrual basis derives income when it is receivable by the taxpayer and incurs expenditure when it is payable by the taxpayer.

An amount is treated as payable by the taxpayer when all the events that determine liability have occurred and the amount of the liability can be determined with reasonable accuracy, but not before economic performance with respect to the amount occurs. Economic performance occurs:

- with respect to the acquisition of services or property, at the time the services or property are provided
- with respect to the use of property, at the time the property is used, or
- in any other case, at the time the taxpayer makes payment in full satisfaction of the liability.

### *Contingent liabilities*
Contingent liabilities are not tax-deductible in Uganda.

### *Depreciation*
A deduction is allowed for the depreciation of the person's depreciable assets, other than minor assets, in accordance with the appropriate applicable rates. The ITA allows a taxpayer a deduction for the depreciation of their depreciable assets on a reducing balance basis. Depreciable assets are classified in four classes as follows:

| Class | Assets included | Rate of tax depreciation (%) |
|---|---|---|
| 1 | Computers and data handling equipment. | 40 |
| 2 | Automobiles, buses, and mini-buses with a seating capacity of less than 30 passengers; goods vehicles with a load capacity of less than 7 tonnes; construction and earth moving equipment. | 35 |
| 3 | Buses with a seating capacity of 30 or more passengers; goods vehicles designed to carry or pull loads of 7 tonnes or more; specialised trucks, tractors; trailer-mounted containers; plant and machinery used in farming, manufacturing, or mining operations. | 30 |

| Class | Assets included | Rate of tax depreciation (%) |
|---|---|---|
| 4 | Rail cars, locomotives, and equipment; vessels, barges, tugs, and similar water transportation equipment; aircraft, specialised public utility plant, equipment, and machinery; office furniture, fixtures, and equipment, and any depreciable asset not included in another class. | 20 |

### Initial allowance

Where a taxpayer places an item of eligible property into service for the first time during the year of income, they qualify for a tax deduction for that year of income which is equal to 75% of the cost of the asset if the property is put into use outside Kampala, Entebbe, Namanve, Jinja, and Njeru. However, if the property is put into use in the above named areas, the tax deduction is equal to 50%.

Eligible property is defined to mean plant and machinery wholly used in the production of income included in gross income but does not include goods or passenger vehicles; appliances of a kind ordinarily used for household purposes; or office or household furniture, fixtures, and fittings.

### Industrial building allowance

A company is eligible for an industrial building allowance on its industrial and commercial buildings at a tax rate of 5% per annum on a straight-line basis. The industrial building allowance will be granted on the actual cost incurred in constructing the buildings.

In addition to the above, a company is entitled to an initial allowance at the rate of 20% on an industrial building in the first year the building is put to use. The industrial building allowance is computed on the residual value after the initial allowance of 20%.

An industrial building is defined to mean any building which is wholly or partly used, or held ready for use, by a person in manufacturing operations, research and development into improved or new methods of manufacture, mining operations, an approved hotel business, an approved hospital, or approved commercial buildings.

### *Goodwill*

No tax deduction is allowed for goodwill in Uganda.

### *Start-up expenses*

A company setting up business for the first time or engaged in the initial public offer at the stock market will be entitled to a tax deduction for all its start-up costs that are of capital nature which would otherwise not be tax-deductible under the ordinary tax rules. The start-up costs will be allowed as tax-deductible costs over a period of four years at a straight-line basis at the rate of 25% per annum.



### *Bad debts*

A deduction is allowed for bad debts only if:

- the amount was included in the person's income in the year of income
- it is in respect of money that was lent in the ordinary course of business by a financial institution in the production of income, or

- the amount of the debt claim was in respect of a loan granted to any person by a financial institution for the purpose of farming, forestry, fish farming, beekeeping, animal and poultry husbandry, or similar operations.

For the bad debt to be deductible, the taxpayer must demonstrate to the URA that reasonable steps to collect the debt were taken and that the taxpayer failed to recover the debt. In relation to a financial institution, it should be a debt in respect of which a loss reserve held against presently identified losses or potential losses, and which is therefore not available to meet losses which subsequently materialise, has been made.

### *Interest expenses*
Interest is deductible if the interest is incurred in respect of a debt obligation by the company in the production of income included in the company's gross income. Interest arising from non-trade-related debt obligation is not deductible.

Interest charged before capital investment is put to use has to be capitalised. Interest incurred after capital investment is put to use is allowed as a deduction.

If the company is foreign controlled, then the interest arising from the loan in excess of two times the company's equity will not be allowed *(see Thin capitalisation rules in the Group taxation section for more information)*.

### *Meals, refreshments, and entertainment*
Expenses for meals, refreshments, and entertainment are deductible only where the value is included in the employment income of the employees or is excluded from employment income owing to the fact that it is provided on equal terms to all workers.

### *Charitable contributions*
Charitable donations are deductible if made to amateur sporting associations; religious, charitable, or educational institutions of public character; trade unions; and other similar associations which have been issued with a written ruling by the Commissioner currently in force stating that it is an exempt organisation. The donations should not exceed 5% of the person's chargeable income.

### *Pension expenses*
Employers are allowed a deduction for the contributions made to pension schemes on behalf of their employees. Employees, on the other hand, do not get a deduction for the contributions they make to pension funds.

### *Payment for directors*
Directors are treated as employees, so expenses incurred in respect of directors are deductible expenses.

### *Bribes, kickbacks, illegal payments*
Non-business expenses are not tax-deductible, including those of a private nature.

### *Net operating losses*
A deduction is allowed for any assessed tax losses carried forward from previous years of income. Such tax losses are carried forward and deducted against future taxable profit of the business in the subsequent years of income. The losses can be carried forward indefinitely. There is no ring-fencing of losses except in the following circumstances:

- Where, during a year of income, there has been a change of 50% or more in the underlying ownership of a company, as compared with its ownership one year previously, the company is not permitted to deduct an assessed loss in the year of income or in subsequent years, unless the company, for a period of two years after the change or until the assessed loss has been exhausted if that occurs within two years after the change:
  - continues to carry on the same business after the change as it carried on before the change and
  - does not engage in any new business or investment after the change where the primary purpose of the company or the beneficial owners of the company is to utilise the assessed loss so as to reduce the tax payable on the income arising from the new business or investment.
- In cases where losses relate to farming, the assessed farming loss can only be deducted from farming income of the taxpayer in the following year and not from any other income.

There is no provision for carryback of losses in Uganda.

### *Payments to foreign affiliates*
Payments to foreign affiliates are deductible as long as they are incurred in the production of income.

## *Group taxation*

There are no specific provisions in the law covering groups, so companies in a group do not get any special treatment for tax purposes in Uganda.

### *Transfer pricing regime*
Uganda does not have specific transfer pricing legislation. However, the anti-avoidance provisions contained in Sections 90 and 91 of the ITA require transactions between associates to be at arm's-length basis. These are the provisions that are often applied by the URA in instances where they are of the view that a non-resident person may be transferring profits from Uganda.

### *Thin capitalisation rules*
Where a company intends to finance some of its Uganda operations by use of foreign debt, the ITA provides for thin capitalisation rules in Uganda, and the safe harbour debt: equity ratio is 2:1.

The thin capitalisation rules are provided for in Section 89(1) of the ITA. According to this Section, where a foreign controlled resident company which is not a financial institution has a foreign debt to foreign equity ratio in excess of 2 to 1 at any time during that year of income, a deduction is disallowed for the interest paid by the company during that year on that part of the debt which exceeds the 2 to 1 ratio.

### *Controlled foreign company (CFC) regime*
Uganda does not have a CFC regime.

## Tax credits and incentives

### Foreign tax credit (FTC)

A resident taxpayer is entitled to FTC for any foreign income tax paid by the taxpayer in respect of foreign-source income included in the gross income of the taxpayer. The FTC allowed is subject to the income tax rate (i.e. 30%) in Uganda.

### Tax holidays for exporters

A tax holiday of ten years is available to exporters who export at least 80% of their produce of finished goods, subject to certain conditions.

### Scientific research expenditure, training expenditure, and mineral exploration expenditure

A 100% allowance is available for scientific research expenditures, training expenditures, and mineral exploration expenditures in the year of expenditure.

### Incentives for the importation of plant and machinery

Plant and machinery is exempt from customs duty and WHT on importation. Also a VAT deferral facility is available where VAT is deferred on importation of plant and machinery and subsequently waived upon approval by the relevant authorities.

### Employment incentives

A deduction of 2% of income tax payable is granted to any employer who can prove to the URA that at least 5% of their employees on full time basis are people with disabilities.

### Other incentives

- Income derived from agro processing is exempt from income tax, subject to certain conditions.
- Business income derived by a person managing or running an educational institution is exempt from income tax.
- New investors may be granted Investment Trader Status where they can claim their input VAT before they start to make taxable supplies. This is subject to certain conditions as specified by the VAT Act.

## Withholding taxes

According to Section 83(1) of the ITA, a tax is imposed on every non-resident person who derives any dividend, interest, royalty, rent, natural resource payment, or management charge from sources in Uganda. WHT at a rate 15% therefore applies on gross dividend payments, interest, management fees, and royalty payments in respect of non-treaty countries.

However, section 83(5) exempts interest paid by a resident company in respect of debentures, which:

- were issued by the company outside Uganda for the purpose of raising a loan outside Uganda
- were widely issued for the purpose of raising funds for use by the company in a business carried on in Uganda or the interest is paid to a bank or a financial institution of a public character, and
- the interest is paid outside Uganda.

A debenture is defined in the ITA as any form of debt, including debenture stock, mortgage stock, loan, loan stock, or any similar instrument acknowledging indebtedness, whether secured or unsecured. The term widely issued is also specifically defined.

### *Double taxation agreements (DTAs)*

A taxpayer may benefit from the provisions of a DTA that Uganda has with another country. Please find below a table showing the countries with which Uganda has DTAs and the applicable WHT rates on various categories of income.

According to section 88 (2) of the ITA, the terms of the international agreement to which Uganda is a party prevails over the provisions of ITA in case the terms of the international agreement are inconsistent with the provisions of the Act.

| Recipient | Dividend (%) | Royalty (%) | Management fees (%) | Taxation of branch profits (%) | Repatriation of branch profits (%) |
|---|---|---|---|---|---|
| Denmark | 15 | 10 | 10 | 30 | 15 |
| India | 10 | 10 | 10 | 30 | 15 |
| Mauritius | 10 | 10 | 10 | 30 | 15 |
| Netherlands | 15 (1) | 10 | 15 | 30 | 15 |
| Norway | 10 | 10 | 10 | 30 | 15 |
| South Africa | 10 | 10 | 10 | 30 | 15 |
| United Kingdom/ Great Britain | 15 | 15 | 15 | 30 | 15 |

Note

1. With respect to the Uganda/Netherland DTA, the rate applicable on dividends is 15% except where the investment is new or is an expansion of the current investment made after the DTA entered into (10 September 2006).

   For new investments and expansions of current investment, the rates are:
   - 0% if the beneficiary holds at least 50% of the shares in the company paying the dividends.
   - 5% if the beneficiary holds less than 50% of the shares in the company making the payment.

## *Tax administration*

### *Returns*

The ITA provides for two provisional returns within a 12-month period (financial year). The first provisional return is due within the first six months of the accounting year while the second is due by the end of the twelfth month of the accounting year.

The Self Assessment Return (SAR) is due by the sixth month after the end of the accounting year.

Electronic filing has been introduced for all tax returns.

### *Payment of tax*

For all companies, a system of provisional payments on account, based on estimated profits, is in place. The first payment of 50% is due in the sixth month of the accounting period and the second payment is due in the 12th month. The balance is expected to be paid together with the SAR.

### *Statute of limitations*
The ITA requires a taxpayer to maintain records for at least five years after the end of the year to which the records relate.

The VAT Act provides for records to be maintained for six years after the end of the tax period to which they relate.

### *Topics of focus for tax authorities*
The focus of the URA keeps shifting but is generally based on the risk analysis of the information availed to them. Currently, the focus is on transfer pricing.

# *Ukraine*

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## *Significant developments*

Ukraine continues developing its tax system. The new Tax Code took effect on 1 January 2011 (the corporate income tax entered into force on 1 April 2011) and introduced the following significant change.

### *Corporate income tax (CIT)*

As of 1 April 2011, the CIT rate has been reduced from 25% from 23%.

## *Taxes on corporate income*

CIT applies to taxable profits earned by resident entities in Ukraine and abroad and non-residents with a permanent establishment (PE) in Ukraine. Resident entities are taxed on their worldwide income. Non-resident entities are taxed on their Ukrainian-source income.

As of 1 April 2011, Ukraine's CIT has a uniform rate of 23% (25% prior to 1 April 2011). The rate will be reduced to 21% as of 1 January 2012, 19% as of 1 January 2013, and 16% from 1 January 2014 onwards.

No CIT is levied at the regional or local level.

A withholding tax (WHT) at a rate of 15% applies for the majority of income payments for non-residents, unless relief is given under a double taxation treaty (DTT). Ukraine has 68 effective DTTs in place. *See the Withholding taxes section for more information.*

### *Favourable tax regime for agricultural producers*

Agricultural producers are entitled to use a very favourable tax regime, provided certain requirements are met. The main criterion requires that income from the sale of their own agricultural products constitutes not less than 75% of their total gross revenue.

### *Reduced rates for insurance companies*

Reduced CIT rates of 0% and 3% are applicable for income of insurance companies in 2011 and the first quarter of 2012. Net insurance premiums (gross premiums less amounts paid to reinsurance companies) are taxed at 0% for long-term life insurance premiums and pension insurance premiums, and 3% otherwise. Profits earned by insurance companies from non-insurance activities are taxed at the standard rate.

## *Corporate residence*

Corporate residence is determined by the place of incorporation.

### Permanent establishment (PE)

The Ukrainian definition of a PE generally follows the PE definition in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, but with a stronger agency tests.

In particular, a non-resident PE is defined as a fixed place of business through which the business activity of a non-resident entity is wholly or partly carried out in Ukraine. A PE includes, among other things, a place of management, affiliate, office, etc.

The Tax Code has introduced the concept of a service PE whereby the provision of services (apart from the provision of personnel), including consultancy services, by a non-resident through its employees or other personnel in Ukraine, shall constitute a Ukrainian PE of this non-resident, provided such activities (within the frame of one project) last more than six months in any 12-month period.

Moreover, a construction site in Ukraine may also give rise to a taxable presence of a non-resident in Ukraine in the form of PE, if the length of the construction activities exceeds six months.

The Tax Code has also assisted with the list of exclusions from the PE definition. In particular, auxiliary and preparatory services of a non-resident should not result in creating a PE for the non-resident.

In practice, the Ukrainian tax authorities usually interpret the term 'business activity' in a very broad sense, and, without DTT protection, may consider any type of activity as giving rise to a taxable presence (i.e. a PE) of a foreign entity in Ukraine.

## Other taxes

### Value-added tax (VAT)

There are two rates of VAT: 20% and 0%. The rate of 20% applies to almost all transactions subject to VAT except the export of goods and related services, which is taxable at 0%. The zero rate also applies to the supply of international transport services (confirmed by a single international shipping document) and toll manufacturing services.

Provision of services to a non-resident is not considered zero-rated. Such services are subject to 20% VAT or considered to be outside the scope of VAT (effectively exempt with no right to claim input VAT) depending on the place of supply.

Transactions that are subject to VAT include the following:

- The supply of goods and services when the place of supply is in Ukraine, including when the supply is made without consideration.
- The importation of goods and ancillary services (i.e. services costs which are included in goods customs value) into Ukraine.
- Exportation of goods.

Transactions that are not subject to VAT include (non-exhaustive list) the following:

- The issue, sale, and exchange of securities.

- The transfer of property from a lesser to a lessee under an operating lease and return of property upon expiration of the operating lease (other than in course of import operations).
- Interest/commission element of lease payments under financial lease agreements.
- Provision of financial loans and bank guarantees.
- Insurance and reinsurance services supplied by licensed insurers and services of insurance/reinsurance agents and brokers.
- Payment of royalties.
- Reorganisation of a legal entity (merge, spin-off, accession, division).
- Transit of cargo and passengers through Ukrainian territory.

### VAT registration

Tax registration as a VAT payer is compulsory if the volume of an entity's taxable transactions exceeds the compulsory registration threshold. The current registration threshold is 300,000 Ukrainian hryvnia (UAH) for the previous 12 months. An entity qualifying as a taxable entity should register with the tax authorities at the place of its location and obtain a VAT registration number. In addition, a voluntarily VAT registration is available if a person makes taxable supplies within 12 previous months and at least 50% of supplies is to VAT payers. There is no mechanism to register for a non-resident without PE in Ukraine. Accordingly, any Ukrainian VAT incurred by non-resident is non-recoverable.

### VAT recovery and refunds

Generally, VAT incurred by a registered entity on the purchase and/or importation of goods and services used for the purpose of its own business (except for VAT incurred in relation to exempt supply) may be recovered by way of a credit against output VAT. In case VAT credit exceeds VAT output for two months consecutively, VAT refund is available in form of cash payment or offset against future VAT liabilities (subject to certain rules and limitations).

In practice, obtaining a VAT refund is extremely difficult. As a one-time solution to the existing problem of VAT refunds, in 2010, the Ukrainian Ministry of Finance issued special VAT bonds in order to settle existing VAT refund debt of the government. The government is liable to the interest at 120% discount rate of the National Bank of Ukraine (NBU) charged on VAT that was not refunded within prescribed statutory terms. As of 2011, an automatic VAT refund procedure has been introduced for eligible exporters.

## *Stamp taxes*

Stamp duty is imposed on certain actions, including notarisation of contracts and filing of documents with the courts. In most cases, the amounts involved are nominal, although there are exceptions. Operations carried out at commodity exchanges and sales of real property attract a stamp duty of 1%.

## *Excise taxes*

Excise tax applies to certain goods imported into or produced in Ukraine. Excisable goods include alcoholic beverages, tobacco and tobacco products, cars and car bodies, as well as petrol and diesel fuel. Ukraine is currently experiencing a gradual augmentation of excise tax on tobacco goods, ethyl alcohol, and alcoholic beverages.

Rates of excise tax can be *ad valorem* (in percentage to the value of goods), specific (in monetary units per unit of goods' characteristic), or combined.

### Property taxes
There is no tax on commercial property in Ukraine (apart from the land tax).

### Customs duties
Import duty is payable by the importer when goods are imported into Ukraine and applies in accordance with the customs tariff. There are currently two rates of duty: relieved and full rates. Relieved rates of duty apply to goods originating from World Trade Organization (WTO) countries and countries which have granted Ukraine 'most favoured nation' trade status. Full rates of duty apply to goods originating from all other countries.

In addition to the reduced rates mentioned above, Ukraine has concluded free-trade agreements with Georgia, the Commonwealth of Independent States (CIS) countries, and Macedonia. Ukraine has also signed a free-trade agreement with the European Free Trade Association (EFTA) countries, although it is not yet in force. These agreements allow many goods to be imported into Ukraine duty-free, subject to compliance with preferential rules of origin. The 2000 CIS Rules for Determining Country of Origin are used to determine whether goods originate from a particular country to qualify for these duty exemptions.

The government is negotiating a free-trade agreement with the European Union, and the president has indicated that his goal is to have this signed in 2011.

Ukraine has no export duties except on natural gas, scrap metal, livestock, rawhide, and certain oil seeds. Recently, export duties were introduced on grain (wheat, maize, barley).

### Land tax
Land tax is assessed annually for the following year and is paid monthly in equal instalments by the owners or users of land. The rate of land tax depends on the category, location, and existence of the state valuation of each particular land plot.

### Special Pension Fund charges
The following special charges are payable to the State Pension Fund:

- 3% charge based on the transfer value of a car.
- 1% charge on the acquisition of real estate payable by individuals and legal entities that purchase real estate.
- 7.5% charge on mobile communication services.

There are also a number of other business activities that require contributions to be made to the Special Pension Fund.

### Charge on environmental pollution
Environmental pollution charges are imposed on any legal entity that discharges contaminants into the environment (air or water) or disposes of waste. The actual rate depends on the type and toxicity of each contaminant.

### Charge for subsoil usage
Companies engaged in extracting mineral resource in Ukraine, regardless of the form of their ownership, are liable to a charge for use of subsoil. For gas and gas condensate, the specific tax rates are applied to the volume of extracted mineral resources. The payments to be made are calculated as follows:

volume of extracted mineral resources * specific tax rate * coefficient

Separate rates of charge for use of subsoil apply to storage of oil and gas products (the amounts are immaterial).

Charges for the use of subsoil are deductible for CIT purposes.

### *Rental payments (oil and gas industry)*
Rental payments are to be made by the companies having the appropriate licenses authorising extraction of oil, gas, and gas condensate.

The tax base is calculated as the volume of extracted mineral resources multiplied by the tax rate. The adjusting coefficients apply to tax rates on rental payments for oil, gas condensate, and for natural gas other than that sold to the buyer authorised by the Cabinet of Ministers. Such coefficient is calculated by the Ministry of Economy (for oil and gas condensate) and the Ministry of Finance (for natural gas) for each reporting period.

Rental payments are deductible for CIT purposes. Product Sharing Agreements (PSA) covered by the Tax Code provide an exemption from these rental payments.

### *Other local taxes*
The Tax Code reduced the number of local taxes, which may be levied at the discretion of local authorities, from 14 to 4.

## *Branch income*

Domestic incorporated branches or other separate units are treated as separate taxpayers for CIT purposes. However, their head offices may pay consolidated CIT.

In Ukraine, it is not currently possible to register a branch of a foreign legal entity. A foreign company may set up a representative office in Ukraine, which is similar to an unincorporated branch. A non-resident company operating via a representative office is deemed to carry out business in Ukraine through a PE and may be subject to CIT at 23% (21% as of 1 January 2012) unless protected by a DTT. When a foreign company conducts business in Ukraine through a PE, taxable income should be determined on the same basis as for domestic entities. If the PE has no separate accounts, the taxable income may be determined as 30% of sale proceeds attributed to the PE.

Distributions made by a PE (out of after-tax income) to its head office should not trigger any further taxation in Ukraine, provided the head office is in a jurisdiction which has a DTT with Ukraine.



## *Income determination*

The Tax Code determines taxable profits as taxable income (items of income defined by the Tax Code) less deductible expenses (expenses allowed for deduction by the Tax Code), including depreciation charges. Taxable income includes any operational (business) income received or accrued within a reporting period (e.g. quarter) and other income, which includes generally passive and irregular receivables. Items of income are recorded when a legal title on goods is transferred or when a document confirming rendering of services is signed by parties.

### *Inventory valuation*
A taxpayer is entitled to adopt any of the methods of inventory valuation prescribed by the national accounting standards.

### *Capital gains on the sale of property*
Capital gains realised by the local entity on the sale of buildings are calculated as the difference between the sales price of the fixed asset and its net book value. Capital gains on the sale of land are computed as the difference between the sale price of land and adjusted purchase price of land.

### *Income from securities*
Income from securities is calculated separately from other income and is based on the so called 'pooling method'. Taxable income is determined by deducting the aggregate cost of acquiring each class of securities from the aggregate proceeds from selling such securities. If aggregate acquisition costs for the year exceed aggregate sales proceeds, the excess is carried forward and applied against sales of securities in subsequent years.

### *Dividend income*
Dividends received by a Ukrainian entity from another Ukrainian entity are exempt from CIT. Dividends received by Ukrainian companies from foreign companies controlled (at last 20% shareholding) by these Ukrainian companies (except for those having 'offshore status') are exempt from CIT.

Companies paying dividends are required to pay advance CIT at the standard rate, unless the dividends are paid to individuals or out of received dividends (with some other exceptions). The advance payment is used to meet subsequent CIT liabilities (other than for insurance companies). If the advance tax is not able to be used in the year the dividend is paid, it is carried over to future income years, but it cannot be refunded.

### *Interest income*
Interest received by taxpayers is included in their taxable income on a general basis.

### *Rent/royalties income*
Income from rent / royalties received by taxpayers is included in their taxable income on a general basis.

### *Foreign exchange gains/losses*
Amounts receivable or payable in foreign currency are recognised as taxable income or expenses at the official currency exchange rate at the date when either (i) they should be recognised under general rules of the Tax Code or (ii) they actually paid, whichever event occurs first.

Realised and non-realised foreign exchange gains/losses are generally treated as taxable/deductible. Foreign currency differences arising from unsettled debt balances and foreign currency account balances are computed according to the accounting standards.

### *Other income*
Ukrainian tax legislation does not provide special tax treatment for bribes, kickbacks, or illegal payments. However, any income, unless a specific provision in the law says otherwise, should be included in taxable income.

Funds or property returned to the holder of corporate rights issued by a legal entity after that entity's liquidation, but not in excess of the shares' par value, are not taxable.

Interest free loans from non-residents are taxable, unless they are received from shareholders for a period not exceeding 365 calendar days.

### *Foreign income*

Foreign income is taxed under general rules, and there are no special rules regarding anti-deferral or unremitted earnings.

## *Deductions*

Deductible expenses include any operational (related to the cost of goods/services sold) or other expense actually incurred or accrued in respect of the taxpayer's business, excluding non-allowable expenses specified by the Tax Code.

Generally, operational expenses are recognised at the date of income recognition from the goods/services sold; other expenses are recognised when they are actually incurred.

Examples of non-deductible items include the following:

- Expenses that are not supported by relevant documents (e.g. contract, voucher, receipt, cheque).
- Service fees paid to related entities, unless there is documentation to prove that the fees are paid in relation to services actually performed.
- Expenses relating to receptions, presentations, entertainment, sampling, and free of charge provisions of goods and services. However, advertising expenses are deductible according to the general rule.
- Costs of goods and services purchased from private entrepreneurs on a simplified tax system.
- Fees for consultancy, marketing, and advertising services, as well as royalties, paid to non-residents, are limited for deduction (up to 4% of net revenue separately for royalties and other services for the year preceding the reporting one, excluding VAT and excise). They are not deductible entirely if their recipient is not a beneficial owner or resident in an offshore jurisdiction. In addition, royalties paid to a person who shall not be taxed with regard to such royalty in the country of its residence or for intellectual property rights generated in Ukraine are also fully not tax deductible.
- Engineering fees payable to a non-resident are deductible only up to 5% of custom value of equipment imported under a related contract. The engineering fees are not deductible entirely if their recipient is not a beneficial owner or a resident in an offshore jurisdiction.
- Payments in respect of goodwill and amortisation of goodwill.
- Fines and penalties.
- Business trip expenses for individuals that are not employees or members of the taxpayer`s management/supervising bodies. Expenses of business trips for employees are deductible within the limits set by the Cabinet of Ministers of Ukraine.
- Expenses relating to the provision of employees with uniforms, safety clothes, and shoes, as well as food, if the amount exceeds the norms established by the Cabinet of Ministers of Ukraine.
- Banks will be entitled to a tax deduction of 20% of loan-loss provisions, excluding off-balance (including interest-accrued, fees, the amount of guarantees issued on the last business day of each tax period, and in respect of all securities). From 1 April 2011 to 1 January 2012, there will be a deduction limit of 30% on such provisions.

Other financial institutions are entitled to a deduction of up to 10% of all loan-loss provisions.

### *Depreciation and amortisation*
Assets costing more than UAH 2,500 (UAH 1,000 for 2011) and with a useful life exceeding one year are required to be depreciated. Depreciation is determined on a monthly basis and is computed using the following methods:

- Straight-line.
- Reducing balance.
- Method of accelerated reduction of a residual value.
- Cumulative.
- Production-based.

Fixed assets are divided into 16 groups according to their statutory minimal useful life. The useful life of the fixed assets may be extended by a tax payer.

Land value may not be depreciated unless the land plot is purchased together with a building (object of Group 1).

As of 1 January 2011, intangibles may be amortised according to the standard depreciation methods over the assets' useful economic lives as defined in documents certifying rights to the intangibles.

### *Organisational and start-up expenses*
Deduction of organisational and start-up expenses incurred prior to the entity registration is not explicitly allowed by the law.

### *Research and development (R&D) expenses*
R&D expenses other than those subject to amortisation are deductible when incurred, provided they are business-related.

### *Interest expenses*
Interest paid is generally deductible for CIT purposes if incurred for business needs. However, a limitation for deducting interest expense applies if at least 50% of the borrower's capital belongs to non-residents and the interest is payable to non-residents (and related entities) that have a holding on the borrower's capital. The same rule applies if the borrower is owned by tax-exempt entities and pays interest to them. The deductible interest paid to those persons and their related parties cannot exceed the amount of interest income derived plus 50% of the company's taxable profit (excluding interest income and before the deduction of interest). Any interest paid to affiliates in excess of this limit is carried forward to future tax periods.

### *Bad debt*
As of 1 April 2011, (subject to some transitional rules) the deduction for bad or doubtful debt is allowed if (i) the creditor applies to the court with a claim for debt collection or for initiating bankruptcy proceedings or (ii) the creditor has a note of execution for collection executed by a notary. The creditor which deducted the bad or doubtful debt must also reduce related deductions (deductions related to income recognised as the bad debt in creditor's accounts).

As of 1 April 2011, (with some transitional provisions) when a creditor pursues action to recover the debt, the debtor is required to adjust its deductions at the moment of

(i) taking effect of the court's decision or (ii) delivery of the note on debt collection by the notary.

### *Pension expenses*

The obligatory Ukrainian social security insurance contributions, including state pension contributions charged on payroll expenses, are deductible for employers. If an employer pays non-state pension contributions at its own expense, such contributions may be deducted in an amount not exceeding 25% of the total amount of payroll expenses accrued for a relevant employee during the tax year of the reporting tax periods in which such payments are incurred.

### *Payment for directors*

Payments (including bonuses) of a business nature are normally deductible payments, if properly structured.

### *Net operating losses*

Ukrainian tax legislation does not provide refunds for deductions. However, tax losses may be carried forward indefinitely. In the past, Parliament regulated specific losses that could be carried forward. For example, taxpayers were able to use only 20% of their losses on 1 January 2010 when paying tax under a return for the first quarter of 2010. No such restriction has been adopted for 2011.

Ukrainian tax legislation does not provide refunds for losses carried back.

### *Payments to foreign affiliates*

Payments of a business nature are normally deductible payments. When such payments are made to related parties, however, the payer is required to hold documentary evidence that the payments are for services actually rendered. The amount of the payment also may not exceed the 'usual' (market) price. Reimbursement of costs incurred by holding companies is directly prohibited for deduction.

Payments for goods or services, as well as interests, to foreign entities in listed jurisdictions operating offshore tax regimes (37 tax haven jurisdictions are listed by Ukraine's Cabinet of Ministers) are deductible at 85% of payments, unless evidence is held that the foreign entity is subject to the ordinary tax rules of the respective foreign jurisdiction (i.e. it does not benefit from the offshore tax regime).

## *Group taxation*

In Ukraine, each company is taxed individually. However, companies that have domestic unincorporated branches may pay consolidated CIT or as separate branches.



### *Transfer pricing regime*

Ukrainian transfer pricing regulations establish the principle of arm's-length pricing for transactions between related parties. Parties are 'related' if, among other things, one party controls, directly or indirectly, a shareholding interest representing more than 20% of the charter capital of the other party.

### *Thin capitalisation*

Ukraine does not have thin capitalisation rules as such. Instead, there are restrictions on related parties' interest deductibility rules. The interest paid to a related party (as defined in the Tax Code) is deductible within the amount of interest income plus 50% of the company's taxable profit (excluding interest income). Any interest paid to affiliates in excess of this limit is carried forward to future tax periods.

### *Controlled foreign company (CFC) regime*
There are no specific CFC rules in Ukraine.

### *Treatment of inter-company items*
Ukrainian tax legislation provides the following treatment for inter-company items:

- Dividends paid by Ukrainian companies are not tax deductible. Dividends received are not generally taxable.
- The payer of royalties is required to hold documentary evidence that the royalty payments are made for services actually rendered. The amount of the payment also may not exceed the 'usual' (market) price. Royalties paid to a non-resident are deductible only to 4% of net revenue. Royalties are completely non-deductible in respect of intangibles originated in Ukraine, paid to residents of the offshore jurisdictions, or paid to persons who are not beneficial owners.
- Expenses in relation to the financing of management bodies, including holding companies, are not tax deductible.
- Cost-sharing and similar intra-group payments, other than remuneration for services actually rendered, may not be deductible.
- Transactions of the receipt (provision) of financial aid between a taxpayer and its branches and other separate units without the legal entity status located in Ukraine shall not affect their taxable income or deductible expenses;
- Interest on loans is limited *(see Interest expenses in the Deductions section)*.

## *Tax credits and incentives*

Ukraine currently has very few tax incentives, although some are available. The following businesses are entitled to benefit from them:

- Income of publishing and agricultural entities may be tax exempt.
- Income received by investment funds is tax exempt.
- For enterprises selling domestically produced energy saving goods in Ukraine and enterprises adopting energy saving projects, up to 50% of profits may be exempt.
- As of 1 January 2010, a tax exemption is available for producers of electric and heat energy generated from bio-energy fuel as well as for producers of bio-energy powered domestic equipment. Tax incentives are also available for producers of gas (methane).
- Certain tax incentives are granted to the Union of European Football Associations (UEFA) and its companies during the hosting stage of 2012 UEFA European Football Championship in Ukraine and to specific segments of the tourism industry (including ten years of CIT exemption for 3, 4, and 5-star hotels).
- Light industry is tax exempt until 2021.

### *Foreign tax credit*
Tax residents are allowed a credit for foreign taxes paid on income received abroad, provided there is a DTT between Ukraine and the relevant foreign state. The amount of foreign tax credit is limited to the amount of Ukrainian tax that would arise from the equivalent income in Ukraine (i.e. maximum 23%, 21% as of 1 January 2012). To claim a tax credit, the taxpayer requires an official confirmation of payment issued by the relevant foreign tax authority.

### Tax holidays

Ukrainian tax legislation envisages tax holidays for small business, which are unlikely to impact international businesses.

## Withholding taxes

WHT must be remitted to the authorities no later than the date when the payment is made to the income recipient.

Passive income (dividends, interest, royalties) from Ukrainian sources that is paid to non-resident entities is generally subject to 15% WHT. Other payments, including payments for engineering services, lease payments, and agency and brokerage fees, are also subject to 15% WHT, but payments for most other services are not subject to withholding.

A 15% WHT applies to income on the sale of real estate and on profits from the sale of securities.

Payments for freight services (including sea freight) are subject to 6% WHT.

WHT rates may be reduced under a relevant tax treaty.

As of 1 January 2011, the Tax Code specifies that the non-resident recipient of income sourced in Ukraine must also be considered the beneficial owner of such income in order to benefit from reduced tax rates under relevant tax treaties. According to the 2011 Tax Code, agents, nominee holders, and other intermediaries in respect of received income cannot be beneficial owners of income sourced in Ukraine, and, therefore, are not entitled to favourable treaty provisions.

Payments to non-resident persons for advertising services are not subject to withholding. However, the resident payer is required to pay, from its own funds, a 20% tax based on the value of such services.

A resident payer is similarly required to pay, from its own funds, a 12% tax if a payment is made to a foreign insurer or reinsurer whose rating of financial reliability does not meet requirements set by the authorised state agency. A 0% rate applies otherwise.

As taxes on advertising and insurance are levied on a resident party, they cannot be relieved using a tax treaty.

| | Dividends (%) | | | |
|---|---|---|---|---|
| **Recipient** | **Non-portfolio (1)** | **Portfolio** | **Interest (%) (2)** | **Royalties (%) (3)** |
| Domestic rates: | | | | |
| Non-resident individuals | 5/15 (16) | 5/15 (16) | 0/5 (4) | 15 |
| Non-resident corporations | 15 | 15 | 15 | 15 |
| Treaty rates: | | | | |
| Algeria | 5 | 15 | 10 | 10 |
| Armenia | 5 | 15 | 10 | 0 |
| Austria | 5 | 10 | 2/5 (5) | 0/5 |
| Azerbaijan | 10 | 10 | 10 | 10 |
| Belarus | 15 | 15 | 10 | 15 |

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| Recipient | Dividends (%) Non-portfolio (1) | Dividends (%) Portfolio | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|---|
| Belgium | 5 | 15 | 2/10 (5) | 0/10 |
| Brazil | 10 | 15 | 15 | 15 |
| Bulgaria | 5 | 15 | 10 | 10 |
| Canada | 5 | 15 | 10 | 0/10 |
| China (PRC) | 5 | 10 | 10 | 10 |
| Croatia | 5 | 10 | 10 | 10 |
| Cyprus (6) | 0 | 0 | 0 | 0 |
| Czech Republic | 5 | 15 | 5 | 10 |
| Denmark | 5 | 15 | 0/10 (7) | 0/10 |
| Egypt | 12 | 12 | 12 | 12 |
| Estonia | 5 | 15 | 10 | 10 |
| Finland | 0/5 (8) | 15 | 5/10 (7) | 0/ 5/10 |
| France | 0/5 (9) | 15 | 2/10 (5) | 0/5 /10 |
| Georgia | 5 | 10 | 10 | 10 |
| Germany | 5 | 10 | 2/5 (5) | 0/5 |
| Greece | 5 | 10 | 10 | 10 |
| Hungary | 5 | 15 | 10 | 5 |
| Iceland | 5 | 15 | 10 | 10 |
| India | 10 | 15 | 10 | 10 |
| Indonesia | 10 | 15 | 10 | 10 |
| Iran | 10 | 10 | 10 | 10 |
| Israel | 5/10 | 15 | 5/10 (10) | 10 |
| Italy | 5 | 15 | 10 | 7 |
| Japan (6) | 15 | 15 | 10 | 0/10 |
| Jordan | 10 | 15 | 10 | 10 |
| Kazakhstan | 5 | 15 | 10 | 10 |
| Korea (ROK) | 5 | 15 | 5 | 5 |
| Kuwait | 5 | 5 | 0 | 10 |
| Kyrgyzstan | 5 | 15 | 10 | 10 |
| Latvia | 5 | 15 | 10 | 10 |
| Lebanon | 5 | 15 | 10 | 10 |
| Libya | 5 | 15 | 10 | 10 |
| Lithuania | 5 | 15 | 10 | 10 |
| Macedonia | 5 | 15 | 10 | 10 |
| Malaysia (6) | 15 | 15 | 15 | 10/15 |
| Moldova | 5 | 15 | 10 | 10 |
| Mongolia | 10 | 10 | 10 | 10 |
| Morocco | 10 | 10 | 10 | 10 |
| Netherlands | 0/5 (11) | 15 | 2/10 (5) | 0/10 |
| Norway | 5 | 15 | 10 | 5/10 |
| Poland | 5 | 15 | 10 | 10 |
| Portugal | 10/15 (12) | 15 | 10 | 10 |
| Romania | 10 | 15 | 10 | 10/15 |
| Russian Federation | 5 (13) | 15 | 10 | 10 |
| Serbia and Montenegro | 5 | 10 | 10 | 10 |
| Singapore | 5 | 15 | 10 | 7.5 |

| Recipient | Dividends (%) Non-portfolio (1) | Dividends (%) Portfolio | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|---|
| Slovakia | 10 | 10 | 10 | 10 |
| Slovenia | 5 | 15 | 5 | 5/10 |
| South Africa | 5 | 15 | 10 | 10 |
| Spain (6) | 15 | 15 | 0 | 0/5 |
| Sweden | 0/5 (14) | 10 | 0/10 (5) | 0/10 |
| Switzerland | 5 | 15 | 0/10 (5) | 0/10 |
| Syria | 10 | 10 | 10 | 15 |
| Tajikistan | 10 | 10 | 10 | 10 |
| Thailand | 10 | 15 | 10/15 (10) | 15 |
| Turkey | 10 | 15 | 10 | 10 |
| Turkmenistan | 10 | 10 | 10 | 10 |
| United Arab Emirates | 5 | 15 | 3 | 0/10 |
| United Kingdom | 5 | 10 | 0 | 0 (15) |
| United States | 5 | 15 | 0 | 10 |
| Uzbekistan | 10 | 10 | 10 | 10 |
| Vietnam | 10 | 10 | 10 | 10 |

Notes

1. The ownership threshold for the non-portfolio rate is 10%, 20%, 25%, or 50%, depending on the specific provisions in the treaty.
2. Several treaties contain a rate of 0% on interest paid to or guaranteed by a government or one of its agencies.
3. If more than one rate is shown, this means that the rate will depend on the type of royalties paid.
4. The lower rate applies to interest on current or deposit bank accounts, certificates of deposit until 1 January 2015.
5. The lower rate applies to interest paid on certain credit sales and on loans granted by a financial institution.
6. The treaties with Cyprus, Japan, Malaysia, and Spain were entered into by the USSR before it dissolved. Ukraine will continue to honour these treaties, unless they are superseded.
7. The lower rate applies to interest paid in connection with the sale on credit of any industrial, commercial, or scientific equipment, unless the indebtedness is between associated enterprises.
8. The 0% rate applies if the investor holds at least 50% of the capital of the company paying the dividends and the capital invested is at least USD 1 million; the payer of dividend should not operate in the field of gambling, show business or intermediation business, or auctions.
9. The 0% rate will apply if a French company or companies hold, directly or indirectly, at least 50% of the capital of the Ukrainian company, and the aggregate investments exceeds 5 million French francs.
10. The lower rate applies to interest paid on any loan granted by a bank.
11. The 0% rate applies if the investor holds directly at least 50% of the capital of the company paying the dividends, and the capital invested is at least USD 300,000.
12. The 10% rate applies if the company receiving the dividend has, for an uninterrupted period of two years before the dividend is paid, owned at least 25% of the capital stock of the company paying the dividends.
13. The 5% rate applies if the capital invested is at least USD 50,000.
14. The 0% rate applies if the Swedish company directly holds at least 25% of the voting power of the company paying the dividends and at least 50% of the Swedish company is held by Swedish residents.
15. The 0% rate applies only if the royalties are taxable in the United Kingdom.
16. The 15% applies to dividends from privileged shares or other fixed payments on shares, as well as to disguised employment income.



## Tax administration

### Returns

Tax returns must be filed by the taxpayer on a monthly (VAT) or a quarterly basis (CIT). Monthly tax returns are due within 20 calendar days following the end of the reporting month, and quarterly returns are due within 40 calendar days following the last day of the reporting quarter.

### *Payment of tax*
Taxes payable assessed on the basis of tax returns are due within ten calendar days following the deadline for filing of relevant tax returns.

### *Statute of limitations*
Under Ukrainian tax legislation, a three year statute of limitations applies on any outstanding Ukrainian tax liability, starting as from the date of a tax return is due to be filed. There is no limit on the period in which an assessment may be made if a taxpayer has deliberately evaded tax (if proven in court) or when a taxpayer fails to file a return.

### *Tax audits*
The tax authorities may carry out scheduled audits once a year. Taxpayers must be notified of the audit in writing at least ten days before the scheduled audit. In addition, the tax authorities may perform out-of-schedule audits in certain circumstances (e.g. if a taxpayer does not file tax returns on a timely basis or is reorganised or liquidated).

### *Penalties*
The tax authorities will charge significant penalties for late filing or understatement of tax liabilities. If a taxpayer fails to withhold tax when required, a penalty of up to 75% of the deficient tax is imposed.

## *Other issues*

### *Exchange controls*
The key issues regarding Ukraine's current exchange control regulations are as follows:

- Payments under foreign trade contracts between a resident and a non-resident entity should be in foreign currency only.
- Payments in foreign currencies between residents in the territory of Ukraine are generally prohibited.
- Salaries to Ukrainian staff must be paid in Ukrainian currency (but expatriate employees can be paid in hard currency).
- Foreign loans must be registered with the NBU before funds are remitted to Ukraine. The NBU has reinstated a maximum interest rate and other charges that may be applied to foreign currency loans obtained from non-residents.
- The maximum allowable interest rates for foreign fixed rate loans in hard currency (inclusive of any fees and charges due under the loan agreement) are 9.8% per annum for loans up to one year; 10% per annum for loans for one to three years; and 11% per annum for loans over three years. For loans with floating interest rates, the maximum allowable interest rate is three months of USD LIBOR plus 7.5%.
- Proceeds from exports must be credited to the exporter's Ukrainian bank account within 180 days from the date of customs clearance (for goods) or date of services delivery. Similarly, prepaid goods must be imported and cleared through customs within 180 days of payment. Failure to do so results in a fine of 0.3% of the amount due or paid for each day of delay.

Payments by Ukrainian business entities for services rendered by non-residents for amounts exceeding EUR 100,000 (annually) require confirmation from the Foreign Markets Monitoring Centre (FMMC) that the fee for the services does not exceed market prices. Provided the relevant documentation is in place, this should not delay payments. However, the process cannot be taken lightly. If the FMMC rejects an application, no payment will be permitted.

A number of foreign currency transactions may be undertaken only if an individual licence has been obtained from the NBU.

### *Choice of business entity*
Generally, a limited liability company is the most widely used corporate vehicle in Ukraine for both residents and non-residents. A limited liability company has simple registration procedure, is inexpensive, and is easy to maintain. It also provides more flexibility in terms of repatriating dividends from Ukraine.

### *Business and tax treatment of intellectual property*
Ukrainian laws concerning intellectual property rights provide for a rather developed background for intellectual property usage. Economic rights of authors and neighboring rights owners may be assigned or licensed. Moral rights are not transferable. However, in the field of enforcement and tax and court practice, there is an enormous lack of practical experience.

Tax treatment for intellectual property transactions is subject to separate analysis on case-by-case basis, as the Ukrainian tax legislation provides different approaches depending on the nature of the agreement concluded. For instance, the transfer of intellectual property may be treated as its sale, provision of services, or royalty agreement.

### *Mergers and acquisitions (M&A) from a business and tax perspective*
There are no specific laws regulating public takeovers and mergers in Ukraine.

The global financial crisis significantly affected M&A transactions in Ukraine. However, M&A activity in the Ukrainian market is gradually increasing now, especially in the view of an announced programme of economic reform which includes the privatisation of Ukraine's regional power grid companies.

The Ukrainian Tax Code provides some guidance on the tax regime of corporate mergers and acquisitions that is generally favourable for M&A transactions. However, no VAT refund in cash will be available in 12 months after transaction. Also, no deduction of tax losses is available if the acquired entity was a related party to an acquirer for less than 18 months.

# *United Arab Emirates*

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## *Significant developments*

There is a growing trend of tax reforms in the Middle East region and this may result in changes to the tax laws in the United Arab Emirates (UAE).

In particular, the United Arab Emirates (along with the other Gulf Cooperation Council or GCC states) has committed to introduce a value-added tax (VAT) system. The UAE government has made significant progress towards the introduction of VAT; however, there is no formal legislative announcement yet on its introduction.

Advice should therefore be sought to confirm the current status of the UAE tax laws and reforms.

## *Taxes on corporate income*

The United Arab Emirates is a federation of seven emirates: Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al-Qaiwain, Ras Al-Khaimah, and Fujairah. Currently, the UAE federation does not impose a federal corporate income tax in the emirates. However, most of the emirates introduced income tax decrees in the late 1960s, and taxation is therefore determined on an emirate by emirate basis.

Under the emirate-based tax decrees, corporate income taxes (CIT) may be imposed on all companies (including branches and permanent establishments) at rates of up to 55%. However, in practice CIT is currently imposed only on branches of foreign banks and companies which produce, trade in, or trade in rights over oil, gas, or other hydrocarbon products (i.e. oil & gas companies) having operations in the emirate.

In addition, some of the emirates have introduced their own specific banking tax decrees which impose tax on branches of foreign banks at the rate of 20%.

## *Corporate residence*

Tax residence under the tax decrees of the various emirates is based upon the French concept of territoriality. Basically, the French territoriality concept taxes profits based on territorial nexus, rather than taxing profits earned outside the country.

### *Permanent establishment (PE)*

For non-resident companies, the CIT liability will also depend on the existence of any kind of PE. Most of the emirate tax decrees include a definition of a PE that generally includes a branch, management or other fixed place of business, and presence through an agent that has and habitually exercises authority to conclude contracts on behalf of such corporation. The definitions need to be considered individually under the applicable tax decree.

## Other taxes

### Value-added tax (VAT)

The United Arab Emirates does not currently operate a VAT regime. However, the United Arab Emirates has made significant progress towards its introduction, and it is known that the introduction of a VAT is expected in the near future.

### Municipal tax

Most emirates impose a municipality tax on properties, mostly by reference to the annual rental value. It is generally the tenants' obligation to pay the tax; however, the tenants' employer will typically pay the tax on behalf of the employee. In some cases, separate fees are payable by both tenants and property owners. For example, in Emirate of Dubai, it is currently imposed at 5% of the annual rental value for tenants or for property owners at 5% of the specified rental index.

Further, a land registration fee may also be levied on transfer of ownership of land or property. For example, a land registration fee is levied in the Emirate of Dubai at a rate of 2% of the sale value of the property (shared between the buyer and seller), payable to Dubai Land department.

These levies are imposed and administered differently by each emirate.

### Customs and excise duties

Generally, a customs duty of 5% is imposed on the cost, insurance, freight (CIF) value of imports. Other rates may apply to certain goods such as alcohol and tobacco, and certain exemptions may also be available.

Currently, there are no separate excise taxes levied in the United Arab Emirates.

### Hotel tax

Most emirates impose a hotel tax of 5% to 10% on the value of hotel services and entertainment.

## Branch income

As each emirate has a different CIT decree, the decree of each emirate must be consulted to determine the treatment of branches of foreign corporations.

In certain emirates, branches of foreign banks are governed by special banking tax decrees where they are taxed at 20% of their adjusted taxable income.

## Income determination

The tax decrees of the various emirates levy taxation on financial accounting profits. The tax decrees may provide for additional adjustments in specific situations. Currently, these adjustments may not be too relevant given that CIT is not imposed for most companies (except for oil & gas companies and branches of foreign banks having operations in the emirate) in the United Arab Emirates.

## Deductions

Deductions are determined based on accounting principles and the tax decrees of the various emirates. Currently, these deductions may not be too relevant given that CIT is not imposed for most companies (except for oil & gas companies and branches of foreign banks having operations in the emirate) in the United Arab Emirates.

## Group taxation

The United Arab Emirates does not currently permit group taxation.

## Tax credits and incentives

The United Arab Emirates offers numerous incentives in the form of tax holidays/ exemptions, including offering a range of free trade zones.

### Free trade zones (FTZs)

Currently, there are over 30 FTZs (and business parks) in the United Arab Emirates, each having its own regulations. Businesses (and their employees) established in FTZs are generally eligible for guaranteed tax holidays for ten to 50 year (renewable) periods. The FTZs also offer exemption from customs duties. The laws granting these holidays and exemptions are not consistent among the various FTZs, and each FTZ therefore needs to be considered separately.

## Withholding taxes

There are currently no withholding taxes in the United Arab Emirates.

### Tax treaty network

Taxpayers resident in the United Arab Emirates have access to an extensive tax treaty network. These treaties may not be immediately relevant for UAE withholding taxes (which are not imposed under the UAE tax decrees); however, they may continue to allow for other beneficial tax provisions (e.g. right to tax in the other treaty country). For completeness, the treaties currently in force are listed below. A number of other treaties are at various stages of negotiation.

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | In force |
|---|---|---|---|---|
| Algeria | 0 | 0 | 10 | 25-Jun-04 |
| Armenia | 0/3 | 0 | 5 | 19-Dec-04 |
| Austria | 0 | 0 | 0 | 1-Sep-04 |
| Azerbaijan | 5/10 | 0/7 | 5/10 | In force |
| Belarus | 5/10 | 5 | 5/10 | 1-Jan-01 |
| Belgium | 0/5/10 | 0/5 | 0/5 | 6-Jan-04 |
| Bosnia & Herzegovina | 0/5/10 | 0 | 5 | 30-Apr-07 |
| Bulgaria | 0/5 | 0/2 | 0/5 | 16-Nov-08 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | In force |
|---|---|---|---|---|
| Canada | 5/10/15 | 0/10 | 10 | 25-May-04 |
| China | 7 | 7 | 10 | 28-Aug-94 |
| Cyprus | N/A | N/A | N/A | Pending |
| Czech Rep. | 0/5 | 0 | 10 | 2-Aug-97 |
| Egypt | 0 | 0/10 | 10 | 16-Jul-95 |
| Estonia | N/A | N/A | N/A | Pending |
| Finland | 0 | 0 | 0 | 26-Dec-97 |
| France | 0 | 0 | 0 | 1-Jul-90 |
| Georgia | N/A | N/A | N/A | Pending |
| Germany (new treaty) | 5/10/15 | 0 | 10 | Pending |
| Greece | 0/5 | 0/5 | 0/5 | Pending |
| Hong Kong | N/A | N/A | N/A | Pending |
| India | 10 | 0/5/12.5 | 10 | 22-Sep-93 |
| Indonesia | 10 | 0/5 | 5 | 8-Nov-96 |
| Ireland | 0 | 0 | 0 | Pending |
| Italy | 5/15 | 0 | 10 | 5-Nov-97 |
| Jordan | N/A | N/A | N/A | Pending |
| Kazakhstan | 5 | 10 | 10 | Pending |
| Korea, Rep of | 5/10 | 0/10 | 0 | 2-Mar-05 |
| Lebanon | 0 | 0 | 5 | 21-May-99 |
| Libya | N/A | N/A | N/A | Pending |
| Luxembourg | 5/10 | 0 | 0 | 1-Jan-10 |
| Malaysia | 10 | 0/5 | 10 | 10-Feb-00 |
| Malta | 0 | 0 | 0 | 18-May-07 |
| Mauritius | 0 | 0 | 0 | 31-Jul-07 |
| Mongolia | 0 | 0 | 10 | Pending |
| Morocco | 0/5/10 | 0/10 | 0/10 | 2-Jul-00 |
| Mozambique | 0 | 0 | 0/5 | 15-Apr-04 |
| Netherlands | 5/10 | 0 | 0 | 2-Jun-10 |
| New Zealand | 15 | 0/10 | 10 | 29-Jul-04 |
| Pakistan | 10/15 | 0/10 | 12 | 30-Nov-94 |
| Philippines | 0/10/15 | 0/10 | 10 | 2-Oct-08 |
| Poland | 0/5 | 0/5 | 5 | 21-Apr-94 |
| Portugal | N/A | N/A | N/A | Pending |
| Romania | 0/3 | 0/3 | 3 | 23-Jan-96 |
| Seychelles | 0 | 0 | 5 | 23-Apr-07 |
| Singapore | 5 | 0/7 | 5 | 30-Aug-96 |
| Spain | 5/15 | 0 | 0 | 2-Apr-07 |
| Sri Lanka | 0/10 | 0/10 | 10 | 1-Apr-04 |
| Sudan | 0 | 0 | 5 | Pending |
| Syria | 0 | 0/10 | 18 | In force |
| Tajikistan | 0 | 0 | 10 | 27-Mar-00 |
| Thailand | 10 | 10/15 | 15 | 28-Dec-00 |
| Tunisia | 0 | 2.5/5/10 | 7.5 | 27-May-97 |
| Turkey | 5/10/12 | 0/10 | 10 | 26-Dec-94 |
| Turkmenistan | 0 | 0 | 10 | Pending |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) | In force |
|---|---|---|---|---|
| Ukraine | 0/5 | 0/3 | 0/10 | 9-Mar-04 |
| Uzbekistan | N/A | N/A | N/A | Pending |
| Venezuela | N/A | N/A | N/A | Pending |
| Vietnam | N/A | N/A | N/A | Pending |
| Yemen | 0 | 0 | 10 | Pending |

## *Tax administration*

Most companies operating in the United Arab Emirates (except oil & gas companies and branches of foreign banks) are currently not required to file CIT returns in the United Arab Emirates.

# United Kingdom

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## Significant developments

Several notable changes to the United Kingdom's (UK) corporate tax system have been made in the past year. The government has also announced a number of reform measures for corporation tax, together with a programme of future changes and consultations, including a roadmap of how reform will develop in the next five years. The overall aim is to improve the international tax competitiveness of the UK economy by reforming four main areas:

- Rate of corporation tax.
- The corporate tax base.
- Policy making.
- Administration and collection.

Because the UK legislative process can lag behind the announcement of proposals, certain changes are already law, others are very likely, or practically certain, to become law, whilst others are issues announced for wider consultation and future enactment into law.

Significant measures introduced and fully enacted in law which have full impact in 2010 and 2011 include a reduction in the rates of corporation tax, the introduction of a debt cap, commencement of the dividend exemption regime, and the introduction of a bank levy with effect from 1 January 2011. Reductions in rates of capital allowances (tax depreciation) from April 2011 are practically certain to be implemented. These changes and areas of future reform and consultation are discussed below.

### Changes that have taken effect in the past year

Following consultation on the taxation of foreign profits, a package of complex and far reaching measures was introduced in 2009 and impacts UK inbound, outbound, and purely domestic businesses through 2010 and 2011 and beyond. It comprises:

- a tax exemption for most non-UK dividends and other distributions (as well as for UK dividends) received on or after 1 July 2009
- the introduction of a 'debt cap' restricting UK tax deductions for finance costs to the level of a group's external finance expense, which applies to amounts payable in accounting periods beginning on or after 1 January 2010, and
- the abolition of certain controlled foreign company (CFC) exemptions for accounting periods starting on or after 1 July 2009, subject to transitional provisions (a fundamental overhaul of the CFC regime is under consideration and the subject of further consultation, *see below*).

Simplification of certain elements of the corporate capital gains regime has been introduced and will almost certainly be effective from July 2011. These elements include reducing the impact of degrouping charges (by election, a group can take advantage of these changes from 1 April 2011), and facilitating group reorganisations and other corporate transactions.

A new bank levy has been introduced from 1 January 2011 (subject to formal legislative process and approval which is almost certain to complete) and will take the form of an annual tax on certain liabilities of most UK based banks and building societies. The tax will be levied at the following rates:

- January and February 2011: 0.05% of a bank's short-term relevant liabilities, and 0.025% of long term equity and liabilities.
- March and April 2011: 0.1% of a bank's short-term relevant liabilities, and 0.05% of long term equity and liabilities.
- 1 May 2011 to 31 December 2011: 0.075% of a bank's short-term relevant liabilities, and 0.0375% of long term equity and liabilities.
- From 1 January 2012: 0.078% of a bank's short-term relevant liabilities, and 0.039% of long term equity and liabilities.

The bank levy will not be deductible for corporation tax purposes. The form of the levy is similar to arrangements being implemented in other countries.

Changes tightening the Disclosure of Tax Avoidance Schemes (DOTAS) (or Tax Avoidance Disclosure (TAD)) regime have been enacted with effect from 1 January 2011 and require both earlier and quarterly disclosures.

Employer's national insurance contributions (NICs) increased by 1% to a maximum of 13.8% from 6 April 2011. *(Employee's NICs also increased from the same date; details are given in the Individual Tax Summaries)*.

The main corporation tax rate was reduced from 28% to 26% from 1 April 2011, see below.

### *Changes enacted but not yet in force*
The Finance Bill (March 2011) changed the main rate of corporation tax from 28% to 26%, and reduces the small profits rate from 21% to 20%, both effective 1 April 2011. Further reductions were announced but these have not yet been enacted (see below). Before March it had been announced that the rate would fall in April 2011 from 28% to 27%, but in his budget the Chancellor announced a further reduction to 26%.

There are firm proposals - very likely to be enacted but not yet law - such that:

- the main rate of corporation tax, currently 26% from 1 April 2011, will fall by a further 1% each year until it reaches 23% on 1 April 2014
- effective for years ending on or after 1 April 2012, the main rates of capital allowances (in effect, statutory depreciation rates) will be reduced; the general rate for plant and machinery will be reduced from 20% to 18% per annum, and the rate for long-life and special plant from 10% to 8% per annum
- the introduction, from 6 December 2010 of a principles-based rule to neutralise any UK tax advantage that arises as a result of financial 'group mismatches', i.e. where intra-group financial transactions are treated differently for tax purposes in the individual group members concerned, and
- the 2% 'entry charge' for property businesses wishing to convert to the tax advantaged regime for Real Estate Investment Trusts (REITS) will be abolished from April 2012.

### *Consultations and proposals - ongoing*
There are a number of announced proposals for future reform, on which consultations are currently in progress, most significantly:

- measures to tackle tax avoidance, including consultation on the introduction of a general anti-avoidance rule (GAAR)
- the simplification of reliefs and allowances
- a review of corporation tax to establish a broad tax base, a low rate and a more territorial approach
- a new approach to policy making and consultation
- reform of the complex CFC regime, with major reform anticipated to be effective from 2012, so that most genuine overseas businesses will be exempt from the CFC charge
- reviewing the UK taxation of foreign branches, which it has now been announced will be conducted alongside the reform of the CFC rules. In particular, it is proposed that profits of foreign branches of UK groups can be elected out of UK corporation tax
- a refocussing of research and development (R&D) tax credits on hi-tech companies, small firms and start-ups, and
- the introduction of a reduced 10% rate of corporation tax on UK patent income from April 2013 - otherwise to be known as the UK 'patent box'.

In addition, the Government has also put taxpayers on notice that it is keeping under review whether to introduce an extension to the 'unallowable purpose' anti-avoidance rule for loan relationships and derivative contracts, along the lines of the measure it proposed as part of the package of measures arising from the taxation of foreign profits consultation but did not enact.

The European Union is presently working towards a Common Consolidated Corporate Tax Base to harmonise the corporate tax base (but not corporate tax rates) across the EU. It is not clear whether the UK will adopt this, nor when it will impact.

## *Taxes on corporate income*

### *General corporation tax rates*
The normal rate of corporation tax is 26% for the year ending 31 March 2012 (it had already been announced that the rate would fall by 1%, but in March 2011 the Chancellor doubled the decrease to 2%). The rate for the year ending 31 March 2011 was 28%, which had been the rate since 1 April 2008, before which it was 30%. This main rate applies to companies with profits in excess of 1,500,000 pounds sterling (GBP). This rate will fall to 25% from 1 April 2012, followed by a 1% reduction each year to 2014. It is proposed (and likely to be enacted) that the prevailing rate from 1 April 2014 will be 23%. For UK resident companies with tax-adjusted profits below GBP 300,000, a lower rate is generally applicable. This small profits rate is 20% from 1 April 2011 (21% to 31 March 2011). For companies with tax-adjusted profits between GBP 300,000 and GBP 1,500,000, there is a sliding scale of tax rates. For corporate entities with associated companies, both profit limits are divided by the number of active companies worldwide.

### *Special corporation tax regimes*
There are no special rates for, for example, financial concerns or manufacturing groups; in general all companies in all sectors are subject to the same corporate tax rates. There are however two exceptions to this general rule.

Profits which arise from oil or gas extraction, or oil or gas rights, in the UK and the UK Continental Shelf ('ring-fence profits'), are subject to tax in the UK in accordance with rates applicable in 2006, i.e. a full rate of 30% and a small companies' rate of 19%. It should also be noted a supplementary tax charge of 32% (increased from 20% from 24 March 2011) applies to 'adjusted' ring fence profits in addition to normal corporation tax.

Life insurance businesses are also taxed under a special regime, which effectively includes different corporate tax rates as well as special rules for quantifying profits.

### *Petroleum revenue tax (PRT)*
A tax of 50% is levied on profits accruing from oil and gas extracted in the United Kingdom and in the UK territorial sea and continental shelf in respect of fields given development consent before 16 March 1993. PRT has effectively been abolished, together with associated relief and allowances, for fields that received development consent after 15 March 1993. PRT paid is deductible in computing corporation tax on the company's total profits.

### *Income tax for companies*
A non-resident company is subject to UK corporation tax only on the trading profits of a UK permanent establishment (*as discussed further in the Corporate residence section*). Any other UK source income received by a non-resident company is subject to UK income tax at the basic rate, currently 20%, without any allowances (subject to any relief offered by a double tax treaty if applicable). This charge most commonly arises in relation to UK rental income earned by a non-resident landlord (NRL). The UK therefore operates a NRL Scheme which requires the NRL's letting agent or tenants to withhold the appropriate tax at source unless they have been notified that the NRL has applied and been given permission to receive rents gross.

### *Local taxes*
There are no local or provincial taxes on income.

Local taxes (known as 'rates') are levied on the occupiers of business property by reference to the property's deemed rental (or 'rateable') value, subject to certain reliefs. The amounts paid are deductible for corporation tax purposes, provided they meet all the usual requirements for deductibility.

## *Corporate residence*

### *Basic rules*
UK incorporated companies are generally treated as UK resident. However, companies resident in the United Kingdom under domestic law, but treated as solely resident in a different country under that country's double taxation treaty with the United Kingdom, are not treated as UK resident for the purposes of UK domestic tax law.

Additionally, subject to the above exception, companies incorporated overseas are also treated as UK resident if their central management and control is situated in the UK. That is, if the place of the highest form of control and direction over a company's affairs, as opposed to decisions on the day-to-day running of the business, is in the UK.

### *Direct tax liability*
Tax residence is important because resident companies are taxable in the UK on their worldwide profits, while non-resident companies are subject to UK corporation tax

only on the trading profits attributable to a UK permanent establishment (PE), plus UK income tax (generally by way of withholding, though this is not the case with UK source rental profits) on certain UK source income.

For non-resident companies, the liability to corporation tax depends on the existence of any kind of PE through which a trade is carried on. The meaning of PE for UK tax purposes is set out in statute; it is largely based on the OECD Model Tax Convention definition, but is not identical in all respects. Subject to the terms of the relevant double taxation agreement, a non-resident company will have a PE in the UK if it either:

- has a fixed place of business in the UK through which the business of the company is wholly or partly carried on, or
- an agent acting on behalf of the company has and habitually exercises authority to do business on behalf of the company in the UK.

A fixed place of business includes (but is not limited to) a place of management, a branch, an office, a factory, a workshop, an installation or structure for the exploration of natural resources, a mine, oil or gas well, quarry or other place of extraction of natural resources, or a building or construction or installation project. A company is not however regarded as having a UK PE if the activities for which the fixed place of business is maintained or which the agent carries on are only of a preparatory or auxiliary nature (also defined in the statute).

Rules exist to explain how the PE's profits should be evaluated for UK tax purposes. Financing arrangements between the branch and head office must be disregarded and there are special rules for banks to stop under-performing loans being allocated to the UK branch in a way that is considered unacceptable and similar potential manipulations. However, a deduction is given for a proportion of head office costs.

Where a non-resident company is liable to UK income tax on non-trading income, otherwise than by way of withholding tax (which, because of rules limiting such liability, almost always means tax on UK net rental income), that tax can only be charged at the basic rate of income tax, currently 20%; companies cannot be charged to tax at the much higher rates which can be applied to individuals.

## *Other taxes*

### *Value-added tax (VAT)*

The standard rate of 20% applies to most goods and services, apart from domestic fuel and power, and certain other reduced-rate supplies, which are subject to VAT at 5% (note that the standard rate was increased from 17.5% with effect from 4 January 2011).



Most exports, most food, most public transport, books and publications, and certain other essential goods and services are zero-rated. Some supplies are exempt, the main categories being the grant of certain interests in land, insurance, financial services, betting and gaming, education, certain sports services, cultural services, and health and welfare. Zero-rating is preferable to exemption, because the VAT on costs incurred in making a zero-rated supply can be recovered, while that incurred in making an exempt supply cannot.

VAT is chargeable on the supply of most goods and services made in the UK by 'taxable persons' in the course of business, when their taxable turnover exceeds the registration thresholds. Taxable persons include individuals, companies, partnerships, clubs, associations, or charities.

Taxable persons who are not normally resident in the UK, and do not have a business establishment in the UK and, in the case of companies, are not incorporated in the UK, but who make taxable supplies, sales to unregistered persons in the UK, or acquisitions of goods in the UK above the relevant limits, may be required to register and account for VAT here.

If the value of taxable supplies is over a specified limit, registration for VAT is compulsory unless the taxable supplies made are wholly or mainly zero-rated, in which case it is possible to apply for exemption from registration. The Government announced in Budget 2011, that it plans to introduce a zero VAT registration threshold for businesses not established in the UK.

The rules applying to VAT and territoriality are different to those applying to direct tax in that they derive from the principles of the place of supply in EU law, as enshrined in EC VAT Directives. Having determined that a supply of goods or services has taken place, the second condition to be determined, if the transaction is to fall within the scope of UK VAT, is whether the supply takes place within the UK. The place of supply rules are different for goods and for services. A person or business belonging outside the UK, with no place of business here may nevertheless be liable to UK VAT registration where the place of supply of those goods or services is in the UK.

From 1 January 2010, for services, the basic rule is that services are treated as made where the customer ‘belongs’ or is established for VAT purposes, and the customer is responsible for accounting for the VAT due via the reverse charge procedure. However, this is subject to a number of special rules and exceptions. Determining where a business is established for VAT purposes is based on EU law criteria. From 1 January 2010, for business to consumer (B2C) supplies, the basic rule is that services are treated as made where the supplier ‘belongs’ or is established for VAT purposes. For goods, the basic rule is that a supply of goods is taxable in the territory where those goods are physically located at the time of supply. Hence if goods are supplied in the UK by a non-established taxable person there will still be a liability for VAT purposes and the person must register for VAT in the UK if the taxable supplies exceed the current UK VAT registration thresholds.

### *Customs and excise duties*

Many goods imported into the UK from outside the European Union are subject to customs duties. The rates of duty are provided by the EU’s Common Customs Tariff and vary widely.

Excise duties are chargeable on most hydrocarbon oil products, alcoholic drinks and tobacco products imported into or produced in the UK. Purely as examples, most road fuels carry a duty of about GBP .58 per litre, cigarettes duty of about GBP 154 per thousand (plus 16.5% of the retail price), tobacco of about GBP 151 per kg, most wines of about GBP 2.41 per litre, and spirits of about GBP 25 per litre of pure alcohol included.

### *Insurance premium tax (IPT)*

IPT at the standard rate of 6% applies to premiums for most general insurance, such as for buildings and contents and motor insurance, where the insured risk is in the UK (note that the standard rate was increased from 5% from 4 January 2011). Life assurance and other long term insurance remain exempt, though there are anti-avoidance rules surrounding long term medical care policies. As an anti-avoidance measure, a higher rate of 20% applies to insurance sold by suppliers of specified goods or services, e.g. mechanical breakdown insurance, travel insurance (irrespective of supplier), insurance sold with TV and car hire, and 'non-financial' guaranteed asset protection (GAP) insurance sold through suppliers of motor vehicles or persons connected with them. Further anti-avoidance rules were introduced with effect from 9 December 2009 affecting administration or similar fees connected with contracts of insurance, charged under separate contracts by brokers and other intermediaries (note that the higher rate was increased from 17.5% from 4 January 2011).

### *Airport passenger duty*
Individuals leaving the UK by air are obliged to pay a duty, which in practice is invariably included in the cost of the air ticket. Rates of duty are based on a system of geographical banding and class of travel, ranging from a reduced rate of GBP 12 for short haul destinations in the lowest class of travel, to GBP 170 for long haul destinations in higher classes of travel.

### *Environmental taxes*
There are several environmental taxes as below, that is, 'landfill tax,' 'climate change levy' and 'aggregates levy'.

#### Landfill tax
This is a tax on waste disposal in landfill sites. The standard rate from 1 April 2011 is GBP 56 per tonne, increasing to GBP 64 per tonne from 1 April 2012. The reduced rate for inert waste is GBP 2.50 per tonne.

#### Climate change levy
This is a tax on energy used in the UK such as electricity, gas, coal and so on, and is charged at rates that depend on the nature of the fuel used. There are reduced rates and exclusions from the charge, for example, supplies to domestic or charitable users and to those who carry out specific energy-saving measures.

#### Aggregates levy
This tax is levied on the extraction or importation of sand, gravel and crushed rock for commercial exploitation in the UK. The rate of tax is GBP 2.00 per tonne from 1 April 2010, increasing to GBP 2.10 per tonne from 1 April 2012.

### *Stamp taxes*
Stamp duty is charged at 0.5% on instruments effecting sales of shares. Agreements to sell shares usually attract stamp duty reserve tax (SDRT) at 0.5%. The liability to SDRT may be cancelled by paying the stamp duty due on a stock transfer form (or other transfer instrument) executed in pursuance of the agreement. Stamp duty is not usually charged on an issue of shares, but is charged at a higher rate of 1.5% on an issue of shares in bearer form. Issues or transfers of shares to clearance services or depositary receipt systems attract SDRT at 1.5%. (Stamp duty at 1.5% may be payable on instruments effecting transfers of shares to such services or systems.) However, following a European Court of Justice ruling in 2009, the 1.5% SDRT charge is no longer collected in respect of an issue of shares (or transfer of newly issued shares) where the clearance service or depositary receipt system is based within the EU. Furthermore, there are arguments that the 1.5% SDRT charge in the context of issue of shares to systems based outside the EU and transfers of shares to these systems are not lawful. This is the subject of ongoing litigation in the UK and those potentially affected are advised to seek specific advice.

Transfers of land and buildings are charged to stamp duty land tax at graduated rates up to 4% (5% for residential property from 6 April 2011). Grants of new leases are charged to stamp duty land tax at 1% of the net present value of the rents payable in excess of GBP 150,000 plus up to 4% (or 5% for residential property from 6 April 2011) on any premium paid.

### *Employers' national insurance contributions*
Employers are obliged to pay national insurance contributions based on a percentage of each employee's earnings. For the year ending 5 April 2011, the rate is 13.8% on all earnings above GBP 136. There is some reduction for employees 'contracted out' of the state pension scheme into a private scheme.

### *Local municipal taxes*
Local taxes are not based on income, but rather are levied on the occupiers of business property by reference to a deemed annual rental value for the property concerned. These taxes are administered by regional local government authorities rather than central government.

### *Pension Protection Fund Levy*
All defined benefit pension schemes pay a levy, based on pension fund liabilities and the financial risk of the employing company. This levy funds a compensation fund for pensioners and employees of failed schemes.

### *Bank levy*
A new bank levy has been introduced from 1 January 2011 (subject to formal legislative process and approval which is almost certain to complete) and will take the form of an annual tax on certain liabilities of most UK based banks and building societies. The tax will be levied at the following rates:

- January and February 2011: 0.05% of a bank's short-term relevant liabilities, and 0.025% of long term equity and liabilities.
- March and April 2011: 0.1% of a bank's short-term relevant liabilities, and 0.05% of long term equity and liabilities.
- 1 May 2011 to 31 December 2011: 0.075% of a bank's short-term relevant liabilities, and 0.0375% of long term equity and liabilities.
- From 1 January 2012: 0.078% of a bank's short-term relevant liabilities, and 0.039% of long term equity and liabilities.

The bank levy will not be deductible for corporation tax purposes. The form of the levy is similar to arrangements being implemented in other countries.

## *Branch income*

### *Basic rules for UK branches*
Tax rates on the profits of permanent establishments (PE) are the same as for domestic corporations, except that the small profits rate is not available to non-UK resident corporations unless under the terms of a double taxation treaty.

There are specific rules setting out how the PE's profits should be evaluated for UK tax purposes, which broadly seek to treat the business as if it were a stand alone company. Financing arrangements between the branch and head office must be disregarded and there are special rules for banks to stop under-performing loans being allocated to the UK branch in a way that is considered unacceptable and similar potential manipulations. However, a deduction is given for a proportion of head office costs.

No tax is withheld on transfers of profits to the head office.

### *UK companies' branches*

The UK taxes on a worldwide basis, so non-UK branch profits are computed and taxed in the normal way for UK tax resident companies. However, UK tax will generally be reduced by credit for local direct taxes paid, either under a treaty or via the UK's unilateral relief rules.

*As noted in the Significant developments section*, this is likely to change drastically in 2011 or 2012. Draft legislation published in December 2010, if enacted, will broadly exempt from UK tax overseas branch profits other than from insurance, shipping and aircraft operations, and most investment activity; the exact scope of the new regime, and its start date, should become clearer during 2011.

## *Taxable income determination*

A UK resident company is taxed on its worldwide total profits.

The UK tax system requires those total profits to be calculated by finding the aggregate of (i) the company's net income from each source and (ii) the company's net chargeable gains arising from the sale of capital assets.

The main sources of income recognised by the legislation are (i) profits of a trade, (ii) profits of a property business, (iii) non-trading profits (or losses) from loan relationships, mainly interest receivable or payable, (iv) non-trading gains (or losses) on intangible fixed assets, and (v) non-exempt dividends or other company distributions. Determining income from the first four of these relies heavily on the company's accounts; determining income from the last does not, nor does calculating chargeable gains or income from other sources.

The rules for determining the gross income in each category differ in certain respects according to the source concerned and are different again when calculating gains. Likewise there are also subtle differences in the rules concerning the deductions that are permissible in respect of different sources of income and in respect of gains. Because of this continuing reliance on taxing companies on a 'source-by-source' basis, the UK system is not well suited to being analysed in terms of income determination and deductions as two wholly separate topics.

### *Basic rules for accounts-based sources*



A company's trading profits are based on its worldwide profit before tax in its accounts. Adjustments are made for non-trading receipts (such as dividends from other companies and income from property) and non-deductible expenditure (such as capital expenditure or expenditure which is not incurred for the purposes of the trade). Depreciation for tax purposes (known as capital allowances) is calculated and substituted for the depreciation charged in the accounts. There are also a number of other statutory adjustments to be made; three important ones are that pension contributions and deferred pay are broadly deductible only when paid, that a deduction is available for the notional cost of certain share awards to employees, and that where acquired intangibles are not depreciated in the accounts a 4% flat-rate deduction can usually be claimed. There are, however, many others.

Similar principles apply in relation to the calculation of profits of a property business.

The profits from a company's trading and non-trading loan relationships and related matters are based on the accounts. For this source of income, the distinction between 'capital' and 'revenue' receipts and deductions is not relevant. All credits and debits in the accounts are aggregated in order to find the net profit or deficit. Certain statutory adjustments have to be made – these include an interest capping limitation. Broadly the same regime applies to income and expenses relating to intangibles including goodwill. For a trader these are therefore specific areas where capital amounts can be taxed or allowed.

For traders any profit or loss on loan relationships, and/or on intangibles, are generally included within the trading profits; they become a single source of profits. For loan relationships and intangibles not connected with a trade, the company has a separate source of profits or a separate class of loss.

### *Income losses*

Where a loss arises in respect of a particular source of income, there are detailed rules regarding the possible offset of the loss. Carry-back and sideways reliefs are often allowed within limits; carry-forward is generally allowed and carried forward losses do not time expire. Losses can also be utilised by other group companies (see the Group taxation section).

More specifically, dealing with the main sorts of income losses,

- trading losses may be set off against any other source of profit (or gains) in the same year, or may be carried back one year against any other source of profit (or gain) (three years on the cessation of the trade), or may be carried forward without time limit against profits of the same trade only
- property losses may also be set off against any other source of profit (or gains) in the same year, or may be carried forward without time limit against profits of any sort; they cannot, however, be carried back, and
- non-trading deficits (i.e. financing losses) can again be set off against any other source of profit (or gains) in the same year, or may be carried back one year against non-trading credits (i.e. financing profits) or may be carried forward without time limit against non-trading profits.

Non-trading companies may deduct the (non-capital) management expenses incurred in managing its investments from its total profits. Any excess management expenses can be carried forward (without limit) to set against profits in future years.

While income losses can generally be off-set against capital gains of the same accounting period, capital losses are never available for offset against any type of income.

### *Inventory*

In general, the book and tax methods of inventory valuation will conform. In practice, inventories are normally valued for tax purposes at the lower of cost or net realisable value. A first in first out (FIFO) basis of determining cost where items cannot be identified is acceptable, but not the base-stock or the last in first out (LIFO) method.

### *Realised and unrealised exchange gains/losses*

Unrealised exchange gains and losses tend to arise on debts and derivatives; they are then taxed or allowed, together with realised amounts, on an accounts basis in the same way as other debits and credits arising out of loan relationships. Where gains or losses arise on other payables or receivables to a trader or property investor, they will again generally be taxed or allowed on an accounts basis. For a trader the taxable or allowable amount will become simply part of the trading profit or loss; for other companies it will become a separate source of taxable profit (a 'non-trading credit') or loss (a 'non-trading deficit').

Where unrealised differences arise on other capital assets they will not generally be taxable or allowable at that stage; instead, the exchange difference becomes part of the computation and is effectively taxed or allowed when the asset is disposed of and any difference is realised.

### *Dividends received*

Most foreign and UK dividends received by UK companies have been exempt from corporation tax since July 2009; one of several criteria has to be met, but these are widely drawn (one test, for example, is that the recipient controls the payer). For non-exempt foreign source dividends, double tax relief (DTR) will be available on a dividend by dividend basis. It would be unusual for companies to be taxed on UK dividends because of the breadth of the exemption, but where they are taxed, there is no concept of DTR for UK dividends.

### *Capital assets*

Gains on capital assets are taxed at the normal corporation tax rates. The chargeable gain (or allowable loss) arising on the disposal of a capital asset is calculated by deducting from gross proceeds the costs of acquisition and subsequent improvements, plus the incidental costs of sale and indexation allowance. Indexation allowance compensates for the increase in costs based on the percentage rise (if any) in the UK retail prices index to the date of disposal. Indexation allowance is however limited: it cannot create or increase a capital loss, it can only reduce or eliminate a chargeable gain. These calculations must be done in sterling, so any foreign exchange gains and losses will be taxed (or relieved) on disposal.

Special rules apply to assets held since 31 March 1982.

Most acquisitions and disposals between UK group companies are treated as made on a no gain no loss basis (i.e. at base cost plus indexation). Otherwise acquisitions from, or disposals to, affiliates are treated as made at fair market value, as are other acquisitions or disposals not at arm's length.

Capital losses are allowed only as an offset to capital gains. An excess of capital losses over capital gains in a company's accounting period may be carried forward without limitation but may not be carried back.



There is a good deal of anti-avoidance legislation concerning the computation of chargeable gains, notably to stop losses being created or gains avoided where assets are depreciated by intra-group transactions, or where losses are 'bought in' from third parties.

Gains realised on certain types of assets can be deferred where all or most of the proceeds are reinvested in other assets of those types within a specified period (generally three years). The 'rolled-over' gain then crystallises as and when the latter assets are sold. At present the main asset categories qualifying for roll-over are land and buildings used for a trade.

Most disposals by trading groups of shareholdings of 10% or more are exempt from tax. The main exceptions will be those of non-trading subsidiaries or subgroups, or of companies acquired within the previous year. As noted previously, gains on goodwill and other intangibles acquired after March 2002 will be taxed as income, not as capital gains.

### *Controlled foreign companies*
Under the CFC regime, a UK resident company may be taxed on a proportion of the undistributed profits of certain UK-controlled non-resident companies in which the resident company has an interest.

No liability arises where one of a number of tests (e.g. the 'exempt activities' test) can be satisfied. An 'acceptable distribution' exemption was withdrawn in 2009 when the rules regarding the taxation of dividends were changed.

As a result of a European Court of Justice decision that the EC Treaty allows intra-EU CFC charges only where the arrangements are 'wholly artificial', an additional exemption (not written into the statute) is available to those CFCs that are actually established in an EEA state and carry on genuine economic activity there.

The government is currently consulting on a radical overhaul of the CFC regime. This process is expected to continue well into 2011 and possibly beyond, with initial legislation not anticipated before Finance Act 2012.

### *Double tax relief*
The UK has an extensive network of double taxation treaties. Unilateral relief is generally available in any event to credit overseas tax paid on non-UK source profits against the UK tax on the same profits, so that while the relevant treaty might sometimes extend that relief, their main function for UK companies is to limit overseas withholding taxes that would otherwise be payable on passive income.

The UK has a complex regime allowing 'underlying' tax relief in respect of foreign dividends, so that tax suffered at lower levels can be relieved (at least in part) where dividends flow to the UK via a chain of companies. This exemption is of limited application since 2009 because most foreign dividends are now exempt from tax.

### *Partnerships*
In broad terms, if companies participate in UK partnerships (whether general partnerships, limited partnerships or limited liability partnerships) they will be taxed on a flow through basis. This will in very broad terms mean that UK corporate partners will be taxed on trading, property or financing income as it arises in the partnership accounts, and on non-exempt dividends on a receipts basis.

When considering overseas entities, the UK authorities will not be bound by how the entity is classified in its country of origin. Case law has determined a number of matters that should be considered when establishing whether a non-UK entity should be taxed in the UK as if it were a company or a partnership. HMRC also maintains a public list of non-UK entities and the decisions it has previously made regarding their classification. However, if the parties have flexibility regarding the constitution of such entities then their classification may be viewed differently, either by HMRC or the courts. This area is complex and therefore specialist advice should be sought.

### *General rules for deductions*

As noted in the income section, the UK tax system requires taxable profits to be calculated by aggregating (i) the company's net income from each source and (ii) the company's net chargeable gains arising from the sale of capital assets. This approach gives rise to a particularly complicated regime so far as deductions are concerned. Expenses are usually allocated to the source of income (or occasionally by reference to income generally) or to the particular gain to which they relate. The rules governing their deductibility differ according to whether the expense relates to a capital gain or to income, and indeed according to the particular source of income concerned. For example, there is a considerable difference in the manner in which tax relief is given for expenses incurred by companies trading in property as compared to those that invest in property. The regime also has a large number of specific rules dealing with particular types of deductions which take priority over the more general rules for each type of income.

We have therefore set out the general rule for trading expenses, being the most common category and, following that analysis, considered some specific common exceptions.

### *General rules for trading expenses*

A trading company is generally permitted to deduct expenses that are incurred wholly and exclusively for the purposes of the company's trade, provided those costs are not capital in nature and are charged to the profit and loss account. There is a significant amount of case law surrounding whether expenses have been incurred wholly and exclusively for the purposes of a company's trade and whether they are capital or not.

Relief is generally given in the period the expenses are accrued in the accounts, subject to some specific exceptions. In particular, contributions to a registered pension scheme are only allowed on a 'paid' basis with some further provisions under which some contributions may be spread over a number of years; and if bonuses and other staff costs are paid out more than nine months after the end of the accounting period in which they are accrued, they are only allowed on a paid basis.

The general rule is made subject to a raft of specific statutory provisions, some of which allow deductions and others of which limit them; some of the more important of these are discussed below, but there are many others. There is, as one example, a bar to deducting the costs of business entertainment, except within quite strict limits.

### *Management expenses*

Holding companies are permitted a deduction for expenses to the extent that they are expenses of managing the company's investment business and are not capital in nature. Such costs would typically include audit fees, directors' costs, rent, local rates, and office costs. These costs can be set against any sources of profit the company may have (such as financing income). For the top company of a listed group, such expenses can be very substantial.

If the company has inadequate income (given that most dividend income will not be taxable) the excess can be surrendered as group relief. Alternatively it can be carried forward to set against future income, with no time limit.

Many of the specific prohibitions on the deduction of trading expenses (though not all) are extended to create a similar bar on the deduction of such costs as management expenses for non-traders; conversely, many rules giving traders a specific deduction for certain costs are extended to allow non-traders similar relief. But this is not invariably the case. For example, traders can only deduct costs 'wholly and exclusively' incurred for the purposes of the trade; there is no similar rule for management expenses. However, the two specific limitations on trading deductions referred to above (pension contributions and late-paid remuneration) are extended to management expenses.

### *Employee share schemes*

A deduction is often available to an employing company for the deemed cost of providing shares to employees, on a formula basis rather than the accounts charge (if any); this depends on the nature of the share plan and of the shares provided. This regime will generally allow a deduction to a subsidiary company whose employees receive shares (or options over shares) in the parent company.

### *Fines, penalties and bribes*

Any payments that would constitute a criminal offence (e.g. a bribe), or would do so if paid inside the UK, are expressly not deductible as trading expenses or management expenses. Likewise fines and penalties imposed for breaking the law are also not deductible, although a deduction is usually available for legal costs incurred in defending such an action. Civil penalties, interest and default surcharges (e.g. relating to certain VAT defaults) are also generally non-deductible, except for damages which are compensatory rather than punitive (e.g. damages for defamation payable by a newspaper company).

The rule that any amount paid by way of a penalty for breach of the criminal law is not deductible derives largely from case law, and was explicitly said to be a policy rule. It is applied strictly; parking fines, and fines for breaches of regulations, or for price-fixing, are not deductible.

The rule does not however extend to compensatory payments which are not punitive. So settlements in relation to negligence which harms customers or patients, or for breach of contract, or with employees for wrongful dismissal, ought to remain deductible.

### *Bad debts, provisions, and reserves*

A provision will be deductible for tax purposes if (or to the extent that) it:

- is in respect of allowable revenue expenditure
- is made in accordance with acceptable accounting practice
- does not conflict with any statutory rule governing the timing of relief (e.g. in relation to payment of staff cots), and
- is estimated with sufficient accuracy.

This rule extends to bad debts on trading account. Generally, however, bad debts are dealt with under the ‘loan relationships’ rules for financing costs and financing income. The rules there, however, are broadly the same; if the bad debt can be identified specifically enough to allow a bad debt provision which satisfies UK accounting standards, it should be deductible.

### *Local taxes*

There are no local taxes on income.

Local municipal taxes (business rates) may be deducted from taxable income. These rates are based on property values.

### *Funding costs*
Funding costs (primarily fees and interest) are broadly deductible on an accounts basis, even if capital in nature, but subject to thin capitalisation constraints (with no explicit safe harbours) and an interest cap based on the group's external debt levels. This extends to foreign exchange deductions relating to debts owed and receivable.

Traders will generally take the deductions in computing trading income (which is also accounts based). Deductions relating to loans not used for trading purposes will give rise to 'non-trading deficits' which, if not group relieved, can be offset against profits of that year generally, or carried back one year (against that year's funding profits), or carried forward indefinitely against non-trading profits.

### *Intangible fixed assets*
A similar regime applies to intangible assets, such as patent rights, know-how and trademarks, and including goodwill. Royalties are generally deductible on an accounts basis, and except in relation to 'grandfathered' assets owned by the group on 31 March 2002, the accounts amortisation is also deductible (with an option to take a flat 4% deduction even if not amortised in the accounts). Traders will take the deductions in computing trading income; non-traders will create a 'non-trading loss on intangible fixed assets' which can be relieved as a loss against any profits of the year, carried back one year, or carried forward indefinitely.

Other types of depreciation/amortisation are very seldom allowable, but instead the UK has a wide (though diminishing) range of 'capital allowances' which are discussed separately below.

Income costs relating to research & development would normally be deductible in any event, but there is a special incentive connected with R&D which generally allows an additional deduction or the payment of a tax credit *(see the Tax credits and incentives section)*.

### *Depreciation/amortisation*
Depreciation of fixed assets (other than of goodwill and other intangibles) is not allowable as a deduction from any source of income. However traders, and most non-traders, are instead allowed specified rates of annual deduction in respect of specified classes of assets, together referred to as 'capital allowances', which are deducted in calculating trading income for traders, and (broadly) against income derived from the use of the fixed assets for non-traders.

In the period of expenditure, capital allowances are available, generally at 20% of the cost of machinery and equipment acquired for use in a trade or property rental business; thereafter, tax depreciation is taken generally at 20% per annum on the reducing balance basis. It is proposed (and likely to be enacted) that this 20% rate will reduce to 18% per annum with effect from April 2012. With some exceptions (notably cars, ships, and machinery and equipment in offices and other non-industrial buildings), the rate of tax depreciation for machinery and equipment with an expected useful life when new of at least 25 years, and purchased after 25 November 1996, is 10%. Since 1 April 2008, this 10% rate also applies to certain integral features in buildings and thermal insulation. This 10% rate will reduce to 8% per annum with effect from April 2012.



All businesses, regardless of size, can claim an annual investment allowance of 100% on the first GBP 100,000 per year of most qualifying expenditure incurred on or after

1 April 2010, but reducing to GBP 25,000 from April 2012. This is restricted to a single allowance for groups of companies or associated businesses.

Enhanced allowances, typically at a rate of 100%, are available for expenditure on certain energy saving plant and other specific categories. The products and technologies supported by this regime are reviewed and updated regularly.

The rate of tax depreciation of most plant or machinery leased to non-residents is restricted, generally to 10% but in some cases to nil. However, HMRC now accept that in some circumstances these rules may be contrary to EU law and for leases finalised on or after 1 April 2006 where the lessee is resident in an EEA country which does not give the lessee relief broadly equivalent to the UK's capital allowances, HMRC will accept that the lessor is entitled to allowances at the normal 20% rate; in addition the 0% rate will not be enforced in the case of other EEA lessees.

No tax depreciation is normally allowed on buildings, apart from certain machinery and equipment embodied in the fabric of the buildings. Prior to April 2011, limited tax depreciation is given for new industrial buildings, agricultural buildings and certain hotels. This allowance is being withdrawn and is 1% (straight-line basis on cost) from 1 April 2010 and 0% after 1 April 2011.

Tax depreciation of machinery and equipment, and of industrial buildings, can be disclaimed in whole or in part, thereby deferring allowances.

Depreciation allowances may also be available in respect of the cost of the acquisition of mineral assets and other qualifying expenditures relating to mineral extraction, generally at the rates of 10% and 25% respectively on the reducing balance basis; and in respect of various other types of capital expenditure, including the cost of ships, construction of public roads, and dredging.

Excess depreciation allowances are generally recaptured on disposal. The recapture is calculated on a 'pool' basis for most machinery and equipment in which case there is no recapture unless the sale proceeds exceeds the total tax written down value of the pooled assets. The rules concerning which pool an asset goes into can be complex; a large company will generally have several pools ranging from single asset pools to a single large pool for most of its plant and machinery. There is no recapture for sales of industrial buildings.

Where assets are leased, capital allowances are generally available to the lessor rather than the lessee. However, this is an area of complexity, and in some situations (generally relating to finance leases), the allowances are only available to the lessee.

### *Losses*

Income losses may be carried forward indefinitely, and, in general, set against any type of non-trading profits, but in contrast losses of a particular trade can be carried forward only against profits of the same trade. Unlimited loss carryback is available for trading losses against total profits of (normally) the previous 12 months (provided the same trade was being carried on in that period). There is a more limited facility to carry back certain non-trading losses, also normally for 12 months. Losses can also generally be surrendered to other group companies to set against their taxable profits for the same period.

Capital losses may also be carried forward indefinitely but may not be carried back. There is no ability to surrender capital losses to fellow group members but gains or losses arising on a particular asset can be allocated to another group member (by means of a joint election on an asset by asset basis) and therefore there is a limited ability for the capital losses of one company to be offset against the gains of a fellow group member in the same or subsequent period.

There are complex anti-avoidance rules which restrict the utilisation of losses where there is a change in ownership of the company.

## Group taxation

### The basic rule

Each individual corporate group member is required to submit their own tax return on a stand-alone basis, with the exception of the election available with respect to VAT (*discussed below*). However, there are a variety of ways in which their relationship with fellow group members is recognised in the UK tax system for the purposes of corporation tax, VAT and stamp duty.

### Corporation tax

The corporation tax system includes a number of measures that advantage UK members of qualifying groups, all of which are subject to anti-avoidance measures.

Operating taxable profits and losses arising in the same period can usually be offset between UK resident 75% affiliates within a worldwide group. This extends to offsetting the UK profits attributed to a UK PE of a non-UK resident group member. There are some restrictions, primarily where one of the two companies is not an economic 75% subsidiary of the group, or is subject to arrangements under which it might leave the group.

Intra-group transfers of capital assets between UK companies, including UK permanent establishments, are normally tax-free, though the definition of group for these purposes is slightly different to the definition for group relief for losses. This treatment is also extended to intra-group transfers of loan relationships, derivatives and intangibles. There is generally a 'degrouping' charge if the transferee company leaves the group within six years.

There is no automatic offset of capital gains and losses where these arise in different group companies, but it is normally possible for offset to be arranged by the appropriate tax-free transfer of the asset being disposed of to the third party. Such a tax-free transfer can either be actually done (prior to the third party disposal) or notionally only (by election between the companies concerned).

A UK resident parent company is able to claim group relief for income losses of a non-UK subsidiary which is resident in the European Economic Area (EEA) or which has incurred the relevant losses in a permanent establishment within the EEA, provided that all possibilities of non-UK relief for the losses have been exhausted and future relief is unavailable. The European Commission has referred the UK to the European Court of Justice (ECJ) over this 'all possibilities' test and the fact that it must be met immediately after the end of the accounting period in which the loss arises, together with the fact that this extension of loss relief only applies to losses incurred after 1 April 2006.



In addition the corporation tax system also has a number of measures that seek to prohibit groups unfairly manipulating the tax system by shifting profits between group members (either internationally or within the UK) in a way that is considered unacceptable.

Under the CFC regime, a UK resident company may be taxed on a proportion of the undistributed profits of certain UK-controlled non-resident companies in which the resident company has an interest. No liability arises where one of a number of tests (e.g. the exempt activities test) can be satisfied. The Government is currently consulting on a radical overhaul of the CFC regime.

There is a transfer pricing regime that applies to UK-to-UK transactions as well as cross-border transactions. UK taxpayers are required to self assess their compliance with its arm's-length principle and must therefore identify and make transfer pricing adjustments when submitting their tax returns. Thin capitalisation is addressed within this regime, with no explicit safe harbours. *This regime is discussed in more detail in the Transfer pricing section under Other issues*.

Where a UK company borrows from a connected party that is not subject to UK tax in respect of the corresponding interest receipt (and certain other limited circumstances), the UK tax deduction may move to a paid basis rather than the usual accruals basis. However this so called 'late paid interest' rule has been modified in order to make it comply with the UK's obligations under the EC Treaty. It now only applies where the creditor is a company that is resident or effectively managed in a non-qualifying territory, broadly a tax haven. The revised rule applies to accounting periods beginning on or after 1 April 2009, although a company may elect that it not have effect for the first accounting period (not ending after 31 March 2011) to which it would otherwise apply.

A debt cap applicable to accounting periods beginning on or after 1 January 2010 limits the aggregated UK tax deductions group members may claim for finance costs to the level of a group's external finance expense.

### *Indirect tax*

Group companies can, subject to certain requirements, elect to account for VAT as if they were one taxable person, and where this is done, no VAT is charged on intra-group supplies of goods or services. The registration is made in the name of the representative member, who is responsible for completing and rendering the single return on behalf of the group. All the companies are jointly and severally liable for any VAT debts. VAT grouping is subject to detailed anti-avoidance provisions.

### *Stamp duty and stamp duty land tax*

Transfers of assets within worldwide 75% groups are generally exempt from stamp duty and stamp duty land tax. The relief can be retrospectively withdrawn in certain circumstances, primarily where the transferee leaves the group within three years of the transfer.

## *Tax credits and incentives*

A variety of tax incentives are given in the form of enhanced tax depreciation allowances (known as capital allowances, *see Depreciation in the Deductions section*). Some of these incentives are given by reference to the expenditure concerned and others by reference to the size of the company incurring that expenditure.

For example, a full write-off can be claimed in the year of expenditure on a range of 'green' products and technologies. The list of items supported in this way is reviewed annually. It currently consists of the following: designated energy saving equipment; designated environmentally beneficial plant and machinery; cars with low emissions; plant or machinery relating to gas stations for refuelling vehicles with natural gas or hydrogen fuel incurred prior to 31 March 2013; and conversion or renovation of business premises in designated disadvantaged areas of the UK for expenditure incurred up to 11 April 2012.

All businesses, regardless of size, can claim an annual investment allowance of 100% on the first GBP 100,000 per year of most qualifying expenditure but reducing to GBP 25,000 from April 2012. This is restricted to a single allowance for groups of companies or associated businesses.

A deduction, currently equal to 130% of the qualifying expenditure on R&D can also be claimed by large companies. For small and medium companies, as defined, a deduction equal to 200% (from April 2011, previously 175%) of the qualifying expenditure on R&D is given in the year in which it is incurred, which can be surrendered for a cash payment (at a rate of GBP 24.50 for each GBP 100 of qualifying R&D spend) by companies that are trading at a loss or have not yet started to trade. From April 2012, this 200% rate increases to 225%.

A deduction equal to 150% of the qualifying expenditure on the remediation of contaminated or derelict land is given in the year incurred, which can be surrendered for a cash payment (at a rate of GBP 16 for each GBP 100 of qualifying land remediation spend) by companies that are trading at a loss. This relief is likely to be abolished during 2012.

There are special tax reliefs available for certain expenditure on UK film production.

There are no tax holidays nor any foreign investment incentives.

## *Withholding taxes*

Under UK domestic law, a company may have a duty to withhold tax in relation to the payment of either interest or royalties (or other sums paid for the use of a patent). The circumstances in which such a liability arises are discussed below.

There is no requirement to deduct withholding tax (WHT) from dividends. Therefore dividends may always be paid gross, regardless of the terms of the applicable double tax treaty.



Please note however that this is not an exhaustive list of all the deductions that might be required to be made in respect of UK tax from payments made to or by companies. In particular, non-resident companies that are subject to UK income tax on UK source rental profits (*see further comment in Taxes on corporate income section above*) will find their letting agent or tenants are obliged to withhold the appropriate tax at source (currently 20% without any allowances) from their rental payments unless the recipient has first applied and been given permission to receive rents gross under the Non-Resident Landlord Scheme. Two other important examples are the UK's deduction at source regime for entertainers and sportsmen, and the scheme under which payments to unregistered subcontractors working on big building projects may need to have tax deducted at source.

### *Interest*

As a general rule, UK domestic law requires companies making payments of interest to withhold tax at 20%. However, there are a number of exceptions to this general rule. The key exclusions are:

- payments of interest by UK resident companies if the beneficial owner of the interest is also a UK resident company, or a UK PE provided the interest concerned will be taxed in the UK as part of the PE's trading profits
- payments of interest on a quoted Eurobond
- payments of interest that qualify for exemption under the EU Interest and Royalties Directive
- payments of interest paid to or by a UK bank (or a UK branch of a foreign bank)
- payments of 'short' interest. This is, broadly speaking, interest on loans that will not be in place for more than a year. However, the definition can be contentious, and detailed advice should be taken on this if intending to utilise this exemption, and
- payments of interest that do not 'arise' in the UK. Whether a payment constitutes UK source interest is a complex issue and specialist advice needs to be taken if seeking to use this exception.

If none of these exceptions apply, a payment of interest must be made after the deduction of WHT unless (or until) HMRC has given authorisation that the payment may be made gross (or with a reduced rate of WHT) because of the applicability of treaty relief for the recipient.

### *Royalties*

UK domestic law requires companies making payments of patent, copyright and design royalties that arise in the UK to deduct WHT at 20%. In addition, there is also the possibility that other royalties that arise in the UK may also be subject to the same rate of withholding tax if they constitute 'qualifying annual payments', so specialist advice will be needed to clarify this. However certain types of royalties, such as film royalties and equipment royalties will generally not be subject to UK WHT.

Unlike the rule regarding interest, a company may make a royalty payment gross of WHT (or subject to a reduced rate of WHT under a treaty) without prior clearance having been given by HMRC if they reasonably believe at the time the payment is made that the payee is entitled to relief under the treaty. However, if that belief is later found to be incorrect, HMRC may direct that the payment must be made net of WHT, with the WHT paid to HMRC, and the payer may be subject to interest and penalties in respect of the WHT that should have been withheld (even if their belief was reasonable).

### *Double taxation treaties*

The table below sets out the rates of WHT applicable to payments of dividends, interest, and royalties under UK domestic law where such a liability arises and the reduced rates that may be available under an applicable double tax treaty.

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Resident corporations | | 20/0 (4) | 20/0 (4) |
| Resident individuals | | 20 | 20 |
| Non-resident corporations and individuals: | | | |
| Non-treaty | | 20 | 20 |
| Treaty (5): | | | |
| Antigua and Barbuda | | 20 | 0 |

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Argentina | | 12 (6, 7) | 15 (8) |
| Australia (47) | | 10 (6) | 5 |
| Austria (51) | * | 0 | 0 (41) |
| Azerbaijan (12) | | 10 (6) | 10 (10) |
| Bangladesh | | 10 (6, 11) | 10 |
| Barbados | * | 15 | 0 (42) |
| Belarus (12) | | 0 | 0 |
| Belgium (13, 51) | (14) | 15 | 0 |
| Belize | * | 20 | 0 |
| Bolivia | | 15 (7) | 15 |
| Bosnia-Herzegovina (16) | | 10 | 10 |
| Botswana | * | 10 (6, 38) | 10 (38) |
| British Virgin Islands | | 20 | 20 |
| Brunei | * | 20 | 0 |
| Bulgaria | | 0 | 0 |
| Burma (Myanmar) | | 20 | 0 |
| Canada | * (14) | 10 (6, 7) | 10 (37) |
| Channel Islands: | | | |
| Guernsey | | 20 | 20 |
| Jersey | | 20 | 20 |
| Chile | | 15 (39) | 10 (23) |
| China, P.R | | 10 (6) | 10 (22) |
| Croatia (16, 47) | * | 10 | 10 |
| Cyprus | * | 10 | 0 (43) |
| Czech Republic (17) | | 0 | 10 (18) |
| Denmark | | 0 | 0 |
| Egypt | | 15 (6) | 15 |
| Estonia (12) | | 10 (6) | 10 (23) |
| Falkland Islands | | 0 | 0 |
| Faroes (52) | | 0 | 0 |
| Fiji | * | 10 (7) | 15 (15) |
| Finland | | 0 (7) | 0 |
| France (50) | | 0 | 0 |
| Gambia | * | 15 (6) | 12.5 |
| Georgia (12, 51) | | 0 | 0 |
| Germany (47) | | 0 | 0 |
| Ghana | | 12.5 (6) | 12.5 |
| Greece | | 0 | 0 |
| Grenada | | 20 | 0 |
| Guyana | | 15 (6,7) | 10 |
| Hong Kong (55) | | 0 (56) | 3 |
| Hungary (47) | | 0 | 0 |
| Iceland | * | 0 | 0 |
| India | * (9) | 15 (6, 7, 19) | 15 (20) |
| Indonesia | * | 10 (35) | 15 (34) |
| Ireland, Rep. of | | 0 | 0 |
| Isle of Man | | 20 | 20 |

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# United Kingdom

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Israel (47) | | 15 | 15/0 (21) |
| Italy | * (14) | 10 (6, 7) | 8 |
| Ivory Coast (Côte d'Ivoire) | | 15 (6) | 10 |
| Jamaica | * | 12.5 (7) | 10 |
| Japan | * | 10 (6) | 0 |
| Jordan | | 10 (6) | 10 |
| Kazakhstan (12) | | 10 (6, 7) | 10 |
| Kenya | * | 15 (35) | 15 |
| Kiribati | * | 20 | 0 |
| Korea, Rep. of | | 10 (6,7) | 10 (36) |
| Kuwait | | 0 | 10 |
| Latvia (12) | | 10 (35) | 10 (23) |
| Lesotho | | 10 (7, 35) | 10 |
| Libya (54) | | 0 | 0 |
| Lithuania (12) | | 10(6) | 10 (23) |
| Luxembourg (51) | * (14) | 0 | 5 |
| Macedonia (16) | * | 10 | 0 |
| Malawi | * | 0 (24) | 0 (24) |
| Malaysia (51) | | 10 (35) | 8 |
| Malta | * | 10 (6) | 10 |
| Mauritius | * | 20 (6) | 15 |
| Mexico (51) | | 15 (7, 25) | 10 |
| Moldova (12) | * | 5 (6) | 5 |
| Mongolia | | 10 (7, 26) | 5 |
| Montenegro (16) | | 10 | 10 |
| Montserrat (51) | | 20 | 0 |
| Morocco | | 10 (6) | 10 |
| Namibia (13) | | 20 | 0 (13) |
| Netherlands (51) | * (14) | 0 | 0 |
| New Zealand (47) | (9) | 10 (6) | 10 |
| Nigeria | | 12.5 (35) | 12.5 |
| Norway | | 0 | 0 |
| Oman (51) | | 0 | 0 |
| Pakistan | | 15 (6) | 12.5 |
| Papua New Guinea | | 10 (6) | 10 |
| Philippines | * | 15 (6, 27) | 25/15 (28) |
| Poland (46) | * | 5 (6) | 5 |
| Portugal | | 10 | 5 |
| Romania | * | 10 | 15 (29) |
| Russian Federation (12) | | 0 | 0 |
| St. Kitts and Nevis (aka St. Christopher and Nevis) | | 20 | 0 |
| Saudi Arabia (44) | | 0 | 8 (23) |
| Serbia (16) | | 10 | 10 |
| Sierra Leone | | 20 | 0 |
| Singapore (51) | | 10 (6) | 10 |
| Slovak Republic (17) | | 0 | 10 (18) |

| Recipient | Dividends (%) (1) | Interest (%) (2) | Royalties (%) (3) |
|---|---|---|---|
| Slovenia (16) | * | 5 (6) | 5 |
| Solomon Islands | * | 20 | 0 |
| South Africa | | 0 | 0 |
| Spain (47) | * | 12 (7) | 10 |
| Sri Lanka | | 10 (6) | 10 (32) |
| Sudan | * | 15 | 10 |
| Swaziland | | 20 | 0 |
| Sweden | * (14) | 0 | 0 |
| Switzerland (51) | * (14) | 0 | 0 |
| Taiwan | | 10 (6) | 10 |
| Tajikistan (12) | | 0 | 0 |
| Thailand (47) | * | 20 (6, 30) | 15 (31) |
| Trinidad and Tobago | * | 10 (6) | 10 (45) |
| Tunisia | | 12 (30) | 15 |
| Turkey | | 15 (6) | 10 |
| Turkmenistan (12) | | 0 | 0 |
| Tuvalu | * | 20 | 0 |
| Uganda | | 15 (35) | 15 |
| Ukraine (12) | | 0 | 0 |
| United States | | 0 (49) | 0 |
| Uzbekistan (12) | | 5 (6, 7, 33) | 5 (33) |
| USSR (former) (12) | | N/A | N/A |
| Venezuela | | 5 (6) | 7 (40) |
| Vietnam | | 10 (6) | 10 |
| Yugoslavia (former) (16) | | N/A | N/A |
| Zambia | * | 10 | 10 |
| Zimbabwe | * | 10 (6) | 10 |
| **Treaties which have been signed but are not yet in force:** | | | |
| Austria | | 0 | 0 |
| Bahrain | | 0 | 0 |
| Belgium | | 10 | 0 |
| Cayman Islands | | 20 | 20 |
| Georgia | | 0 | 0 |
| Hong Kong | 0 | 0 | 3 |
| Luxembourg | | 0 | 5 |
| Malaysia | | 10 | 8 |
| Mexico | | 15 | 10 |
| Montserrat | | 20 | 0 |
| Netherlands | | 0 | 0 |
| Oman | | 0 | 8 |
| Qatar | | 20/0 | 5 |
| Singapore | | 10 | 10 |
| Switzerland | | 0 | 0 |

Notes

1. A tax credit is available to UK resident individual shareholders on dividends received, as described above. Some double taxation treaties allow a half or full tax credit (less, normally, a 5% to 15% notional withholding tax) also to non-resident individuals and usually to corporate portfolio investors. Treaties that allow a payable credit are indicated by an asterisk (*). However, since 6 April 1999 the

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credit has been reduced from one quarter to one ninth, which has the result that unless note 14 below applies, the tax credit indicated by the asterisk is now in effect useless, since it is wholly eliminated by the (usually 15%) withholding tax allowed by the treaty.

2. Withholding tax applies only to ‘annual interest’ (i.e. excluding interest on certain short-term loans). Banks and similar financial institutions are also normally able to pay annual interest to non-UK residents free of withholding tax. In addition, most of the UK treaties provide for a zero-rate of withholding on interest paid to governmental and quasi-governmental lenders. Such exemptions are not separately indicated in the table below.
3. Some types of royalties are not subject to UK withholding tax, including film royalties and equipment royalties. Treaty provisions specifically relating to these are therefore not mentioned here.
4. From 6 April 2001, payments to any UK resident company (not just banks, as before) can be made free of withholding tax if the recipient is chargeable to tax on the interest or royalty. Discussions continue as to whether this provision will be extended to recipients who are exempt from UK tax on the interest or royalty.
5. Where a reduced rate of withholding is allowed by any treaty, whether on interest or royalties, it is usual for this reduced rate to be stated not to apply to amounts which are in excess of a normal commercial rate of interest/royalty, or where the interest/royalty is effectively connected to a PE in the United Kingdom of the recipient or where the debt/license was created primarily to obtain the advantage of the treaty; such general limitations are not specifically indicated in the table below.
6. Zero-rate on certain loans.
7. Treaty rate not applicable to certain loans held by tax-exempt holders and resold within three months of acquisition.
8. Lower rates, primarily of 3% on use of news, 5% on copyright royalties other than films and TV, and 10% on certain intellectual property, will in practice apply in almost all cases.
9. No repayable tax credit for companies.
10. A 5% rate on literary/artistic copyright royalties.
11. A 7.5% rate on interest paid to banks and other financial institutions.
12. The United Kingdom announced that the old UK/USSR treaty ceased to apply to certain former Soviet Republics on 5 April 2002 (such that from that date there was no treaty in force with any of those countries), whilst it continued to apply to others until new treaties were concluded. Treaties have subsequently been signed with a number of these states such that the old UK/USSR treaty currently only continues to apply to Tajikistan, Turkmenistan and Belarus (the last of which concluded a new treaty with the UK in 1995 which is not yet in force). The only remaining states without a treaty in force with the UK post 5 April 2002 are Armenia and Kyrgyzstan. Moldova signed a new treaty with the UK on 8 November 2007 which took effect in the UK from 6 April 2009.
13. A rate of 5% applies to patent royalties and no relief is given for motion picture film royalties, as provided by the 1962 treaty with South Africa that was extended to Namibia by an Exchange of Notes.
14. Half tax credit payable by the UK Exchequer to non-resident companies possessing 10% or more of the voting power of the paying company, subject to a notional withholding tax (which in current circumstances makes the actual repayment very small).
15. Zero-rate on literary/artistic or scientific copyright royalties, excluding payments in respect of cinematograph films and films or tapes for radio or TV broadcasting.
16. The United Kingdom’s treaty with the former Yugoslavia is regarded as still in force between the United Kingdom and Croatia, Montenegro, Serbia and Bosnia-Herzegovina. Macedonia signed a new treaty with the UK on 8 November 2006 which took effect for UK withholding tax purposes on 1 January 2008. A new treaty with Slovenia was signed on 13 November 2007 and came into effect in the UK in April 2009.
17. The independent states of the Czech Republic and the Slovak Republic have confirmed that they will honour the treaty between the United Kingdom and the former Czechoslovakia.
18. The 10% rate applies to royalties for use of industrial, commercial or scientific equipment or experience as well as royalties in respect of patent, trade marks and know-how. Zero-rate on all other royalties.
19. A rate of 10% on certain bank loans.
20. A rate of 10% in certain cases.
21. A rate of 15% on film and TV royalties.
22. A rate of 7% on royalties for use of (or right to use) industrial, commercial, or scientific equipment.
23. A rate of 5% on royalties for use of industrial, commercial, or scientific equipment.
24. No relief is available if the payment concerned is made to a company controlling (directly or indirectly) more than 50% of the voting power of the paying company. In addition, no relief is available in respect of cinematograph film royalties or amounts paid in respect of the extraction of natural resources.
25. Zero-rate on government and local authority loans. The rate is 5% where the beneficial owner is a bank or insurance company or the interest is derived from bonds and securities that are regularly and substantially traded on a recognised securities market. The rate is 10% where the beneficial owner is not a bank or insurance company but the interest is paid by a bank or by the purchaser of machinery and equipment to a person who sold that equipment on credit.
26. A rate of 7% on interest paid to banks.
27. A rate of 10% on interest on bonds issued to the public.
28. A rate of 15% on royalties on films, TV and radio broadcasting.
29. A rate of 10% on copyright royalties.
30. A rate of 10% on interest paid to banks and other financial institutions.
31. A rate of 5% on literary/artistic/scientific copyright royalties.

32. Full relief for copyright royalties.
33. Lower rate may be substituted to match any lower rate agreed in a treaty between Uzbekistan and a third Organization for Economic Cooperation and Development (OECD) country.
34. A rate of 10% for royalties on industrial, commercial or scientific equipment.
35. Zero-rate on certain government loans.
36. A rate of 2% for royalties on industrial, commercial or scientific equipment.
37. Zero-rate on literary/artistic copyright royalties, patent royalties and royalties for use of industrial, commercial or scientific know-how and computer software.
38. New treaty effective for UK income tax (and therefore withholding tax) from 6 April 2007 reduced withholding tax on both interest and royalties to the rates shown in table. Prior to this the rate of withholding tax on interest and royalties was 15% in both cases (subject, in the case of interest, to note 7).
39. A rate of 5% applies to loans from banks and insurance companies, interest paid on securities quoted on a stock exchange and on some sales of machinery and equipment.
40. A rate of 5% on royalties for the use of a patent etc concerning industrial, commercial, or scientific experience.
41. A rate of 10% can be withheld if the recipient of the royalties controls more than 50% of the voting power of the payer.
42. A rate of 15% can be withheld on royalties in respect of cinematograph or television films.
43. A rate of 5% can be withheld on royalties in respect of cinematograph or television films.
44. A new treaty with Saudi Arabia was signed on 31 October 2007 and entered into force from 1 January 2009. It will be effective in the UK from 1 April 2010 for corporation tax and from 6 April 2010 for income tax and capital gains tax purposes, including withholding tax. The withholding tax rates were not changed by the new treaty and therefore the figures shown above are valid both before and after this date.
45. Full relief is available for literary, artistic or scientific copyright (excluding royalties on cinematograph films and films or tapes for TV or radio broadcasting). No relief is available for amounts paid in respect of the extraction or removal of natural resources.
46. A new treaty with Poland was signed on 20 July 2006 and entered into force on 27 December 2006. It took effect in respect of UK withholding taxes from 1 January 2007, changing the rates to those shown in the table above. The rates were previously zero in respect of interest and 10% in respect of royalties.
47. HMRC intends to progress negotiations on new treaties in the year ending 31 March 2010 with: Australia, Croatia, Ethiopia, Germany, Hungary, Israel, New Zealand, Spain and Thailand.
48. Zero-rate if recipient is: the State; an individual; a company whose shares are substantially and regularly traded on a stock exchange; a company owned at least 75% by residents of Qatar; a pension scheme; or a financial institution independent of the payer.
49. Relief may be restricted to 15% in certain circumstances.
50. A new treaty with France was signed on 19 June 2008 and entered into force on 18 December 2009. It will take effect with respect to UK withholding taxes from 6 April 2010 but the rates remain as shown in the table above.
51. New tax treaties/protocols with the following states have been signed but have not yet entered into force: Mexico (2009), Cayman Islands (2008), Belgium (2009), Qatar (2009), Luxembourg (2009), Singapore (2009), Switzerland (2009), Malaysia (2009), Austria (2009), Oman (2009), Montserrat (2009), and Bahrain (2010). These agreements will enter into force once both countries have completed the required Parliamentary procedures and exchange of diplomatic notes and will take effect on the dates set out therein. The Netherlands and Georgia treaties signed in 2008 and 2010 have now come into force, and both will take effect in the UK from 6 April 2011. The Oman treaty is largely in force (January 2011), but from April 2012 for withholding taxes.
52. Treaty effective in the UK for WHT purposes from 6 April 2009.
53. Reduced treaty rate only applicable if one of various conditions is met by either the beneficial owner or payer of the interest. This is to ensure that the benefit of the interest article can only flow to residents of the other treaty state.
54. The first tax treaty between the UK and Libya entered into force on 8 March 2010 and has effect in the UK for WHT purposes from 6 April 2010.
55. The first tax treaty between the UK and Hong Kong entered into force on 8 March 2010 and has effect in the UK for WHT purposes from 6 April 2011.
56. Provided one of several conditions is specified, one of which is that the recipient is quoted, another being that HMRC accepts that the interest is not paid in connection with tax avoidance (broadly).



## Tax administration

### Direct tax

Companies are assessed by reference to accounting periods. Normally, the accounting period is the period for which the company makes up its accounts. However, an accounting period for corporation tax purposes cannot exceed 12 months so companies preparing statutory accounts for longer than 12 months need to prepare more than one corporation tax return. Companies must file their statutory accounts and tax return within one year from the end of the accounting period; the return must include a self-assessment of the tax payable, eliminating the need for assessment by HMRC (though HMRC retains assessing powers for certain cases where it is not satisfied with the return, or where the company fails to make a return).

For smaller companies, corporation tax is payable nine months after the end of the accounting period to which it relates (so before the return must be filed). For larger companies and groups, a system of quarterly payments on account (based on estimated profits) is in place, with the first payment being due in the seventh month of the accounting period concerned. A company will generally be considered large for this purpose in any accounting period in which it has taxable profits in excess of GBP 1,500,000 (that limit being reduced by reference to the number of companies under common control, where relevant).

For companies which are members of medium or large groups, there is generally a period of one year after the statutory filing dates for the tax authorities to start an enquiry into any aspect of the return. For other companies, enquiries can be started up to 12 months after the date of actual filing. These periods are extended for returns submitted after the filing deadline, that are amended by the taxpayer, or where an issue is subsequently discovered that was not sufficiently disclosed within the standard period.

The UK tax system can impose numerous penalties for failing to adhere to the self-assessment system. These include penalties for late filing of returns, failing to maintain appropriate records, submitting an incorrect return, making errors in certain documents sent to HMRC, unreasonably failing to report errors in assessments by HMRC and failing to respond to a notice of enquiry from the tax authorities within the specified time limit.

Requirements to file online and pay electronically are expected to be phased in for corporation tax from 2011. From 1 April 2011, returns for accounting periods ending after 31 March 2010 must be filed online and such returns must be filed in a specified format which is machine readable by the tax authorities.

Large companies are required to notify HMRC of the identity of their senior accounting officer, who must certify annually that the accounting systems are adequate for the purposes of accurate tax reporting. Penalties are chargeable on the officer and the company for careless or deliberate failure to meet these obligations.

### *Indirect tax*
VAT returns must be completed at preset intervals (usually every three months). Larger companies may be required to file monthly returns, or make monthly payments on account. From 1 April 2010, companies with an annual turnover of GBP 100,000 or more, and all newly-registered businesses (whatever their turnover) are required to submit their VAT returns online and pay electronically. From 1 April 2012, businesses with an annual turnover of less than GBP 100,000 will also be required to file VAT returns online and make electronic payments. Smaller enterprises can apply for annual returns. VAT returns are usually required to be filed 30 days after the end of the period.

Annual accounting is available for taxable persons with annual turnover (taxable supplies, excluding VAT) not exceeding GBP 1,350,000.

Cash accounting is available for taxable persons with annual turnover (taxable supplies, excluding VAT) not exceeding GBP 1,350,000.

In addition a flat rate scheme operates for small businesses and is intended to simplify VAT accounting procedures.

## Other issues

### Adoption of IFRS

IFRS is mandatory for the consolidated financial statements of UK listed companies.

Companies continue to have the choice of adopting IFRS or remaining on UK GAAP at entity level for all entities. Many groups therefore continue to apply UK GAAP in their entity accounts.

The UK Accounting Standards Board (ASB) is proposing a new three-tier system of reporting going forward. It is proposed that all publicly accountable UK registered companies will have to report under IFRS (as endorsed by the EU) in accounting periods beginning on or after 1 July 2013. In addition, UK registered SMEs (broadly entities that do not have public accountability and publish general purpose financial statements for external users) must apply 'IFRS for SMEs' (a simplified IFRS) from the same date. Finally, the Financial Reporting Standard for Smaller Entities (FRSSE) will still be an option for small companies or small groups as defined by the Companies Act 2006. However the options available to a company are subject to the requirements of the UK Company Law framework for consistency of GAAP within a group.

In our experience, many large groups are considering early adoption of EU-endorsed IFRS. However, under current UK law early adoption of IFRS for SMEs or FRSSE is not possible.

### Transfer pricing

The UK has widely drafted transfer pricing rules that are intended to apply to almost any kind of transaction made or imposed between related parties that give rise to a provision that:

- differs from one that would have been made between third parties, and
- gives rise to a UK tax advantage (potential or actual) to one or more of the parties.

These rules apply to UK-to-UK transactions as well as cross-border transactions.

This regime therefore applies not only to the provision of products and services but also to finance arrangements, including both the rate of return charged and the amount of loan principle (or equivalent) made available. It is therefore the mechanism by which the UK's revenue authorities address the issue of thin capitalisation. Unlike many other territories, the UK does not operate any 'safe harbours' of any kind in relation to the amount of debt or interest (or equivalents) it considers demonstrate that a UK company or group is not thinly capitalised. (Note that the UK also has a debt cap regime which limits the amount of finance expense for which a UK tax deduction will be available by reference to the worldwide group's external finance expense, *as discussed in the Significant developments section*).

Parties are considered related for this purpose where either one controls the other, or both are under common control. Control here is not confined to situations in which one



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party is the majority shareholder in the other. Effectively, control exists where one party has the power to ensure that the affairs of another party are conducted in accordance with the first party's wishes. The concept is also subject to two important extensions:

- the rules apply to many joint venture companies where two parties each have an interest of at least 40%, and
- there are attribution rules to trace control relationships through a number of levels in determining whether parties are controlled for the purposes of the transfer pricing rules.

In addition, the regime restricts interest deductions to an arm's-length basis where a financier, and persons who collectively control a company or a partnership, have 'acted together' in relation to the financing arrangements of that company or partnership. The financier (usually a bank) can then be taken as controlling the company or partnership, and the loan becomes subject to transfer pricing limitations.

There are a number of exemptions which essentially exclude SMEs and dormant companies from the regime.

The effect of the rules is to require an arm's-length provision to be substituted for the actual one, thereby increasing the party's UK tax liability and cancelling out the UK tax advantage that would otherwise have arisen.

Where both parties to the transaction are UK taxpayers, the disadvantaged party will generally be entitled to claim a compensating adjustment (except where the transaction falls within the transfer pricing regime because of the 'acting together' provisions), but only after the UK adjustment has been made. The legislation also provides that parties may make balancing payments to each other in such circumstances, of any amount up to the transfer pricing adjustment, which will neither be taxable for the recipient nor tax deductible for the payer.

Where the disadvantaged party is outside the UK tax net they can pursue a claim for relief under the relevant double tax agreement, if that provides a mechanism for such relief; where the adjustment in the UK is to reduce a deduction for an amount paid under deduction of UK tax, the compensating adjustment rules should allow the overseas party to reclaim any withholding tax paid on the disallowed amount.

UK taxpayers are required to self assess their compliance with this arm's-length principle. Companies and partnerships must therefore identify and make transfer pricing adjustments when submitting their tax returns. This is the case even where the disadvantaged party would be entitled to claim a compensating adjustment equal to the transfer pricing adjustment. An important implication of this approach is the potential for interest and penalties if the adjustment made is subsequently held to be wrong.

### *UK tax legislation*

Announcements of proposed new legislation generally occur at least once a year. The main announcement is made on Budget Day (generally in March) when tax rates are set for the coming year. Other announcements can be made at other times and, subject to becoming approved and adopted law, can apply from a specified date. The new legislation is then included in an annual Finance Act, which is normally finalised in July. Much of the legislation introduced in recent years has been due to challenges under the EC treaty, or as a result of the tax planning being notified under the UK's tax avoidance disclosure regulations. In years of a general election (such as 2010) there may be additional Budget Days and Finance Acts.

UK tax law is periodically consolidated. Until recently the latest consolidation Act dated from 1988, which covered both income tax and corporation tax. Over the last few years income tax and corporation tax legislation has been consolidated separately, and currently the latter is to be found in the Corporation Tax Acts 2009 and 2010, and the Taxation (International and Other Provisions) Act 2010.

# United States

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## Significant developments

On 16 December 2010, the House of Representatives voted 277 to 148 to give final approval to an 858 billion dollar (USD) package of individual and business tax relief provisions. The package's total cost includes a USD 56.5 billion, 13-month extension of unemployment benefits. The House action follows Senate approval of the measure by a vote of 81 to 19 on 15 December 2010, and cleared the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010' for President Barack Obama's signature on 17 December 2010. Under the legislation, full expensing for qualified business capital investments apply for property placed in service after 8 September 2010, through the end of 2011. In addition, the bill renews 50% bonus depreciation for 2012, and allows taxpayers to elect to accelerate certain AMT credits in lieu of bonus depreciation for taxable years 2011 and 2012. Certain section 179 small business expensing provisions are extended. The temporary expensing provisions are estimated to cost USD 21.8 billion over ten years. The bill includes a retroactive two-year extension of the research credit and other expired business provisions, through the end of 2011. The bill also includes a number of energy tax incentives.

The business tax relief provisions in the legislation include reinstatement and extension of the research credit, controlled foreign corporation (CFC) look-through rule, active financing income exception, and 15-year depreciation for qualified leasehold improvements; these provisions had expired as of 31 December 2009. In general, these provisions are reinstated for calendar year 2010 and extended through 2011.

Under the CFC look-through rules, dividends, interest, rent, and royalties received or accrued from a related CFC, are not treated as Foreign Personal Holding Company Income (FPHCI.) This rule applies only to the extent attributable or properly allocable to income of the payor that is not subpart F income and not effectively connected income.

The active financing income exception allows certain income from the active conduct of banking, financing, or similar businesses, or from the conduct of an insurance business to be excluded temporarily from the definition of Subpart F income.

In addition to the provisions mentioned above, the legislation extends numerous other provisions, including:

- Indian employment tax credit.
- New markets tax credit.
- Railroad track maintenance credit.
- Mine rescue team training credit.
- Employer wage credit for employees who are active duty members of the uniformed services.

- Seven-year recovery period for motorsports entertainment complexes.
- Accelerated depreciation for business property on an Indian reservation.
- Enhanced charitable deduction for contributions of food inventory.
- Enhanced charitable deduction for contributions of book inventories to public schools.
- Enhanced charitable deduction for corporate contributions of computer inventory for educational purposes.
- Election to expense mine safety equipment.
- Special expensing rules for certain domestic film and television productions.
- Expensing of 'Brownfields' environmental remediation costs.
- Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico.
- Modification of tax treatment of certain payments to controlling exempt organisations.
- Treatment of certain dividends of a regulated investment company (RIC).
- RIC qualified investment entity treatment under Foreign Investment & Real Property Tax Act (FIRPTA).
- Basis adjustment to stock of S corporations making charitable contributions of property.
- Empowerment zone tax incentives.
- Tax incentives for investment in the District of Columbia.
- Temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands.

## *Taxes on corporate income*

**2011 taxable income**

| Over (USD) | But not over (USD) | Pay + (USD) | % on excess | of the amount over____(USD) |
|---:|---:|---:|---:|---:|
| 0 | 50,000 | 0 | 15 | 0 |
| 50,000 | 75,000 | 7,500 | 25 | 50,000 |
| 75,000 | 100,000 | 13,750 | 34 | 75,000 |
| 100,000 | 335,000 | 22,250 | 39 | 100,000 |
| 335,000 | 10,000,000 | 113,900 | 34 | 335,000 |
| 10,000,000 | 15,000,000 | 3,400,000 | 35 | 10,000,000 |
| 15,000,000 | 18,333,333 | 5,150,000 | 38 | 15,000,000 |
| 18,333,333 | ............... | | 35 | 0 |

The US corporate income tax rate is based on a progressive rate schedule; however, an alternative minimum tax (*see the Other taxes section*) provides for a flat rate with fewer deductions. The 39% tax rate applies to taxable income between USD 100,000 and USD 335,000 to eliminate the benefit of the 15% and 25% rates, and the 38% tax rate applies to taxable income between USD 15,000,000 and USD 18,333,333 to eliminate the benefit of the 34% rate. Special rules apply to personal service corporations and personal holding companies.



## *Corporate residence*

A corporation organised or created in the United States under the law of the United States or of any state is a domestic corporation. A domestic corporation is a resident corporation even though it does no business or owns no property in the United States. Resident corporations are taxed based on worldwide income. Generally, a foreign corporation engaged in a US trade or business is taxed at regular US corporate tax rates on income from US sources that is effectively connected with that business and at 30% on US source income not effectively connected with that business.

## Other taxes

### Top rate on net capital gains

On current transactions, the long-term capital gains tax rate is the same as the tax rates applicable to ordinary income. Thus, the maximum rate is 35%, excluding the additional phase out rates. However, differences may arise where the alternative minimum tax is imposed.

### Federal alternative minimum tax

An alternative minimum tax (AMT) is imposed on corporations other than S corporations *(see below)* and small C corporations (generally those with no three year average annual gross receipts exceeding USD 7.5 million). The tax is 20% of alternative minimum taxable income (AMTI) in excess of a USD 40,000 exemption amount (subject to a phase out). AMTI is computed by adjusting the corporation's regular taxable income by specified adjustments and 'tax preference' items. Tax preference or adjustment items could arise, for example, if a corporation has substantial accelerated depreciation, percentage depletion, intangible drilling costs, or non-taxable income.

### Accumulated earnings tax

Corporations (other than S corporations, domestic and foreign personal holding companies, corporations exempt from tax under Subchapter F of the Internal Revenue Code (the Code), and passive foreign investment companies) accumulating earnings and profits for the purpose of avoiding shareholder personal income tax are subject to a penalty tax in addition to any other tax that may be applicable. The accumulated earnings tax is equal to 15% of 'accumulated taxable income'. Generally, accumulated taxable income is the excess of taxable income with certain adjustments, including a deduction for regular income taxes, over the dividends paid deduction and the accumulated earnings credit. Note that a corporation can justify the accumulation of income, and avoid tax, based on its reasonable business needs.

### Personal holding company tax

US corporations and certain foreign corporations that receive substantial 'passive income' and are 'closely held' may be subject to personal holding company tax. The personal holding company tax is 15% of undistributed personal holding company income and is levied in addition to the regular tax.

### S corporations

Corporations with 100 or fewer shareholders, none of whom may be corporations, that meet certain other requirements may elect to be taxed under Subchapter S of the Code and are thus known as S corporations. S corporations are taxed in a manner similar, but not identical, to partnerships. Thus, S corporations generally are not subject to US federal income tax.

### Payroll taxes

Employers are subject to federal unemployment insurance tax (FUTA) of 6.2% on the first USD 7,000 of wages paid to employees meeting certain criteria. In addition, states impose workers' compensation insurance tax at varying rates depending on state law and the nature of employees' activities. Employers also are subject to social security contributions tax of 7.65% (including 1.45% Medicare tax) on the first USD 106,800 (for 2009 and 2010) of wages paid to employees and 1.45% of Medicare tax on any wages in excess of USD 106,800.

### *State and municipal taxes*
Corporate income tax rates vary from state to state and generally range from 1% to 12% (although some states impose no income tax). The most common taxable base is federal taxable income, which is modified by state provisions and generally is allocated to a state on the basis of a three factor formula: tangible assets and rental expense, sales and other receipts, and payroll. Other taxes that states may impose, in lieu of or in addition to taxes based on income, include franchise taxes and taxes on the capital of a corporation. State and municipal taxes are deductible expenses for federal income tax purposes.

### *Excise taxes*
The federal and state governments impose excise taxes on a variety of goods. For example, a federal and state excise tax is imposed on gasoline and diesel fuel used for transportation. The excise taxes are levied item by item and lack any uniformity in rates.

### *Value-added tax (VAT)*
No provisions exist for a VAT at the federal level. However, state and local governments may impose sales taxes.

### *Stamp tax*
No provisions exist for a stamp tax at the federal level. However, state and local governments frequently impose stamp taxes at the time of officially recording the transaction based upon the value of the real estate.

### *Other*
Most states and some cities impose sales or use taxes and a variety of property taxes on both real and personal property. The sales tax on real estate may be a stamp tax on the documents recording the transfer of the real estate.

## *Branch income*

Tax rates on branch profits are the same as on corporate profits. The law also imposes a 30% branch profits tax in addition to US corporate level income taxes on a foreign corporation's US branch earnings and profits for the year that are effectively connected with a US business. The taxable base for the branch profits tax is increased (decreased) by any decrease (increase) in the US net equity of the branch. The branch profits tax on profits may be reduced or eliminated entirely if a relevant treaty so provides (subject to strict 'treaty shopping' rules). The purpose of the branch profits tax is to treat US operations of foreign corporations in much the same manner as US corporations owned by foreign persons.



With certain exceptions, a 30% (or lower treaty rate) branch profits tax also will be imposed on interest payments by the US branch to foreign lenders. In addition, the tax will apply if the amount of interest deducted by the branch on its US tax return exceeds the amount of interest actually paid during the year.

## Income determination

### List of common book/tax adjustments

Tax and financial accounting typically have differing treatment for the following items:

- research and development
- domestic manufacturing costs
- depreciation of fixed assets
- amortisation of intangibles
- meals and entertainment
- foreign taxes, and
- fines/penalties.

### Inventory valuation

Inventories generally are stated at the lower of cost or market on a first in first out (FIFO) basis. Last in first out (LIFO) may be elected for tax purposes on a cost basis only and generally requires book and tax conformity.

The tax law requires capitalisation for tax purposes of several costs allocable to the manufacturing process that frequently are expensed as current operating costs for financial reporting (e.g. the excess of tax depreciation over financial statement depreciation).

### Capital gains

Gains or losses on the sale or exchange of capital assets held for more than 12 months are treated as long-term capital gains or losses. Gains or losses on the sale or exchange of capital assets held for 12 months or less are treated as short-term capital gains or losses. The excess of net long-term capital gain over net short-term capital loss is considered net capital gain. Capital losses are allowed only as an offset to capital gains. An excess of capital losses over capital gains in a taxable year may be carried back three years and carried forward five years to be used against (offset) capital gains.

For dispositions of personal property and certain non-residential real property used in a trade or business, net gains are first taxable as ordinary income to the extent of the depreciation/cost recovery, with any remainder generally treated as capital gain. For other trade or business real property, net gains generally are taxed as ordinary income to the extent that the depreciation or cost recovery claimed exceeds the straight-line amount, with any remainder treated as capital gain.

An exception to capital gain treatment exists to the extent that losses on business assets were recognised in prior years. A net loss from the sale of business assets is treated as an ordinary loss. Future gains, however, will be treated as ordinary income to the extent of such losses recognised in the five immediately preceding years.

### Inter-company dividends

A US corporation generally may deduct 70% of dividends received from other US corporations. The dividends received deduction is increased from 70% to 80% if the recipient of the dividend distribution owns at least 20% but less than 80% of the distributing corporation. Generally, dividend payments between US corporations that are members of the same affiliated group (*see the Group taxation section*) are deferred or eliminated until a transaction with a third party occurs. With minor exceptions, a US corporation may not deduct dividends it receives from a foreign corporation.

### *Foreign income (Subpart F income) of US taxpayers*
Generally, a US corporation is taxed on its worldwide income, including foreign branch income earned and foreign dividends when received. Double taxation is avoided by means of foreign tax credits. Alternatively, a deduction may be claimed for actual foreign taxes that are paid. In the case of foreign subsidiaries that are more than 50% owned by US shareholders (commonly known as controlled foreign corporations or CFCs), certain types of undistributed income will be taxed currently to the US shareholders (Subpart F income). Generally, Subpart F income includes income that is easily transferred to a low-tax jurisdiction.

Income from certain passive foreign investment companies (where 75% or more of the income is passive or at least 50% of the assets held produce passive income) also is subject to current taxation. Current taxation occurs if the corporation elects to be a qualified electing fund (QEF) or there are actual distributions. If a QEF election is not made and the corporation makes an actual distribution, the distribution will be treated as an excess distribution to the extent it exceeds 125% of the average of the distributions made with respect to the stock over the three immediately preceding years. The excess distribution is spread over the taxpayer's holding period, and the amount allocated to each year in the holding period is subject to tax at the highest marginal tax rate in effect for that year. This deferred tax amount also is subject to an interest charge. The interest charge is designed to pay the benefit of the tax deferral that arises out of having an overseas investment that pays no US income taxes.

### *US income of foreign taxpayers*
Generally, if a foreign entity engages in a US trade or business, all income from sources within the United States that is connected with conducting such trade or business is classified as Effectively Connected Income (ECI). There are also situations in which foreign source income could be ECI. ECI generally is subject to tax at the same rate as corporate profits. A 30% branch profits tax is levied in addition to the US corporate level income tax, which may be reduced or eliminated entirely if a relevant treaty so provides. Deductions are allowed against ECI.

Tax treaties between the United States and other countries may provide special rules for allocating taxing authority between the treaty partners. Tax treaties may provide that income earned by a foreign entity that would otherwise be considered ECI is only taxable in the United States to the extent the profits are attributable to a permanent establishment of the foreign entity in the United States. A permanent establishment generally is defined as a fixed place of business.

### *Foreign Investment & Real Property Tax Act (FIRPTA)*
FIRPTA provides that the gain or loss of a foreign person from the disposition of a US real property interest should be taken into account as if the taxpayer were engaged in a US trade or business and such gain or loss were effectively connected with such business. In these situations, the party purchasing the US real property interest from the foreign party is required to withhold 10% of the amount realised.



### *Fixed, determinable, annual, or periodical (FDAP) income*
FDAP income includes all income except gains from the sale of real or personal property and income excluded from gross income, without regard to whether the owner of the income is a US or foreign entity. Some examples of FDAP income include dividends, interest, royalties, and commissions. The gross amount of FDAP income or gains from US sources that are not effectively connected with a US trade or business are taxed at a rate of 30%. Deductions against FDAP income are not allowed.

Certain kinds of FDAP income are treated as ECI by reason of statutory requirements, allowable elections, or meeting the requirements under either the Asset-Use Test or Business Activities Test.

### *Stock dividends*

A US corporation can distribute a tax-free dividend of common stock proportionately to all common stock shareholders. If the right to elect cash is given, all distributions to all shareholders are taxable as dividend income whether cash or stock is taken. There are exceptions to these rules, and extreme caution must be observed before making such distributions.

### *Partnership income*

The income (loss) of a partnership passes through to its partners so that the partnership itself is not subject to tax. Thus, each partner generally accounts for their distributive share of the partnership's taxable income.

### *Corporate reorganisations*

In general, a corporate reorganisation involving a merger, acquisition, or consolidation is a taxable event under the general recognition provisions of the Code. However, a corporate reorganisation that meets certain statutory and judicial requirements may qualify as a tax-free transaction, with gain or loss generally not recognised or deferred to a later date.

### *Transfer pricing*

Transfer pricing regulations govern how related entities set internal prices for the transfers of goods, intangible assets, services, and loans in both domestic and international contexts. The regulations are designed to prevent tax avoidance among related entities and place a controlled party on par with an uncontrolled taxpayer by requiring an arm's-length standard. The arm's-length standard generally is met if the results of a controlled transaction are consistent with results that would have been realised if uncontrolled taxpayers had engaged in a similar transaction under similar circumstances. If a company is not in compliance with the arm's-length standard, the Internal Revenue Service (IRS) may raise taxable income and tax payable in the United States. After a transfer pricing adjustment, a multinational company may face double tax, paying tax twice on the same income in two countries. Multinational companies may request competent authority relief from double taxation through a tax treaty.

In order to avoid potential transfer pricing penalties, one avenue available to companies may be to obtain an advance pricing agreement with the IRS, unilaterally, or with the IRS and another tax authority, bilaterally, covering inter-company pricing.

### *Other*

Interest income, rents, and royalties generally are includible in the determination of gross income.

## *Deductions*

### *Depreciation*

Depreciation deductions are allowances that may be taken for capital outlays for tangible property. For property placed in service after 1986, capital costs must be recovered by using the modified accelerated cost recovery system (MACRS) method. Depending on the type of tangible property, the general cost recovery periods are three, five, seven, ten, 15, 20, 27.5, and 39 years (31.5 years for property placed in service before 13 May 1993). The cost recovery methods and periods are the same for both new and used property. Most tangible personal property is in the three, five or seven year class. Property placed in the three, five, seven or ten year class is depreciated by first applying the 200% declining balance method and then switching to the straight-line method at such a time as when use of the straight-line method maximises the depreciation deduction. Property in the 15 or 20 year class is depreciated by using the 150% declining-balance method and later switching to the straight-line method. An election may be made to use the Alternative Depreciation System (basically, the straight-line method over prescribed lives). Residential rental property generally is depreciated by the straight-line method over 27.5 years. Non-residential real property is depreciated by the straight-line method over 39 years (31.5 years for property placed in service before 13 May 1993).

An election to use the straight-line method over the regular recovery period or a longer recovery period also is available. Alternatively, taxpayers may elect to use the 150% declining-balance method over the regular recovery period for all property other than real property. This method is required for alternative minimum tax purposes.

For most tangible personal and real property placed in service in the United States after 1980 but before 1 January 1987, capital costs were recovered using the Accelerated Cost Recovery System (ACRS), which applied accelerated methods of cost recovery over periods specified by statute. The general ACRS recovery periods were three, five, ten, 15, 18, and 19 years.

Special rules apply to automobiles and certain other ‘listed’ property. Accelerated depreciation deductions can be claimed only if the automobile is used 50% or more for qualified business use as defined in related regulations. Further, for automobiles placed in service after 1986, the allowable yearly depreciation deduction cannot exceed specific dollar limitations.

Separate methods and periods of cost recovery are specified by statute for certain tangible personal and real property used outside the United States.

Rapid amortisation may be allowable for certain pollution control facilities.

Tax depreciation is not required to conform to book depreciation. Tax depreciation generally is subject to recapture on the sale or disposition of certain property, to the extent of gain, which is subject to tax as ordinary income.

### *Section 179 deduction*

Corporations can elect to expense, up to a statutory amount per year, the cost of certain eligible property used in the active conduct of a trade or business. This is commonly referred to as the section 179 deduction. The maximum annual expensing amount for tax years that begin in 2008 and 2009 is USD 250,000. For tax years beginning in 2010, the maximum annual expensing amount is USD 134,000. For tax years beginning in 2011 and thereafter, the maximum amount is USD 25,000.



The maximum deduction amount is reduced dollar for dollar where the corporation places in service during the tax year qualified tangible personal property in excess of USD 800,000 for tax years that begin in 2008 and 2009. For tax years beginning in 2010, the investment limitation is USD 530,000. For tax years beginning in 2011 and thereafter, the investment limitation is reduced to USD 200,000.

In addition, the deduction under this election is limited to the taxable income of the business. The annual expensing limit is increased by an additional USD 35,000 for qualifying assets placed in service in certain distressed communities. The annual expensing limit also is increased for certain property placed in service in the Gulf Opportunity Zone or Kansas disaster area.

### *Bonus depreciation*

A 50% special first year depreciation allowance (i.e. bonus depreciation) applies (unless an election out is made) for new MACRS property with a recovery period of 20 years or less, certain computer software, water utility property, and certain leasehold improvements acquired after 31 December 2007 and before 1 January 2010. The special allowance applies for regular income tax and AMT purposes. No AMT adjustment is made if the special allowance is used. The property must be placed in service before 2010 (before 2011 for certain longer lived property). The special allowance does not apply to property that must be depreciated using the Alternative Depreciation System or to 'listed property' not used predominantly for business. The special allowance reduces basis before regular depreciation is figured. Additionally, claiming bonus depreciation on automobiles may affect the first year depreciation limits on such automobiles.

The 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010', signed into law on 17 December 2010 extends bonus depreciation and temporarily increases the available deduction. Bonus depreciation which provides an additional first-year depreciation deduction equal to 50 percent of the cost of qualifying property is extended through 31 December 2012 (31 December 2013 for long-production period property (LPPP) and certain aircraft). This provision currently was set to expire on 31 December 2010 (31 December 2011, for LPPP and certain aircraft) as extended by the Small Business Jobs Act of 2010.

- The legislation provides a temporary 100% bonus depreciation deduction for qualifying property acquired and placed in service after 8 September 2010, through 31 December 2011 (31 December 2012, for LPPP and certain aircraft). Under this provision, property acquired pursuant to a written binding contract entered into before 1 January 2008 is not qualified property for purposes of the 100% bonus depreciation deduction.
- The legislation does not change the definition of eligible property under the current bonus depreciation rules. Current-law rules generally provide that property with a recovery period of 20 years or less, water utility property, certain computer software, and qualified leasehold improvements are eligible.
- The 100% bonus depreciation provision in the legislation operates by substituting '100' for '50' in the applicable 100% period. Thus, property that meets the 100% bonus depreciation requirements will not be eligible property for purposes of the 50% bonus depreciation requirement. For such property, a taxpayer could claim 100% bonus depreciation or elect to forego the bonus depreciation deduction altogether.
- The bonus depreciation provisions, including 100% bonus depreciation, are mandatory. However, as indicated above, a taxpayer may make an election out of bonus depreciation for any particular tax year. This election is made on a class-by-class and entity-by-entity basis.
- The legislation re-enacts the provision allowing a corporation to elect to accelerate AMT credits in lieu of bonus depreciation. This election is available for property placed in service after 31 December 2010, and before 1 January 2013 (1 January 2014 for LPPP and certain aircraft).

### *Depletion*
For natural resource properties other than timber and certain oil and gas properties, depletion may be computed on a cost or a percentage basis.

Cost depletion is a method of depletion applied to exhaustible natural resources, including timber, which is based on the adjusted basis of the property. Each year, the adjusted basis of the property is reduced, but not below zero, by the amount of depletion calculated for that year. The current year cost depletion deduction is based on an estimate of the number of units that make up the deposit and the number of units extracted and sold during the year.

Percentage depletion is a method of depletion applied to most minerals and geothermal deposits, and, to a more limited extent, oil and gas. Percentage depletion is deductible at rates varying from 5% to 25% of gross income, depending on the mineral and certain other conditions. Percentage depletion may be deducted even after the total depletion deductions have exceeded the cost basis. However, percentage depletion is limited to 50% (100% for oil and gas properties) of taxable income from the property (computed without allowance for depletion). Generally, percentage depletion is not available for oil or gas wells. However, exceptions exist for natural gas from geopressurised brine and for independent producers of oil and gas.

### *Net operating losses*
A net operating loss (NOL) is generated when business deductions exceed gross income in a particular tax year. Depending on current tax law, an NOL may be carried back to offset past income and possibly obtain a refund or carried forward to offset future income. Generally, a loss may be carried back two years and, if not fully used, carried forward 20 years. For tax years beginning before 6 August 1997, a loss may be carried back three years and, if not fully used, carried forward 15 years. For state tax purposes, carryback and carryforward provisions are often similar to the federal provisions, except that several states do not permit any carrybacks or carryforwards.

Special rules surrounding NOLs may apply if a taxpayer is located in a qualified disaster area.

Special rules also apply relating to specified liability losses.

Complex rules may limit the use of net operating losses after a reorganisation or other change in corporate ownership. Generally, if the ownership of more than 50% in value of the stock of a loss corporation changes, a limit is placed on the amount of future income that may be offset by losses carried forward.

With certain exceptions, taxpayers may elect to increase the carryback period for an applicable NOL to three, four, or five years from two years under the Worker, Homeownership, and Business Assistance Act of 2009, which was signed by President Obama on 6 November 2009. Under this act, an applicable NOL is the taxpayer's NOL for any tax year ending after 31 December 2007, and beginning before 1 January 2010. Generally, an election may be made for only one tax year, but an eligible small business that made or makes an election under the Code as in effect before 6 November 2009, may make an election for two tax years.

Under this special provision of the Worker, Homeownership, and Business Assistance Act of 2009, the amount of an NOL that may be carried back to the fifth tax year before the loss year may not exceed 50% of the taxable income for that fifth preceding tax year, determined without consideration of any NOL generated in the loss year or during any tax year after the loss year. An NOL otherwise carried to tax years following the fifth preceding tax year is adjusted to take into account that the NOL may offset only 50% of the taxable income for that fifth preceding tax year. Note that the 50% limitation does not apply to an applicable 2008 NOL of certain eligible small businesses that made an earlier election.

The Worker, Homeownership, and Business Assistance Act of 2009 also suspends the 90% limitation on the use of any alternative tax NOL deduction attributable to the carryback of an applicable NOL for which the extended carryback period is elected. Transition rules prescribe how a taxpayer may revoke certain elections to waive the carryback period.

### *US manufacturing deduction*

Over the last several decades, various tax incentive systems have been enacted in the United States to encourage exports and later repealed, including the extraterritorial income (ETI) regime, which was repealed as a result of a World Trade Organization ruling that the ETI regime favoured US goods and violated the national treatment provisions of the General Agreement on Tariffs and Trade. In response, the United States enacted the American Jobs Creation Act of 2004, which introduced a phase-out repeal of ETI, and introduced the domestic production activities deduction under section 199, seeking to compensate US manufacturers for the loss of ETI benefits.

Under section 199, taxpayers are allowed a 9% deduction for qualified production activities (QPA) income (subject to a taxable income limitation), phased in at 3% in 2005 and 2006; 6% in 2007 through 2009 and 9% in 2010 and thereafter. The deduction is available to all taxpayers actively engaged in QPA. For corporate taxpayers, the deduction generally will mean a federal income tax rate of 33.95%, 32.90% and 31.85%, respectively, for the years in question, on QPA income. Importantly, the deduction also applies in calculating the alternative minimum tax. There is a limit on the amount of the deduction equal to 50% of W-2 wages allocable to QPA (subject to a specific effective date), and the deduction is not allowed for taxpayers that incur a loss from their production activities or have an overall loss (including a carryover loss) from all activities.

A taxpayer's QPA income is calculated using the following formula: domestic production gross receipts less the sum of cost of goods sold allocable to such receipts and other expenses, losses, or deduction which are properly allocable to such receipts.

### *Payments to foreign affiliates*

A US corporation generally may claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates, to the extent the amounts are actually paid and are not in excess of what it would pay an unrelated entity, (i.e. are at arm's length). In addition, US withholding on these payments may be required.

### *Debt-to-equity rules*

Thin capitalisation rules may apply to disallow interest payments related to excess debt and re-characterise such payments as dividends. The interest expense deduction can be limited and suspended if more than 50% of the adjusted taxable income of a thinly-capitalised corporation (with similar rules for a corporate partner in a partnership) is sheltered by interest paid to a related party (or paid to a third-party but guaranteed by the related party) who is not subject to US tax on the income.

### *Employee benefit plans (pension plans and expenses)*
Through the Code, the government provides incentives for employers to provide retirement benefits to workers, including employee benefit, qualifying profit-sharing, or stock bonus plans. Usually, the employer will be allowed a current deduction for any contributions made to the fund, and the employee's tax liability will be deferred until the benefit is paid. For profit, non-government employers generally have two types of available plans, which generally are subject to the reporting and disclosure requirements set forth under the Employee Retirement Income Security Act of 1974 (ERISA).

The first category of employee benefit plans is the defined benefit plan, or more commonly known as a pension plan, to which an employer contributes money, on an ongoing basis, to cover the amount of retirement income owed to retired employees under the plan (which will vary based on years of service, average salary, and/or other factors). Any investment gains or losses will not affect the amount of benefits paid to participants but will affect the amount an employer needs to contribute in order to cover its obligation.

The second category of employee benefit plans is the defined contribution plan, or more commonly known in the United States as a '401(k) plan', to which an employer's contributions (if any) are allocated amongst the separate accounts of participating employees, who also may contribute to their respective accounts. Investment gains or losses and the history of contributions will affect the value of a participant's account at retirement but would not affect an employer's contributions since the employer is not obligated to ensure any specified level of benefit in the plan.

Non profits, including churches and government entities, have similar employee benefit plans, except different requirements apply. Small employers and self-employed individuals also have similar options available but are subject to different requirements.

### *Bribes, kickbacks, illegal payments*
An amount paid, directly or indirectly, to any person that is a bribe, kickback, or other illegal payment is not deductible.

### *Taxes*
See, for example, *State and municipal taxes under the section on Other taxes*.

### *Other significant items*
- Deductions for allowable charitable contributions may not exceed 10% of taxable income computed without regard to certain deductions, including charitable contributions themselves. Deductions for contributions so limited may be carried over to the five succeeding years, subject to the 10% limitation annually, as noted above.
- Bad debt resulting from a trade or business may be deducted in the year the debt becomes worthless. Determining the date the debt becomes worthless may present difficulty.
- No deduction generally is allowed for a contingent liability until such liability is fixed and determinable.
- No deduction generally is allowed for fines or penalties paid to the government for violation of any law.
- The cost of goodwill and most other intangibles assets generally is capitalised and amortisable rateably over 15 years.

- Generally, start up expenditures must be amortised over a 15 year period; however, a certain taxpayer may elect to deduct some expenses in the tax year in which the trade or business begins.
- Costs incurred for entertainment must meet strict tests in order to be deductible. The deduction for business meal and entertainment expenses is 50% of the expenses incurred. There are also limitations on the deductibility of international and domestic business travel expenses.
- Royalty payments, circulation costs, mine exploration, and development costs, and other miscellaneous costs of carrying on a business are deductible subject to certain conditions and limits.
- Depending on the taxpayer's tax accounting method, research and experimental expenditures may be deducted as incurred or treated as deferred expenses and amortised over a period of not less than 60 months; however, in general, the method used must be consistently applied.

## *Group taxation*

An affiliated group of US 'includible' corporations, consisting of a parent and subsidiaries directly or indirectly 80% owned, generally may offset the profits of one affiliate against the losses of another affiliate within the group by electing to file a consolidated federal income tax return. A foreign incorporated subsidiary may not be consolidated into the US group, except for certain Mexican and Canadian incorporated entities. A partnership may not be included in a consolidated return, even if it is 100% owned by members of an affiliated group, since a partnership is not a corporation. However, a member's earnings that flow through from a partnership are included as part of the consolidated group's taxable income or loss. Filing on a consolidated (combined) basis also is allowed (or may be required or prohibited) in certain states.

Sales, dividends, and other transactions between corporations that are members of the same group generally are deferred or eliminated until such time as a transaction occurs with a non-member of the group. Losses incurred on the sale of members of the group are disallowed under certain circumstances.

## *Tax credits and incentives*

### *Inbound investment*

There generally are no specific incentives related to inbound investment at the federal level, other than certain portfolio debt and bank deposit exceptions. The portfolio debt exception enables non-residents and foreign corporations to invest in certain obligations (which must meet certain statutory requirements to qualify as 'portfolio debt') in the United States without being subject to US income (or withholding) tax on the interest income. Certain state and local benefits may also be available.

### *General business credit*

Various business credits are available to provide special incentives for the achievement of certain economic objectives. In general, these credits are combined into one 'general business credit' for purposes of determining each credit's allowance limitation for the tax year. The general business credit that may be used for a tax year is limited to a tax based amount. In general, the current year's credit that cannot be used in a given year because of the credit's allowance limitation may be carried back to the tax year preceding the current year and carried forward to each of the 20 years following the current year.

In general, the current year business credit is a combination of the following credits:

- investment credit
- work opportunity credit
- alcohol fuels credit
- research credit
- low-income housing credit
- enhanced oil recovery credit
- disabled access credit for certain eligible small businesses
- renewable electricity production credit
- empowerment zone employment credit
- Indian employment credit
- employer social security credit
- orphan drug credit
- new markets tax credit
- small employer pension plan startup cost credit for eligible employers
- employer-provided child care credit
- railroad track maintenance credit
- biodiesel fuels credit
- low sulfur diesel fuel production credit
- marginal oil and gas well production credit
- distilled spirits credit
- advanced nuclear power facility production credit
- non-conventional source production credit
- new energy efficient home credit
- energy efficient appliance credit
- a portion of the alternative motor vehicle credit
- a portion of the alternative fuel vehicle refueling property credit
- Hurricane Katrina housing credit
- Hurricane Katrina employee retention credit
- Hurricane Rita employee retention credit
- Hurricane Wilma employee retention credit
- mine rescue team training credit
- agricultural chemicals security credit for eligible businesses
- differential wage payment credit
- carbon dioxide sequestration credit, and
- a portion of the new qualified plug-in electric drive motor vehicle credit for vehicles that will vary based on the date of purchase.

### *Employment credits*
A 'work opportunity tax credit' is available for employment of certain types of workers who began work for an employer after 30 September 1996 and before 1 September 2011. 'Creditable' wages generally are the first USD 6,000 of wages paid to each qualified employee for the year. The credit is 40% of creditable wages, for a maximum credit of USD 2,400.

### *Research and development (R&D)*
A credit against the federal tax equal to 20% of the sum of qualified research expenses incurred prior to 31 December 2009 in excess of the base amount (as discussed below) and basic research payments (as discussed below) to a qualified organisation may be obtained for certain periods. The base amount cannot be less than 50% of the current year's qualified research expenditures. In tax years ending after 8 August 2005, the research expense credit also includes 20% of the taxpayer's expenditures on qualified energy research undertaken by an energy research consortium. The 'Tax Relief,

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Unemployment Insurance Reauthorization, and Job Creation Act of 2010' includes a retroactive two-year extension of the research credit and other expired business provisions, through the end of 2011.

In addition, for taxable years ending after 2006 taxpayers may be able to use the new alternative simplified credit (ASC) that does not use a gross receipts factor. The ASC generally equals 12% (14% in 2009) of qualified research expenditures (QRE) for taxable years that exceed 50% of the average QRE for the three taxable years preceding the credit determination year. Special transition rules apply to fiscal year 2006-2007 taxpayers.

Those taxpayers that, despite significant R&D investments, are unable to claim the standard R&D credit because their current R&D intensity is lower than during the credit's 1984–88 'fixed base' period may use an elective 'alternative incremental research credit' (AIRC). Under the AIRC, a graduated rate system applies to the extent that the taxpayer's current year qualified research expenses (QREs) exceed a specified percentage of its average gross receipts for the prior four years (the 'base amount'). This election to be subject to the alternative incremental credit regime applies to the tax year for which it is made and all later years unless the IRS consents to its revocation.

The deduction for R&D expenditures must be reduced by the entire amount of the credit unless an election is made to reduce the amount of the credit.

### *Puerto Rico*
Puerto Rico is the most populous and politically significant US possession. Puerto Rico corporations are considered foreign for US tax purposes. In general, Puerto Rico corporations are liable to the US for tax on income effectively connected to a US trade or business and on passive income from US sources and on US branch profits. Tax paid to the United States may be eligible for a foreign tax credit against Puerto Rico tax liability.

US corporations operating in Puerto Rico may take a credit against income from Puerto Rico sources. The credit applies to income from operating an active trade or business in Puerto Rico or from the sale of substantially all the assets of such a trade or business. For tax years beginning after 1995, this credit is subject to limitations and generally is available only to existing claimants. All claimants may also take the credit on possession source investment income received or accrued before 1 July 1996. The credit is repealed for tax years beginning after 2005.

### *Other US possessions*
The American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the US Virgin Islands have their own independent tax departments. Accordingly, they have their own rules in addition to special provisions in the US tax code.

### *Qualified private activity bonds*
Interest income received on certain qualified private activity bonds generally is exempt from federal income tax. This enables a business enterprise to issue the bonds at a lower interest rate.

### *Foreign tax credit*
Generally, in any year, a taxpayer can choose whether to take as a credit (subject to limitation) or as a deduction foreign income, war profits, and excess profit taxes paid or accrued during the taxable year to any foreign country or US possession. A foreign tax credit (FTC) reduces US income tax liability dollar for dollar, while a deduction reduces

the US income tax liability at the marginal rate of the taxpayer. For taxpayers with net operating losses, the FTC is of no value in such year. However, a benefit might be received either in an earlier year (through a refund of previously paid taxes) or a later year (through a reduction of future taxes). It also should be noted that a taxpayer has an ability to switch from credit to deduction (or from deduction to credit) at any time in a 10-year period commencing when the foreign taxes were paid or accrued. Generally, a foreign tax credit may be carried back one year and, if not fully used, carried forward 10 years.

In addition, the FTC goes beyond direct taxes to include foreign taxes paid 'in lieu of' a tax upon income, war profits, or excess profits, which would otherwise generally be imposed. It also includes deemed-paid (indirect) taxes paid for certain US corporate shareholders of non-portfolio foreign corporations when actual or deemed dividends are received. Furthermore, the FTC system has numerous limitations to mitigate the potential abuses of the credit by the taxpayer.

### *Other incentives*

State and local governments provide numerous incentives to encourage business and, thus, employment in their jurisdictions.

## *Withholding taxes*

The US has entered into various income tax treaties with countries in order to avoid double taxation of the same income and to prevent tax evasion. The table below from IRS Publication 901 (April 2010) summarises the benefits resulting from these treaties.

| Recipient | Interest paid by US obligors general | Paid by US corporations general (1) | Dividends qualifying for direct dividend rate (1, 2) | Royalties* |
|---|---|---|---|---|
| Australia | 10 (3, 6, 23) | 15 (3, 24) | 5 (3, 24, 26) | 0 (3)/5 (3)/5 (3) |
| Austria | 0 (3, 21) | 15 (3, 11) | 5(3, 11) | 0 (3)/10 (3)/0 (3) |
| Bangladesh | 10.5 (3, 13, 21) | 15 (3, 24) | 15 (3, 24) | 10 (3)/10 (3)/10 (3) |
| Barbados | 5 (3) | 15(3, 11) | 5 (3, 11) | 5 (3)/5 (3)/5 (3) |
| Belgium | 15 (3, 21) | 15 (3, 30, 31) | 5 (3, 26, 30, 31) | 0 (3)/0 (3)/0 (3) |
| Bulgaria | 5 (3, 21, 23, 30) | 10 (3, 30, 31) | 5(3, 30, 31) | 5 (3)/5 (3)/5 (3) |
| Canada | 0 (3, 21) | 15 (3, 24) | 5 (3, 24) | 0 (3)/10 (3)/0 (3) |
| China, People's Republic of | 10 (3) | 10 (3) | 10 (3) | 10 (3, 10)/10 (3)/ 10 (3) |
| Commonwealth of Independent States | 0 (8) | 30 | 30 | 0/0/0 |
| Cyprus | 10 (3) | 15 (3) | 5 (3) | 0 (3)/0 (3)/0 (3) |
| Czech Republic | 0 (3) | 15 (3, 11) | 5 (3, 11) | 10 (3)/0 (3)/0 (3) |
| Denmark | 0 (3, 22) | 15 (3, 30, 31) | 5 (3, 26, 30, 31) | 0 (3)/0 (3)/0 (3) |
| Egypt | 15 (4) | 15 (4) | 5 (4) | 0 (4)/0 (4)/15 (3) |
| Estonia | 10 (3, 22) | 15 (3, 11) | 5 (3, 11) | 5 (3, 15)/10 (3)/ 10 (3) |
| Finland | 0 (3, 22) | 15 (3, 30, 31) | 5 (3, 26, 30, 31) | 0 (3)/0 (3)/0 (3) |
| France | 0 (3) | 15 (3, 24) | 5 (3, 24, 26) | 0 (3)/0 (3)/0 (3) |
| Germany | 0 (3,21) | 15 (3, 30, 31) | 5 (3, 26, 30, 31) | 0 (3)/0 (3, 16)/0 (3) |
| Greece | 0 (4) | 30 | 30 | 0 (4)/30/0 (4) |

# United States

| Recipient | Interest paid by US obligors general | Paid by US corporations general (1) | Dividends qualifying for direct dividend rate (1, 2) | Royalties* |
|---|---|---|---|---|
| Hungary | 0 (3) | 15 (3) | 5 (3) | 0 (3)/0 (3)/0 (3) |
| Iceland | 0 (3, 22) | 15 (3, 17, 24) | 5 (3, 17, 24) | 0 (3, 5)/5 (3)/0 (3) |
| India | 15 (3, 14) | 25 (3, 11) | 15 (3, 11) | 10 (3, 15)/15 (3)/ 15 (3) |
| Indonesia | 10 (3) | 15 (3) | 10 (3) | 10 (3, 15)/10 (3)/ 10 (3) |
| Ireland | 0 (3) | 15 (3, 24) | 5 (3, 24) | 0 (3)/0 (3)/0 (3) |
| Israel | 17.5 (3, 14, 19) | 25 (3, 11) | 12.5 (3, 11) | 15 (3)/10 (3)/ 10 (3) |
| Italy (new treaty) | 10 (3, 25) | 15 (3, 24) | 5 (3, 24) | 5 (3)/8 (3)/8 (3, 27) |
| Italy (old treaty) | 15 (3) | 15 (3) | 5 (3) | 10 (3, 9)/8 (3)/5 (3) |
| Jamaica | 12.5 (3) | 15 (3) | 10 (3) | 10 (3)/10 (3)/ 10 (3) |
| Japan | 10 (3, 28, 29, 30) | 10 (3, 28, 30, 31) | 5 (3, 28, 30, 31) | 0 (3, 28)/0 (3, 28)/ 0 (3, 28) |
| Kazakhstan | 10 (3) | 15 (3, 18) | 5 (3, 18) | 10 (3, 32)/10 (3)/ 10 (3) |
| Korea, South | 12 (3) | 15 (3) | 10 (3) | 15 (3)/10 (3)/ 10 (3) |
| Latvia | 10 (3, 22) | 15 (3, 11) | 5 (3, 11) | 5 (3, 15)/10 (3)/ 10 (3) |
| Lithuania | 10 (3, 22) | 15 (3, 11) | 5 (3, 11) | 5 (3, 15)/10 (3)/ 10 (3) |
| Luxembourg | 0 (3, 4) | 15 (3, 33) | 5 (3, 11) | 0 (3)/0 (3)/0 (3) |
| Mexico | 15 (3, 20) | 10 (3, 24, 15) | 5 (3, 10, 24, 26) | 10 (3)/10 (3)/ 10 (3) |
| Morocco | 15 (3) | 15 (3) | 10 (3) | 10 (4)/10 (3)/ 10 (3) |
| Netherlands | 0 (3) | 15 (3) | 5 (3) | 0 (3)/0 (3, 16)/0 (3) |
| New Zealand | 10 (3) | 15 (3) | 15 (3) | 10 (3)/10 (3)/ 10 (3) |
| Norway | 0 (3) | 15 (3) | 15 (3) | 0 (3)/0 (4)/0 (3) |
| Pakistan | 30 | 30 | 15 (4) | 0 (4)/30/0 (4) |
| Philippines | 15 (3) | 25 (3) | 20 (3) | 15 (3)/15 (3)/ 15 (3) |
| Poland | 0 (3) | 15 (3) | 5 (3) | 10 (3)/10 (3)/ 10 (3) |
| Portugal | 10 (3) | 15 (3, 11) | 5 (3, 11) | 10 (3)/10 (3)/ 10 (3) |
| Romania | 10 (3) | 10 (3) | 10 (3) | 15 (3)/10 (3)/ 10 (3) |
| Russia | 0 (3) | 10 (3, 18) | 5(3, 18) | 0 (3)/0 (3)/0 (3) |
| Slovak Republic | 0 (3) | 15 (3, 11) | 5 (3, 11) | 10 (3)/0 (3)/0 (3) |
| Slovenia | 5 (3) | 15 (3, 24) | 5 (3, 24) | 5 (3)/5 (3)/5 (3) |
| South Africa | 0 (3, 21) | 15 (3, 11) | 5 (3, 11) | 0 (3)/0 (3)/0 (3) |
| Spain | 10 (3) | 15 (3, 11) | 10 (3, 11) | 8 (3, 12)/8 (3, 12)/ 5 (3, 12) |
| Sri Lanka | 10 (3, 21) | 15 (3, 34) | 15 (3, 34) | 0 (3)/10 (3)/10 (3, 9) |
| Sweden | 0 (3) | 15 (3, 30, 31) | 5 (3, 26, 30, 31) | 0 (3)/0 (3)/0 (3) |
| Switzerland | 0 (3, 21) | 15 (3, 11) | 5 (3, 11) | 0 (3)/0 (3)/0 (3) |
| Thailand | 15 (3, 14) | 15 (3, 11) | 10 (3, 11) | 8 (15)/5/ 15 (5) |
| Trinidad & Tobago | 30 | 30 | 30 | 15 (3)/30/0 (3) |
| Tunisia | 15 (3) | 20(3, 11) | 14 (3,11) | 10 (3, 15)/15 (3)/ 15 (3) |
| Turkey | 15 (3, 7, 14) | 20 (3, 11) | 15 (3, 11) | 5 (15)/10/ 10 |
| Ukraine | 0 (3) | 15 (3, 18) | 5 (3, 18) | 10 (3)/10 (3)/ 10 (3) |

| Recipient | Interest paid by US obligors general | Paid by US corporations general (1) | Dividends qualifying for direct dividend rate (1, 2) | Royalties* |
|---|---|---|---|---|
| United Kingdom | 0 (3, 22, 28) | 15 (3, 24, 28) | 5 (3, 24, 26, 28) | 0 (3, 28)/0 (3, 28)/ 0 (3, 28) |
| Venezuela | 10 (3, 22, 23) | 15 (3, 24) | 5 (3, 24) | 5 (3, 15)/10 (3)/ 10 (3) |
| Other countries | 30 | 30 | 30 | 30/30/30 |

Notes

* Please note the tax rates and associated footnotes appearing in the 'Royalties' column in the table address three types of royalties, as denoted in the most recent IRS publication. These three are industrial royalties, motion picture and television copyright royalties, and 'Other' copyright royalties. The back slashes '/' between each figure and associated footnote(s) are meant to demarcate these three types of royalties, respectively.

1. No US tax is imposed on a dividend paid by a US corporation that received at least 80% of its gross income from an active foreign business for the three-year period before the dividend is declared.
2. The reduced rate applies to dividends paid by a subsidiary to a foreign parent corporation that has the required percentage of stock ownership. In some cases, the income of the subsidiary must meet certain requirements (e.g. a certain percentage of its total income must consist of income other than dividends and interest). For Italy, the reduced rate is 10% to 50% of the voting stock (for a 12-month period) of the company paying the dividends. For Japan, dividends received from a more than 50% owned corporate subsidiary are exempt if certain conditions are met.
3. The exemption or reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment. Under certain treaties, the exemption or reduction in rate also does not apply if the property producing the income is effectively connected with a fixed base in the United States from which the recipient performs independent personal services. Even with the treaty, if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a permanent establishment in the United States under IRC section 894(b).
4. The exemption or reduction in rate does not apply if the recipient is engaged in a trade or business in the United States through a permanent establishment that is in the United States. However, if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a permanent establishment in the United States to apply the reduced treaty rate to that item of income.
5. For Thailand, the rate is 5% for royalties on the use of any copyright of literary, artistic, or scientific work, including software. For Iceland the rate is 5% for trademarks and any information for rentals of industrial, commercial, or scientific equipment.
6. Interest determined with reference to the profits of the issuer or one of its associated enterprises is taxed at 15%.
7. Contingent interest that does not qualify as portfolio interest is treated as a dividend and is subject to the rates under columns 2 and 3, as appropriate.
8. The exemption applies only to interest on credits, loans, and other indebtedness connected with the financing of trade between the United States and the C.I.S. member. It does not include interest from the conduct of a general banking business.
9. The rate for royalties with respect to tangible personal property is 7% (5% in the case of Sri Lanka).
10. Tax imposed on 70% of gross royalties for rentals of industrial or scientific equipment.
11. The rate in column 2 applies to dividends paid by a regulated investment company (RIC) or a real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is an individual holding less than a 10% interest (25% in the case of Portugal, Spain, and Tunisia) in the REIT.
12. Royalties not taxed at the 5% or 8% rate are taxed at a 10% rate, unless footnote (3) applies.
13. The rate is 5% for interest (i) beneficially owned by a bank or other financial institution (including an insurance company), or (ii) paid due to a sale on credit of any industrial, commercial, or scientific equipment, or of any merchandise to an enterprise.
14. The rate is 10% if the interest is paid on a loan granted by a bank or similar financial institution. For Thailand, the 10% rate also applies to interest from an arm's-length sale on credit of equipment, merchandise, or services.
15. This is the rate for royalties for the use of, or the right to use, industrial, commercial, and scientific equipment. The rate for royalties for information concerning industrial, commercial and scientific know-how is subject to the rate in column 4 ('Other royalties').
16. The exemption does not apply to cinematographic items, or works on film, tape, or other means of reproduction for use in radio or television broadcasting.

17. Amounts paid to a pension fund or employee benefit organisation that are not derived from the carrying on of a business, directly or indirectly, by the fund or organisation are exempt.
18. The rate in column 2 applies to dividends paid by a regulated investment company (RIC). Dividends paid by a real estate investment trust (REIT) are subject to a 30% rate.
19. An election can be made to treat this interest income as if it were industrial and commercial profits taxable under article 8 of this treaty.
20. The rate is 4.9% for interest derived from (i) loans granted by banks and insurance companies, and (ii) bonds or securities that are regularly and substantially traded on a recognised securities market. The rate is 10% for interest not described in the preceding sentence and paid (i) by banks, or (ii) by the buyer of machinery and equipment to the seller due to a sale on credit.
21. The rate is 15% (10% for Bulgaria; 30% for Germany and Switzerland) for contingent interest that does not qualify as portfolio interest.
22. The rate is 15% for interest determined with reference to (i) receipts, sales, income, profits, or other cash flow of the debtor or a related person, (ii) any change in the value of any property of the debtor or a related person, or (iii) any dividend, partnership distribution, or similar payment made by the debtor to a related person.
23. Interest received by a financial institution is tax exempt. For Venezuela, the rate is 4.95% if the interest is beneficially owned by a financial institution (including an insurance company).
24. The rate in column 2 applies to dividends paid by a regulated investment company (RIC) or real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (i) an individual holding not more than a 10% interest in the REIT, (ii) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (iii) a person holding not more than a 10% interest in the REIT and the REIT is diversified.
25. Interest paid or accrued on the sale of goods, merchandise, or services between enterprises is exempt. Interest paid or accrued on the sale on credit of industrial, commercial, or scientific equipment is exempt.
26. Dividends received from an 80%-owned corporate subsidiary are exempt if certain conditions are met.
27. Royalties for the use of, or right to use, a copyright of literary, artistic, or scientific work (excluding royalties for software, motion pictures, films, tapes, or other means of reproduction used for radio or television broadcasting) are exempt.
28. Exemption or reduced rate does not apply to amount paid under, or as part of, a conduit arrangement.
29. Interest is exempt if (i) paid to certain financial institutions, or (ii) paid on indebtedness from the sale on credit of equipment or merchandise.
30. Amounts paid to a pension fund that are not derived from the carrying on of a business, directly or indirectly, by the fund are exempt. This includes amounts paid by a REIT only if the conditions in footnote 31 are met. For Sweden, to be entitled to the exemption, the pension fund must not sell or make a contract to sell the holding from which the dividend is derived within two months of the date the pension fund acquired the holding.
31. The rate in column 2 applies to dividends paid by a regulated investment company (RIC) or real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (i) an individual or a pension fund holding not more than a 10% interest in the REIT, (ii) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (iii) a person holding not more than a 10% interest in the REIT and the REIT is diversified. Dividends paid to a pension fund from a RIC, or a REIT that meets the above conditions, are exempt. For Sweden, the pension fund must also satisfy the requirements in footnote 30.
32. If the payments were for the use of, or the right to use, industrial, commercial, or scientific equipment, an election may be made to compute the tax on a net basis as if such income were attributable to a permanent establishment or fixed base in the US.
33. The exemption does not apply if the recipient of the gain is an individual who is present in the United States for more than 119 days during the year.
34. The rate applies to dividends paid by a real estate investment trust (REIT) only if the beneficial owner of the dividends is (i) an individual holding less than a 10% interest in the REIT, (ii) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (iii) a person holding not more than a 10% interest in the REIT and the REIT is diversified.

## *Tax administration*

### *Returns*

The US tax system is based on the principle of self-assessment. A corporate taxpayer is required to file an annual tax return (generally Form 1120) by the fifteenth day of the third month following the close of its tax year. A taxpayer can obtain an additional six month extension of time to file its tax return. Failure to timely file may result in penalties.

### *Important tax return due dates*

| Form No. | Title | Purpose | Due date |
|---|---|---|---|
| W-2 | Wage and Tax Statement | Employers must provide employees with statements regarding total compensation and amounts withheld during year. | Must be sent to employees on or before 31 January. |
| 1099 series | Various | Information returns to be provided to recipients of dividends and distributions, interest income, miscellaneous income, etc. | Must be sent on or before 31 January. |
| 1120 series, including 1120S (for S Corps) | US Corporation Income Tax Return | Income tax returns for domestic corporations or foreign corporations with US offices. | 15 March (Form 7004 may be filed to obtain an automatic six month extension) |
| Schedule K-1 | Partner's Share of Income (Loss) from an Electing Large Partnership | Information returns to be provided to partners by large partnerships. | 15 March |
| 1065 | US Return of Partnership Income | Information returns to be filed by large partnerships. | 15 April (Form 7004 may be filed to obtain an automatic six month extension) |
| State tax returns | Various | Income tax returns for states where corporation carries on trade/business. | Varies – often 15 April |

### *Payment of tax*

A taxpayer's tax liability generally is required to be prepaid throughout the year in four equal estimated payments and fully paid by the date the tax return is initially due. For calendar year corporations, the tax instalment payments are due by the fifteenth day of April, June, and September, and the tax liability must be fully paid by the fifteenth day of December. For fiscal year corporations, the tax instalment payments are due by the fifteenth day of the fourth, sixth, and ninth months, and the tax must be fully paid by the fifteenth day of the twelfth month of the tax year. Generally, no extensions to pay are allowed. Failure to pay the tax by the due dates as indicated above can result in estimated tax and late payment penalties and interest charges.

The instalment payments must include estimates of regular corporate income tax, alternative minimum tax, environmental tax, and, for foreign corporations, the tax on gross transportation income. To avoid a penalty, corporations must calculate the instalment payments based on at least 25% of the lesser of (i) the tax shown on the current tax return, or (ii) the prior year's tax liability, provided that the tax liability was a positive amount in the prior year and that such year consisted of 12 months. However, corporations with taxable income of at least USD 1 million (before use of NOLs or capital loss carryforwards) in any of the three preceding years are not permitted to calculate the instalment based payment on the prior year's tax liability, except in determining the first instalment payment. Instead, such corporations must calculate the instalment payments based on the tax shown on the current tax return.



Corporations with more than USD 1 billion in assets will be required to make estimated tax payments that are 100.25% of the amount otherwise due in July, August, or September of 2014. Such overpayments will be balanced out in October, November, or

December of 2014 when payments of 99.75% of the amount otherwise due will be paid by corporations with more than USD 1 billion in assets.

Taxpayers that acquired and placed in service property on or after 8 September 2010, and before 1 January 2011, have based their 2010 estimated tax payments on the assumption that 100% expensing would not be enacted. With enactment of 100% expensing via the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010', these taxpayers may find they have overpaid 2010 estimated taxes. Taxpayers that have overpaid estimated taxes generally can recoup the overpayment only after the year in which the overpayments were made, by filing the appropriate federal income tax return or a Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax. A corporation may file a Form 4466 if its overpayment is at least USD 500 and 10% of the expected tax liability.

### *Audit cycle*

Generally, the US tax system is based on self-assessment; however, many large and midsize businesses are under continuous audit by the IRS and state tax authorities. The audits may include the entire list of taxes for which the business is liable. Smaller business and persons with lower incomes are generally subject to audit on a random basis.

Currently, the IRS is focused on abusive payments related to contribution to capital of a corporation, domestic manufacturing deduction, foreign earnings repatriation, foreign tax credit generators, repairs vs. capitalisation change in accounting method, research credit claims, transfer of intangibles/offshore cost sharing, withholding taxes, and employee classification.

### *Statute of limitations*

The IRS generally has three years after an original return is filed to assess income taxes. A return will be deemed to have been filed on its due date, even if the return is actually filed on an earlier date.

### *Tax shelter*

Treasury regulations require taxpayers to disclose transactions determined to be abusive or possibly abusive. Current information on these transactions, known as listed and reportable transactions, is available from the IRS website (www.irs.gov).

### *Tax accounting and internal controls*

ASC 740, Income Taxes (formerly known as FASB Statement No. 109, Accounting for Income Taxes) addresses how companies should account for and report the effects of taxes based on income. ASC 740's principles and requirements apply to domestic and foreign entities in preparing financial statements in accordance with US generally accepted accounting principles (GAAP), including not-for-profit entities with activities that are subject to income taxes. This scope includes: (i) domestic federal (national) income taxes (US federal income taxes for US enterprises) and foreign, state, and local (including franchise) taxes based on income, and (ii) an enterprise's domestic and foreign operations that are consolidated, combined, or accounted for by the equity method.

In recent years, controls around the accounting for income taxes have been a critical source of material weaknesses in companies' internal controls over financial reporting. Accounting for income taxes also has been a primary reason for restating financial statements. Management should ensure that its judgments and estimates are reasonable (e.g. assessing the need for a valuation allowance on deferred taxes) and that the underlying internal control processes are reliable.

The adoption of International Financial Reporting Standards (IFRS) in the United States is set by the Securities and Exchange Commission (SEC). The timeline included in the SEC's roadmap provides for adoption of IFRS in the United States between 2014 and 2016. The SEC has stated that it will reassess the transition to IFRS in 2011.

### *Accounting for income taxes*

For US federal tax purposes, the two most important characteristics of a tax method of accounting are (i) timing, and (ii) consistency. If the method does not affect the timing for including items of income or claiming deductions, it is not an accounting method and generally IRS approval is not needed to change it. In order to affect timing, the accounting method must determine the year in which an income or expense item is to be reported.

In general, in order to establish an accounting method, the method must be consistently applied. Once an accounting method has been adopted for federal tax purposes, any change must be requested by the taxpayer and approved by the IRS. Changes in accounting methods cannot be made through amending returns. The two most common methods of accounting are the accrual basis and cash basis methods.

### *Penalties*

Civil and criminal penalties may be imposed for failing to follow the IRC when paying US taxes. The civil penalty provisions may be divided into four categories: delinquency penalties, accuracy-related penalties, information reporting penalties, and preparer, promoter, and protester penalties. Many, but not all, have exception provisions to cover reasonable cause. In addition many have provisions directing how the penalties interact with the other penalties.

These four main civil penalty categories may further be divided. First the delinquency penalties may be divided into failure to file, failure to pay, and failure to make timely deposits of tax. Failure to make timely deposits of tax applies to taxpayers required to make instalment payments and withholding tax payments.

Second, the penalties relating to the accuracy of tax returns are divided into the negligence penalty, the substantial understatement penalty, substantial overstatement of pension liabilities, substantial estate or gift tax valuation underestimate, and the valuation penalties. These penalties are also coordinated with the fraud penalty to eliminate any stacking of the penalties. Again, like other provisions, the fraud penalty is not intended to be imposed as a stacked penalty.

The third category of penalties is the information reporting penalties. These penalties may be imposed upon those who only have a duty to report information to the IRS.



The fourth and final major categories of civil penalties are the preparer, promoter, and protester penalties. Currently the most notable of these is the return preparer penalty for which there is a penalty for a position on a return for which the preparer did not have substantial authority. Also included in this provision is a penalty for wilful or reckless attempt to understate the tax liability of another person. Additionally, return preparer penalties may be imposed for failure to furnish a copy of a return or claim for refund to the taxpayer, sign the return or claim for refund, furnish his or her identifying number, or file a correct information return.

Other promoter and protestor penalties include a penalty for promoting abusive tax shelters, aiding and abetting the understatement of tax liability, and filing frivolous income tax returns. Additionally, a court may award sanctions and costs if a person institutes or maintains a proceeding primarily for delay, takes a position that is frivolous, or unreasonably fails to pursue available administrative remedies.

In addition to these major civil penalties, international tax related penalties for failures other than timely and accurate filing (e.g. wilful failure to report international boycott activity, failure of an agent to furnish a notice of a false affidavit relating to the withholding tax on dispositions of US real property interests, failure of a US person to furnish information relating to controlled foreign corporations and controlled foreign partnerships, failure of a US person to report foreign bank accounts, etc.) exist. Pension and employee benefit related tax penalties exist that protect the policy reasons for the tax incentives including, most notably, early withdrawal of pension funds. Another group of specialised penalties apply to exempt organisations.

Criminal penalties exist for situations when the failures to stay within the tax system are more egregious. Although applicable to corporate taxpayers, they are applied more frequently to individuals.

In addition to the penalty provisions, interest at statutory rates generally applies to underpayments of tax.

# Uruguay

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## Significant developments

Uruguay has signed double tax treaties (DTTs) following the model of the Organisation for Economic Co-operation and Development (OECD) with Germany (renegotiation), India, Liechtenstein, Malta, Mexico (in force as of January 2011), Portugal, Spain (in force as of 24 April 2011), and Switzerland, as well as a memorandum to cooperate in the exchange of information with France. The memorandum with France is already approved by the Uruguayan Parliament. DTTs with Belgium, Chile, Malaysia, Equator, Luxembourg, and South Korea are currently under negotiation.

Uruguay has modified the Investment Law, achieving a better framework for local and foreign investments in the country. Three years of experience with the promotional regime in force since 2007 and a new social and economic reality led the authorities to amend certain provisions, maintaining the tax benefits to be granted.

The amendments follow, among others, these objectives:

- Improve the regime in order to connect the investments being promoted with the tax benefits being granted.
- Promote the generation of qualified employment.
- Encourage geographic decentralization.
- Promote production that generates more value added.
- Increase the incentives granted to investments that achieve cleaner energy production; improve technological investigation, innovation, and development; improve energy efficiency; and achieve adaptation to climate changes.
- Promote the development of micro and small-investment projects.

## Taxes on corporate income

Net income derived from business activities conducted in Uruguay, obtained by legal entities resident in Uruguay and non-residents operating through a PE in Uruguay, is taxed at a corporate income tax (CIT) rate of 25% under the source principal (i.e. the territorial system of taxation). Accordingly, Uruguay taxes only income that is derived from activities conducted within its borders, income generated from property located in Uruguayan territory, or income derived from the economic use of rights within its territory.



In order to determine the net taxable income, all accrued expenses that are necessary for the generation of Uruguayan-source income and that are duly documented are allowed as deductions. Additionally, a taxpayer will be able to deduct expenses from its gross income if such expenses are subject to taxation (either foreign or local taxation) in the hands of the other party. A compulsory proportional deduction must be calculated if the tax is at a rate that is lower than 25%.

A 12% withholding tax (WHT) is imposed on Uruguayan-sourced income obtained by non-residents, except in cases where the income is obtained through the operations of a PE in Uruguay *(see the Withholding taxes section for more information)*.

### *Trading companies*

Uruguayan corporations that sell and buy foreign goods or services from Uruguay (which are not physically introduced to the country, in the case of goods, or which are not economically used in Uruguay, in the case of services) may determine the net Uruguayan-source income on a notional basis of 3% of the gross margin (difference between the selling price and the purchase price). This gross margin has to be compliant with transfer pricing rules (in line with OECD guidelines). The applicable effective CIT rate is 0.75% (25% x 3%).

## *Corporate residence*

Legal entities are deemed to be resident in Uruguay when they are incorporated according to the local legislation.

### *Permanent establishment (PE)*

The concept of PE in the Uruguayan tax legislation follows, in general terms, OECD. From a Uruguayan law perspective, the term PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on in Uruguay. The term PE especially includes: (i) places of management; (ii) branches; (iii) offices; (iv) factories; (v) workshops; (vi) mines; oil or gas wells; quarries or any other place of extraction of natural resources; (vii) buildings, constructions, installation projects, or the management activities associated to them, when they last more than three months; and (viii) services rendered (in particular consultancy) by a non-resident through employees or hired personnel in Uruguay during a period or periods exceeding six months on an annual basis. Please note that item (viii) constitutes an exception to the OECD model and is based on the provisions of the United Nations (UN) model.

## *Other taxes*

### *Value-added tax (VAT)*

Uruguayan VAT is levied at a general rate of 22% on the provision of services and on the circulation of goods within the limits of the Uruguayan territory. The import of goods and value-added in regard to the construction of immovable assets are also within the scope of this tax.

The following items are either subject to a reduced 10% VAT rate or exempt from VAT entirely.

Items subject to the 10% VAT rate:

- Food and medicines.
- Hotel services.
- Health services.
- The first sale of immovable assets.

Items exempt from VAT:

- Milk.
- Books.
- Magazines.
- Agriculture machinery.
- Accessories.

Exports are VAT zero-rated. VAT on purchases of the exporters can be recovered in the form of credit certificates that can be used for the payment of other taxes as well.

### *Customs duties*

- Consular duty: 2% (from 1 January 2011).
- Customs computer services duty: a scale flat duty, with a limit of 50 US dollars (USD).
- Customs extraordinary duty: a scale flat duty, with a limit of USD 600.
- Global customs duty (TGA): depends on the origin of goods. If they come from Mercosur, the TGA is zero. If not, it varies depending on the type of product, with a maximum rate of 20%, with exceptional levels that range from 23% to 35% (corresponding mainly to certain types of shoes, sugar, and automotives).
- Commission of BROU: 0.05%.

All imports and exports duties are applied on the 'customs value' (in general, in imports it is considered as cost, insurance, and freight (CIF), and in exports as freight on board (FOB)).

On imports, VAT is also applicable according to the following detail:

- Goods subject to the general VAT rate (22%):
  - 'Import VAT' at the rate of 22%.
  - 'Advanced payment import VAT' at a rate of 10%.
- Goods subject to the reduced VAT rate (10%):
  - 'Import VAT' at the rate of 10%.
  - 'Advanced payment import VAT' at a rate of 3%.

The tax base of VAT on imports is the customs value plus the customs duties.

Additionally, some goods are also subject to an 'advanced payment import on account of CIT' at a rate of 10%, which can be deducted from the amount of CIT for the fiscal year.

### *Export duties*

Exports are not subject to any taxes, and there are almost no prohibitions regarding the type of goods to be exported. On the contrary, several instruments are offered to promote exports, such as the reimbursement of taxes. For VAT on exports, *please see VAT above.*

For the reimbursement of indirect taxes, the exporter may recover internal taxes that are added to the cost of the products exported. The amount to be reimbursed is a percentage of the FOB value set by the Executive Power for each product.

Additionally, temporary admission consists of the import of raw materials, pieces, motors, package material, and other industrial input without import duties or taxes. To be subject to this customs duties exemption, the company has to export the finished goods within 18 months from the introduction of the exempt goods or materials. The subsequent local sale of such finished goods is not entitled to this benefit.

### *Excise tax*
In general, excise tax applies on the first transaction effected in the domestic market by manufacturers or importers of goods. Exports are not taxable.

Excise tax rates vary for each item, and they are generally fixed by the government within maximum parameters established by law.

Goods subject to the highest rates are alcoholic beverages (from 20.20% to 80%, depending on the alcohol degree), tobacco (from 28% to 70%), lubricants (from 5% to 35%) gasoline, fuel, and other petroleum products (from 5% to 133%).

### *Net wealth tax (NWT)*
All types of legal entities and business enterprise owners are subject to a NWT at a rate of 1.5% on the value of net assets. This tax also follows the source principle, whereby only assets located or economically used in Uruguay are taxable. Taxpayers may reduce their capital tax liability in determining the NWT basis, up to their total amount of CIT for the fiscal year. In practice, taxpayers deduct 1%, which was established prior to the tax reform law.

The deduction of liabilities from the amount of taxable assets to determine the NWT basis is limited to: (i) the average of debts with financial institutions, (ii) debts with suppliers of goods and services, (iii) taxes not yet due, (iv) debts with governments, international credit offices of which Uruguay is a member and with foreign state financial institutions that lend funds for long-term productive projects, and (v) debts documented in debentures and obligations, if their emission is done in a public offering and such papers are quoted in a stock exchange.

### *Property taxes*
Regarding taxes of relevance for those doing business in Uruguay, *please see Net Wealth Tax above.* There are additional property taxes of less significance, levied by Municipal authorities (e.g. Contribución Inmobiliaria) and by National authorities (e.g. Impuesto de Primaria).

### *Tax of control of corporations*
Upon the set up of a corporation, a tax is payable at a 1.5% rate on a notional basis amount, which is determined annually by the authorities. For fiscal year 2011, the estimated amount of this tax (lump sum) is approximately USD 950.

This tax is also due annually at the end of each fiscal year, at a rate of 0.75% on said notional amount, and can be deducted from the NWT. For fiscal year 2011, the estimated amount of this tax (lump sum) is approximately USD 475.

### *Tax on real estate transfer*
A tax on real estate transfer applies to the transfer of immovable assets. Transfer is defined in an ample sense, as a sale, a cession of the right to use, a transfer of inheritance rights, etc.

Both parties to the transfer contract are subject to this tax at a rate of 2% on the property’s tax value (according to a National Register, a value generally lower than market value). When the property is transferred without payment, the beneficiary pays tax at a rate of 4% on the property tax valuation, except in instances where the property is transferred to direct heirs or legatees, who pay this tax at a rate of 3%.

### *Stamp taxes*
Stamp taxes are not applicable in Uruguay.

## *Branch income*

CIT is imposed at a rate of 25% on net income derived from business activities carried out in Uruguay. A 7% WHT is imposed on profits remitted or credited to a home office. Dividends and/or profits paid or credited to non-resident shareholders will not be subject to WHT when they are paid out of non-taxable income for CIT purposes.

## *Income determination*

### *Inventory valuation*
Replacement cost is permitted for tax purposes, as well as the first in first out (FIFO), last in first out (LIFO), or average cost methods, irrespective of the inventory valuation method used for accounting purposes.

### *Capital gains*
Capital gains are treated as ordinary income, except for capital gains on property located in rural areas, which is exempt from tax under certain conditions.

### *Inter-company dividends*
Dividends received from local subsidiaries are exempt. Dividends received from foreign subsidiaries are out of the scope of this tax since they are considered foreign sourced, thus non-taxable income.

### *Foreign income*
Uruguayan legal entities (CIT taxpayers) and non-residents operating through a PE in Uruguay are only subject to tax on income from Uruguayan sources under the territorial system of taxation. Hence, foreign-source income is not subject to tax.

Income derived from activities performed, assets located, or rights utilised outside Uruguay, regardless of the nationality, domicile, or residence of the parties participating in the transactions and the place where the transaction agreements are subscribed, is not subject to CIT.

### *Income adjustment for inflation*
An income adjustment for inflation has been in force since 1 January 1981 and is calculated by multiplying the variation in the wholesalers' price index for the financial year by the difference between:

1. total assets at the beginning of the year (excluding fixed assets) and
2. total liabilities at the beginning of the year.

If (1) is higher than (2), then an inflation loss adjustment is deducted from gross income. However, if (2) is higher than (1), then an inflation gain adjustment is added.

## Deductions

As a general rule, duly documented expenses that are necessary to obtain and preserve gross taxable income are tax deductible. On the contrary, those expenses associated with deriving or preserving income not subject to income tax are not deductible from the taxable basis.

### Depreciation and depletion

Straight-line depreciation over useful life is mandatory. Specific rates exist for the following cases: (i) 2% per year for urban buildings, (ii) 3% per year for rural buildings, and (iii) no less than 10% per year for new vehicles. Other rates are accepted if economically justified. No conformity between book and tax depreciation is required.

Percentages for depletion computed on the cost of natural resource properties are allowed in accordance with generally accepted criteria.

Depreciation and depletion percentages are computed on the historical cost of fixed assets revaluated at year-end, based on the variation of the wholesalers' price index. Capital gains derived from the revaluation of fixed assets are not taxable income.

### Taxes

CIT and NWT are not deductible.

### Net operating losses

Losses may be carried forward and deducted from the net taxable income of the following five years, once adjusted for inflation. There are no loss carrybacks.

### Payments to foreign affiliates

All accrued expenses that are necessary for the generation of Uruguayan-source income and that are duly documented are allowed as deductions. Additionally, a taxpayer may deduct expenses from its gross income provided such expenses are subject to taxation (either via foreign or local taxation) in the hands of the other party. A compulsory proportional deduction must be calculated if the tax is at a rate that is lower than the CIT rate of 25%.

## Group taxation

Group taxation is not permitted in Uruguay.

### Transfer pricing rules

As a general principle, transfer pricing rules are applicable to international transactions between related parties. However, Uruguayan legislation has extended the scope of these regulations to transactions carried out with low-tax or no-tax jurisdictions or regimes (either international or domestic) and to certain operations through third intermediaries. Domestic transactions with Uruguayan Free Zone users fall under this category.

The definition adopted by the law for related parties is quite broad. Such a relationship is configured when both parties are subject (directly or indirectly) to the management or control of the same individuals or legal entities, or when they have power of decision to direct or define the taxpayer´s activities due either to their participation in capital interest, the level of their credit rights, or their functional or any other type of influence (whether contractual or not).

### *Thin capitalisation*
Thin capitalisation rules do not apply in Uruguay.

## *Tax credits and incentives*

### *CIT reduction for income reinvested in fixed assets*
40% of income reinvested in the purchase of (i) industrial and agricultural machinery, (ii) vehicles and installations, (iii) computers, (iv) telecommunications equipment, and (v) some assets for the tourism industry is exempt from CIT.

20% of income reinvested in the construction and expansion of industrial, agricultural, and tourism buildings is exempt from CIT (limited to 40% of net taxable income in the year of expenditure).

The joint amount of said investments can be deducted from the taxable basis, with a limit of 40% of the annual net profit, once the amount of other exemptions has been deducted. The excess can be deducted (with the same limitations) in the following two tax periods. It is important to mention that income exempt by these provisions cannot be distributed and must be retained as a reserve account, which ultimately can only be capitalised.

### *NWT exemption*
Movable fixed assets directly connected to the industrial cycle and equipment for data processing are exempt from NWT.

### *Investments law (IL)*
Uruguay has modified the IL, achieving a better framework for local and foreign investments carried out in the country. To obtain tax benefits, the IL requires that enterprises obtain a government statement in this regard. The Bureau of Investor Assistance is in charge of monitoring the correct compliance of these projects.

The IL grants two types of benefits:

#### Automatic benefits
This kind of benefit is only for manufacturing, extractive, or farming/ranching activities, and includes:

- Exemption from NWT for chattel property directly engaged in the production cycle and data-processing equipment.
- Exemption from VAT and CIT paid on the importation of such goods, and reimbursement of VAT in the case of locally purchased items.



#### Discretionary benefits
Benefits that may be obtained at the discretion of the Executive Power for any type of business activity (not cumulative with automatic benefits) include:

- Tax exemptions on importation of fixed assets items.
- NWT exemptions: permanent for chattel property items, for a period of eight years for construction work in Montevideo (capital city), and for a period of ten years in the rest of the country.
- VAT reimbursement on local purchase of goods and services for civil construction work.

- Increased deductions for CIT in respect of fees and remunerations related to technological developments.
- Exemption from CIT, depending on the nature and size of the project to be carried out. The Executive Power takes into account the following criteria to grant this benefit:
  - Addition of technology to improve competitiveness.
  - Contribution to export growth and diversification.
  - Contribution to geographic decentralisation.
  - Improvement of technological investigation, innovation, and development.
  - Generation of employment.

### *Auto-saving 'direction' benefit*
The auto-saving 'direction' benefit allows a company to deduct from the CIT basis the amount of the capital increase that occurred as a consequence of the reserves capitalisation or of the in-kind distribution of shares, for an amount equivalent to the investment carried out with the investor's own funds. The amount of the CIT deduction and the period/s to which said exemption will apply is granted by the government through a statement issued by the Executive Power.

### *Free zones (FZ)*
Following the approval of the FZ law in 1987, this system has become an important tool for attracting investments to Uruguay.

It has been utilized for carrying out traditional activities in the FZ (warehousing, logistics, and distribution), for the provision of services (software, finance, call centres, etc.) and for manufacturing activities such as cellulose pulp and leather production. In a clear sign of stability, none of the administrations in office over the last three decades has modified the basics of the FZ system.

The law defines FZ as privately or publicly owned isolated and fenced off areas of Uruguayan territory determined by the Executive Branch with the purpose of carrying out all types of manufacturing, commercial, and service activities within the zone, while enjoying tax exemptions and other benefits envisaged in the law.

Companies in these areas cannot carry out industrial, trading, or service activities in the non-FZ Uruguayan territory, except for services expressly authorized by the government (listed below) but are allowed to render all types of services within the FZ or to third countries.

FZ users are allowed to render the following services to the non-FZ Uruguayan territory (the provision of these services is subject to the general tax system, not to the tax holidays):

- International call centres, except for those whose main destination is the non-FZ Uruguayan territory.
- E-mail, distance learning, electronic signature certificate issuance.
- Software production, technology consulting, and related training services.
- Accounting, administration, and management services rendered to related companies who carry out port and shipping logistics activities, if said services are lower than 20% of the total income obtained during the fiscal year.
- Processing of film material and data.

FZ users are exempt from all current and future national taxes, including those taxes for which a specific legal exemption is required, in connection with the activities performed within the FZ. The Uruguayan government guarantees all the exemptions and benefits granted by the law for the term of their contracts. FZ can be located outside or inside the cities; it depends on the kind of FZ.

Social security taxes as well as certain WHTs are excluded from the exemption. Income tax WHT on payments of dividends made by these companies to their non-resident shareholders are exempt.

### *Holding companies*

Uruguayan legal entities holding shares in non-resident entities or investing in assets not located in Uruguay are not subject to tax (due to the application of the source principle).

### *Printing industry incentives*

Companies that print books and educational material are exempt from the NWT and VAT.

### *Electric power industry incentives*

Companies which generate electric power from non-traditional energy sources have special benefits regarding CIT.

### *Shipping industry incentives*

Imports of material, supplies, and equipment required for the construction, maintenance, and repair of shipyards or vessels are exempt from CIT.

### *Water and air transportation incentives*

The income of water and air transportation companies is tax exempt. In the case of foreign companies, the exemption is subject to reciprocal treatment. The government may exempt from CIT companies engaged in transportation by land, subject also to the conditions of reciprocal treatment.

### *Forestry plantation incentives*

Income derived from forestry plantations up to July 2007 is tax exempt. Income derived from new forestry plantations is also tax exempt, but under strict conditions, such as wood quality.

### *Software industry incentives*

50% of the income derived from the production, development, implementation, updating, and correction of previous versions (amongst others) of software was exempt from CIT for fiscal years ending between 1 January 2010 and 31 December 2010. There were some requirements for exemption, such as the tasks had to be directly developed by the computer support producer. Related services had to be rendered to logical support producers as well.

### *Industrial park incentives*

Individuals or legal entities that establish industrial parks within Uruguayan territory, as well as companies located within such industrial parks, are entitled to CIT exemption for their industrial equipment, excise tax and VAT exemption on the acquisitions of such goods, and other benefits.

### *Tourism industry incentives*

Investments in the tourism industry have tax benefits related to CIT, VAT, and NWT, as follows:

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- Deduction of up to 40% of CIT in investments made in the fiscal year in hotel equipment and equipment for improving entertainment and information services to tourists and deduction of up to 20% of CIT in investments made in construction and expansion of hotel buildings, with the limits mentioned in previous sections (40% of the annual net profit, once the amount of other exemptions has been deducted).
- VAT refund included in local acquisitions of goods and services for construction, improvement, or expansion of tourist complexes.
- VAT exemption on import of goods for construction, improvement, or expansion of tourist complexes.
- The list of operations included in the concept of exports of services for VAT purposes (thus zero-rated) was broadened to include, among others, services related to accommodation that hotels, apartments, and rural tourism establishments provide to tourists.
- NWT exemption for ten years on investments in infrastructure and civil work for construction, improvement, or expansion of tourist complexes.
- NWT exemption for four years on fixed assets investment for tourist complexes.
- 50% exemption of import duties on materials and goods for construction, improvement, or expansion as well as fixed assets of tourist complexes.

## *Withholding taxes*

All Uruguayan-sourced income obtained by non-residents (other than those obtained through a PE in Uruguay) is taxed at flat rates of up to 12% on gross income, with some exceptions. This tax is basically collected by way of WHT.

The exceptions are as follows:

- Interest on deposits in local currency for terms exceeding one year is taxed at 3%.
- Interest on public bonds is not taxed.
- Dividends paid or credited by CIT taxpayers are taxed at 7%, provided they are derived from taxable income.

Profits originated in the alienation of stock of CIT taxpayer companies obtained by non-residents are exempt only if the capital of the local company is expressed in bearer shares. The alienation of registered stock is taxed at a rate of 12%.

Although the Uruguayan tax law follows the source principle, technical services (defined as services rendered in the fields of management, technical administration, or advice of any kind) rendered by non-residents but associated with taxable income obtained by the local user in Uruguay are considered to be Uruguayan sourced for tax purposes and subject to WHT. However, when the taxable income obtained by the local user of the service does not exceed 10% of its total income, then only 5% of the service fee paid or credited abroad will be subject to non-resident WHT. Therefore, in these cases, the effective WHT rate is only 0.6% (5% x 12%).

## *Tax administration*

### *Returns*

VAT, CIT, and NWT are self assessed. CIT and NWT returns are filed on a fiscal-year basis (on the fourth month following the date of the year end). VAT and excise tax rules require monthly payments and/or tax returns. Also, WHTs are declared and payable to the Tax Office on the month following the one in which the tax was due.

***Payment of tax***
Income and capital taxes are paid monthly by way of advanced payments, which are calculated on the basis of the previous year's tax. The difference between the advanced tax payments and the total annual tax calculated at fiscal year-end is paid four months after the fiscal year-end.

# Uzbekistan, Republic of

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## Significant developments

The Tax Code of the Republic of Uzbekistan was introduced on 1 January 2008 to consolidate the previous Tax Code and separate instructions on specific taxes. The Tax Code is amended annually, and the currently effective version reflects amendments as of 1 January 2011. The most notable amendments as of that date are as follows.

### Value-added tax (VAT)

Import of medicines that had previously been exempt from VAT is now subject to the restriction that relief is only granted to medicines that are not available from local manufacturers.

The exemption from VAT on sale of precious metals has been abolished.

Sale of cotton fibre within Uzbekistan is subject to zero-rated VAT.

### Property tax

A new mandatory charge was introduced at 0.25% of the historic value of fully depreciated equipment that continues to be used by enterprises. At the same time, such enterprises may benefit from exemption from corporate income tax (and unified tax payment) in respect of revenue from sale/disposal of such equipment.

### Unified social payment (USP)

Employment income paid at expense of grants issued by states, international and foreign governmental organisations, international and foreign non-governmental organisations, as well as grants issued under international agreements of Uzbekistan, is exempt from USP (otherwise chargeable at 25%).

## Taxes on corporate income

Resident corporations pay corporate income tax (CIT) on their worldwide income, whereas non-residents (i.e. foreign legal entities that have a permanent establishment (PE) in Uzbekistan or have income from sources in Uzbekistan not associated with a PE) pay CIT on income resulting from activities/sources in Uzbekistan.

Non-resident corporations are taxed directly at the level of their Uzbek PE, if there is one, or via withholding tax (WHT) at the source of payment of the Uzbek source income.

CIT is charged on taxable profit calculated as a difference between gross income and deductible expenses reduced by applicable incentives granted by the Tax Code, other laws, or presidential decrees.

The CIT rate is set annually by presidential decree. By virtue of the government's annual initiatives for rate reduction, the CIT rate has been reduced over time as follows:

| | | |
|---|---|---|
| 2011: 9% | 2006: 12% | 2001: 26% |
| 2010: 9% | 2005: 15% | 2000: 31% |
| 2009: 10% | 2004: 18% | 1999: 33% |
| 2008: 10% | 2003: 20% | 1998: 35% |
| 2007: 10% | 2002: 24% | |

In 2011, enterprises (i.e. legal entities) are generally subject to CIT at the rate of 9%. Commercial banks are subject to CIT at the rate of 15%.

### *Local income taxes*
There is a local tax on accounting profit (less CIT), an infrastructure development tax, which is charged at a maximum rate of 8%.

## *Corporate residence*

For Uzbek tax purposes, corporations are classified as resident or non-resident. A resident corporation is a legal entity that passed state registration in Uzbekistan (i.e. Uzbek legal entity). Other legal entities would be regarded as non-resident corporations for tax purposes.

### *Permanent establishment (PE)*
PE is defined by the Tax Code as "any place through which non-resident carries out entrepreneurial activity in the Republic of Uzbekistan, including activity carried out through an authorised person. PE would also be existent where non-resident carries on entrepreneurial activity for 183 days (or more) in any consequent 12-month period ending in the current tax period".

## *Other taxes*

### *Value-added tax (VAT)*
Legal entities are subject to VAT, which is applied to taxable turnover and taxable imports. The rate for taxable turnover is 20%. This rate also applies to taxable imports, for which the tax base is determined as the customs value plus import duties and excise tax (on excise-liable goods). Export of goods for hard currency is generally zero-rated. Insurance and most types of financial services are exempt.

### *Excise tax*
Legal entities producing or importing excise-able goods are subject to excise tax. Rates vary from 5% to 200% depending on the type of goods produced/imported. The taxable base is determined as the value of produced/imported goods excluding VAT.

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### *Customs duties*
Import of certain goods to Uzbekistan is subject to customs duties. The taxable base is determined as the customs value of imported goods. Rates of customs duties vary from 5% to 40% depending on the type of imported goods. There is also a customs clearance fee of 0.2% from the customs value of imported goods.

### *Stamp duties*
According to Uzbek legislation, stamp duty is an obligatory payment charged for performance of legal actions and/or issuance of legal documents. The following actions, among others, are subject to stamp duties: filing claims, performing notary actions, civil registration, state registration of a legal entity, obtaining licenses/ permits to carry out certain activities, etc.

The rates of stamp duties generally vary from o.5 to 20 times minimum monthly wage (MMW, approximately USD 29), depending on the type of action executed. For instance, duty for filing a claim depends on the amount of claim. If the amount is less than 20 MMW, the duty comprises 5% of this amount; if the amount exceeds 80 MMW, the duty is 20% of this amount. Duty for notarization of copies of documents for legal entities is 2% of the MMW per each page of the document. Duty for registration of legal entities with foreign investment comprises 5 times the MMW plus USD 500.

### *Property tax*
The property tax rate in 2011 is 3.5% for legal entities. The tax is computed quarterly, based on the net book value of the fixed assets, adjusted for the effect of revaluation, which should be performed annually on 1 January, the residual value of intangibles, and the value of overdue construction-in-progress. The rate is doubled for equipment not installed in due time.

As of 1 January 2011, a charge of 0.25% of the historic value of outdated equipment will be collected from legal entities (except for micro-firms and small enterprises) for exploitation of fully depreciated equipment.

Newly opened enterprises are exempt from property tax for a period of two years from their date of registration, unless such enterprises have been created on the basis of production facilities or assets of existing enterprises. There is also a rate reduction benefit available to companies engaged in production and export of goods (work, services). Property tax exemption is also available in respect to leased property, for a period of the lease, and new technological equipment, for a period of up to five years.

### *Turnover taxes*
There are three mandatory contributions that are charged on the enterprise's gross annual turnover (less VAT and excise tax):

- Road fund to be imposed at a rate of 1.4%.
- Pension fund at a rate of 1.6%.
- Educational institutions fund (for reconstruction, capital repair, and equipment) at a rate of 0.5%.

The taxable base (and tax rate in exceptional cases) for these mandatory contributions may differ depending on the type of activity of a company.

### *Land tax*
Enterprises, including foreign legal entities operating in Uzbekistan via a PE, owning land plots or rights of their use are subject to land tax or land lease payment. Land tax is charged at fixed fees that vary depending on the quality, location, and level of water supply of each land plot. Land lease payment is charged at negotiable rates; however, the minimum amount cannot be less that the land tax rate for the respective land plot. Land tax and land lease payment are computed based on the area of the land being in use.

### *Water-use tax*
Enterprises (including PEs) using water in their production are subject to water-use tax. The tax rate is set by the Cabinet of Ministers and depends on the source of water consumption (i.e. surface or underground). Water-use tax is calculated based on the volume of the water consumed.

### *Unified social payment (USP)*
Employers are subject to USP assessed on total payroll cost related to local and expatriate staff. This payment is collected by the tax authorities. The rate of USP is 25%.

### *Taxes of subsurface users*
In addition to standard taxes, subsurface users (i.e. legal entities and individuals exploring and extracting natural resource) are subject to subsurface users' specific taxes, as listed below:

#### Subsurface use tax (royalty)
Subsurface use tax is charged on volume of produced (extracted) natural resources that are ready for sale or transfer (including free of charge) and consumption for internal purposes. Taxable base is determined as average weighted sales price.

| Business activity | Tax rate examples |
|---|---|
| Extraction of natural resources | natural gas 30%, precious stones 24%, oil 20%, gold 5%, silver 8% |
| Utilisation of by-products received during the extraction of natural resources | 30% of tax rate applicable to main natural resources extracted |

#### Excess profits tax
Excess profits tax is assessed on the difference between the selling price of the extracted natural resources (as per the list) and the statutory price set by the legislation. Excess profits tax is not payable by entities operating under production sharing agreements.

The list of natural resources and goods subject to excess profits tax includes: copper, cement, natural gas, polyethylene granules, clinker. Excess profits tax is paid at 50% of the taxable base.

#### Signing and commercial discovery bonuses
Signing and commercial discover bonuses are one-off payments to the state budget. The signing bonus is payable for the right to engage in exploration and extraction of natural resources and range from 100 to 10,000 times the MMW, depending on the type of minerals. The commercial discovery bonus is paid for each field where a subsurface user discovers the natural resources and comprises 0.1% from the cost of the proved reserve volume.

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## Branch income

There is no concept of a 'branch' of a foreign legal entity in the Uzbek legislation. Instead such entities use a PE registration to perform business activities without establishing an Uzbek company.

In addition to CIT, non-residents operating in Uzbekistan via PE pay net profit tax assessed at 10% on accounting profit less CIT.

## Income determination

### Inventory valuation

Uzbek legislation permits the application of the weighted average cost method (AVECO) and the first in first out (FIFO) method for the valuation of inventory for tax purposes.

### Capital gains

Capital gains arising from the disposal of tangible and intangible assets are calculated as the difference between the selling price and the net book value of an asset. The capital gain is included in taxable profits (unless specifically exempt), and the capital losses are deductible (only if the disposed asset had been used for business purposes for three or more years). This is applicable to Uzbek legal entities and PEs of foreign legal entities. Capital gains on non-resident companies may be subject to WHT at 20% as 'other' income.

### Dividend income

Dividends paid by a domestic subsidiary will be subject to 10% WHT at the source. The net dividends received by its domestic parent company will then be excluded from its CIT base. Such net dividends received by a foreign parent company would be taxed in accordance with the respective country's internal legislation or double taxation treaty (DTT) provisions (if Uzbekistan has a DTT with this country). *See the Withholding taxes section for a list of countries with which Uzbekistan has an applicable tax treaty.*

### Foreign income

Gross foreign income of a resident corporation (e.g. income from its foreign branch) should be included in its aggregate income on an accrual basis, regardless of remittance date. Expenses incurred abroad in relation to such foreign income would be deducted subject to provisions of the Uzbek Tax Code. Foreign income tax paid on such income should be credited against the Uzbek CIT only if this branch is registered in a country with which Uzbekistan has a DTT. There are no deferrals for foreign income to be recognised for Uzbek tax purposes.

## Deductions

The tax base for CIT purposes varies significantly from the computation of taxable profits in most Western jurisdictions. Expenditures such as entertaining, benefits in-kind, and business trip allowances exceeding the statutory norms (that are generally low) are non-deductible.

There are additional costs that cannot be deducted by PEs of foreign legal entities, such as interest on head office loans, commission fees charged by head office, royalty, administrative and management expenses of head office incurred outside Uzbekistan.

However, PEs are eligible to deduct expenses incurred outside of Uzbekistan if they directly relate to their business in Uzbekistan.

### *Depreciation and amortisation*
For tax purposes, depreciation/amortisation is calculated with application of rates defined by the Tax Code. If depreciation for accounting purposes is charged at higher rates (compared with the Tax Code rates), the difference would be treated as a temporary difference for CIT purposes (i.e. deducted in future periods).

Depreciation is calculated from a month following the month when the asset was put into use until it is fully depreciated, disposed, or written off. The maximum annual depreciation rates applicable to different types of fixed assets are outlined in the table below.

| Depreciable item | Rate (%) |
|---|---|
| Buildings and other structures | 5 |
| Cars, tractors, special equipment, computers and related hardware | 20 |
| Lorries, buses, special cars and trucks, industrial machinery and equipment, agricultural machinery and equipment, oil extraction and mining equipment, office furniture | 15 |
| Railway, river and air transport vehicles, thermo-technical equipment, turbines, electric and diesel drives, power supply and communication lines, pipelines | 8 |
| Depreciable assets not mentioned above | 10 |

For statutory accounting purposes, fixed assets can be depreciated using one of the following methods:

- Straight-line.
- Production method.
- Double-declining-balance method.
- Sum-of-the-years’ (cumulative) method.

Intangible assets, including leases and other property rights, are amortised over the shorter of an asset’s useful life or the period of activity of the enterprise. Where an asset’s useful life cannot be determined, the asset would be amortised over five years.

Expenses related to geological exploration and developmental works necessary for the extraction of natural resources are deductible for CIT purposes through depreciation at the rate of 15% per annum.

### *Interest on short-term loans*
Interest is deductible, except for interest on overdue/delayed loans (i.e. ‘penalty interest’) and interest capitalised in the value of fixed assets (i.e. in cases where a loan was obtained to purchase fixed assets).



### *Taxes*
Generally, taxes are deductible for CIT purposes. The exceptions are the infrastructure development tax based on after-tax profits and the net profit tax for PEs.

### *Other tax losses*
In cases where goods or services are sold below cost (or given for free), the revenue should be adjusted for tax purposes to the cost or purchase price of the goods or services.

Production wastes and defects within statutory norms, and losses resulting in force-majeure circumstances are generally deductible.

Losses from the disposal of fixed assets also may be deducted, if the fixed asset has been used for three or more years.

### Net operating losses
Tax losses may be carried forward for a period of five years, allowing a reduction of taxable income of the respective year by up to 50%. Loss carrybacks are not permitted.

## Group taxation

There is no provision for consolidation of income or losses by related companies for tax purposes in Uzbekistan. A foreign legal entity that has several PEs in Uzbekistan may not consolidate those for tax purposes.

### Transfer pricing
As of 1 January 2010, the transfer pricing concept was reintroduced in the Uzbek Tax Code. However, it is limited to a couple of paragraphs stating that tax authorities may adjust prices used by interrelated parties if these prices differ from the prices which would have been used in transactions with independent parties. There is no further guidance for application of this rule, which gives rise to different interpretation by tax authorities and taxpayers.

### Thin capitalisation
Effective legislation does not provide for thin capitalisation rules, except for debt-to-equity ratios set up by the Central bank of Uzbekistan (CBU) for commercial banks.

## Tax credits and incentives

The current tax legislation offers tax incentives for enterprises in oil and gas exploration/development projects, enterprises engaged in the production and export of goods for foreign currency (when export share exceeds 15%), and companies rendering certain services.

### Incentives for oil and gas exploration and extraction companies
Foreign companies carrying out oil and gas exploration works, as well as their foreign contractors/subcontracts engaged in such works, are exempt from payment of all forms of taxes and contributions to non-budget funds during the exploration period. Additionally, import by these companies of equipment, material, and technical resources and services necessary for the exploration and related works is exempt from customs duties.

Resident corporations supplying materials and rendering services to foreign companies carrying out oil and gas exploration are exempt from VAT.

Furthermore, if foreign companies carrying out oil and gas exploration form joint venture companies for extraction of oil and gas at respective fields, such companies are granted a seven-year CIT holiday starting from the date of commencement of extraction.

### *Incentives for carrying out export activities*
Enterprises exporting goods (works, services) of their own production for freely convertible currency may apply reduced rates of CIT as follows:

- If export share of total sales ranges from 15% to 30%, the effective rate shall be reduced by 30%.
- If export share of total sales is 30% or more, the effective tax rate shall be reduced by 50%.

This incentive is applied likewise in regards to property tax as follows:

- If export share ranges from 15% to 30%, the property tax rate is reduced by 30%.
- If export share is 30% or more, the property tax rate is reduced by 50%.

The incentive in both cases is subject to a restriction that it does not apply to wholesale/retail sale or intermediary companies, nor to revenues from the export of specific items such as cotton fibre, oil, gas, precious metals, etc.

Producers can also defer payment of their import VAT in respect of material and technical resources used for production of goods to be exported. The deferral is granted for up to 90 days without application of any interest.

### *Incentives for service companies*
Microfirms and small enterprises engaged in certain types of activity are exempt from CIT and unified tax payment until 1 January 2012. These types include, without limitation, leasing, insurance, auditing/bookkeeping services, and repair of footwear and leather goods.

### *Exemptions from customs payments*
There are certain customs exemptions offered by the legislation for the following:

- Technological equipment imported by foreign investors as their charter fund contribution.
- Technological equipment imported under projects for creation of new or the modernisation of existing production facilities (with appropriate certificates issued by an authorised bank).
- Property imported for production needs by foreign investors and enterprises with foreign investment with foreign participation in the equity of not less than 33%.

### *Foreign tax credit*
In accordance with international tax treaties of the Republic of Uzbekistan, legal entities/residents of Uzbekistan can obtain a tax credit in respect of CIT paid outside of Uzbekistan. In order to claim tax credit, legal entities should provide a copy of tax payment order, confirmation from a competent tax authority, or any other document confirming payment of the tax outside of Uzbekistan.



## *Withholding taxes*

WHT is to be withheld and remitted to the state budget by entities paying income to non-residents if these entities qualify under a tax agent definition (i.e. by (i) Uzbek legal entities and (ii) non-residents operating in Uzbekistan via PE).

The domestic WHT rates are as follows:

| Payment | WHT (%) |
|---|---|
| Dividends and interest | 10 |
| Insurance and reinsurance payments | 10 |
| Freight | 6 |
| Royalties, services (including management, consulting services), rents, other income | 20 |

### *Double taxation treaty (DTT) relief*

Foreign legal entities that do not carry on activities in Uzbekistan through a PE are subject to WHT on income from sources in Uzbekistan, subject to the terms of a relevant DTT. Uzbekistan has signed DTTs with 50 countries; 46 of them are in force.

DTTs in force establish WHT rates as follows:

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Austria | 5 (2)/15 | 10 | 5 |
| Azerbaijan | 10 | 10 | 10 |
| Bahrain | 8 | 8 | 8 |
| Belarus | 15 | 10 | 15 |
| Belgium | 5 (2)/15 | 10 | 5 |
| Bulgaria | 10 | 10 | 10 |
| Canada | 5 (1)/15 | 10 | 5 (3, 4)/10 |
| China | 10 | 10 | 10 |
| Czech Republic | 10 | 5 | 10 |
| Finland | 5 (1)/15 | 5 | 5 (5)/10 (4) |
| France | 5 (2)/10 | 0 (7,9,12)/5 | 0 |
| Georgia | 5 (8)/15 | 10 | 10 |
| Germany | 5 (8)/15 | 0 (9)/5 | 3 (3, 10)/5 (4) |
| Greece | 8 | 0 (7)/10 | 8 |
| Hungary | 10 | 0 (15)/10 | 10 |
| India | 15 | 0 (7)/15 | 15 |
| Indonesia | 10 | 10 | 10 |
| Iran | 8 | 10 | 5 |
| Israel | 10 | 10 | 5 (4)/10 |
| Italy | 10 | 0 (9)/5 | 5 |
| Japan | 15 | 0 (7,9)/10 | 0 (4)/10 (3, 5, 6, 10) |
| Kazakhstan | 10 | 0 (7,9)/10 | 10 |
| Kuwait | 5 (8)/10 | 0 (7,9)/8 | 20 |
| Kyrgyzstan | 5 | 5 | 15 |
| Latvia | 10 | 0 (7,9)/10 | 10 |
| Lithuania | 10 | 0 (7,9)/10 | 10 |
| Luxembourg | 5 (8)/15 | 0 (7)/10 | 5 |
| Malaysia | 10 | 0 (9)/10 | 10 |
| Moldova | 5 (1)/15 | 0 (7,9)/10 | 15 |
| (The) Netherlands | 5 (8)/15 | 10 | 10 |
| Oman | 7 | 7 | 10 |
| Pakistan | 10 | 0 (7,14)/10 | 15 |
| Poland | 5 (11)/15 | 0 (7,9)/10 | 10 |

| Recipient | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Romania | 10 | 0 (14)/10 | 10 |
| Russia | 10 | 0 (7,14)/10 | 0 |
| Saudi Arabia | 7 | 7 | 10 |
| Singapore | 5 | 5 | 8 |
| Slovak Republic | 10 | 10 | 10 |
| South Korea | 5 (8)/15 | 5 | 2 (10)/5 |
| Switzerland | 5 (11)/15 | 0 (12)/5 | 5 |
| Thailand | 10 | 0 (9)/10 (13)/15 | 15 |
| Turkey | 10 | 0 (7,9)/10 | 10 |
| Turkmenistan | 10 | 0 (7,9)/10 | 10 |
| Ukraine | 10 | 10 | 10 |
| United Kingdom | 5 (11)/10 | 5 | 5 |
| Vietnam | 15 | 0 (9,12)/10 | 15 |

Notes

1. Where the beneficial shareholder owns no less than 10% of the voting shares.
2. Where the beneficial owner holds at least 10% of the capital of the paying entity.
3. Where royalties are paid for patents, trademarks, know-how, etc.
4. Where royalties are paid for copyrights on literature, cinema, musical works, etc.
5. Where royalties are paid for secret formulas, processes, or know-how.
6. Where royalties are paid for computer software, patents, designs, models, or plans.
7. Where one of the following conditions is met: (a) recipient is a local authority or corporate body constituted under public law, including the central bank of the state, or interest is paid by the local authorities or corporate bodies; (b) interest is paid in respect to debt claims or loans, guaranteed, insured, or aided by the state or on behalf of the state; (c) interest is paid in respect to credit sales of industrial, commercial, scientific equipment of goods and merchandise or provision of services by an enterprise to another enterprise; or (d) interest is paid in respect to a loan of any kind granted by a bank.
8. Where the beneficial shareholder owns no less than 25% of the capital of the paying entity.
9. Where the recipients of the interest are governments of contracting states or any governmental body (such interest is exempt from WHT).
10. Where royalties are paid in respect to uses or the rights to use industrial, commercial, or scientific equipment.
11. Where the beneficial shareholder owns no less than 20% of the voting shares.
12. Where interest is paid in respect to: (a) a loan made, guaranteed, or insured by the government of the other state; (b) the sale on credit of industrial, commercial, or scientific equipment; (c) the sale of merchandise by an enterprise to another enterprise; or (d) a loan of any kind granted by a bank.
13. Where the interest is received by any financial institution (including insurance companies).
14. Where interest is beneficially owned by the other contracting state or local authority or an instrumentality of such other state authority and is not subject to tax by that other state.
15. Where the recipients of the interest are governments of contracting states, National Bank of Hungary, Eximbank Hungary Pte. Ltd., Central Bank of Uzbekistan, or the National Bank of Uzbekistan for foreign economic activity (such interest is exempt from WHT).

Note that there may be other WHT rates offered by protocols to the individual treaties.



## Tax administration

### Returns

CIT is reported quarterly before 25th day of the month following the reporting quarter, with an annual return due by 25 March following the reporting year for enterprises with foreign investment and 15 February following the reporting year for other categories of CIT payers. PEs report on CIT once a year prior to 25 March following the reporting year.

### *Payment of tax*
Uzbek enterprises, including enterprises with foreign investment, are required to make advance instalments of CIT in each quarter based on estimated profits in the quarter. The instalments are payable by the 15th day of each month. Final quarterly payments based on actual profit figures are payable no later than the filing deadline for the quarterly tax returns (which is the 25th day of the month following the period of assessment). In case the final quarterly payment is more than 10% higher than advance instalments made in this quarter, tax authorities have the right to recalculate the advance instalments based on the actual quarterly profit figures and charge late payment interest accordingly.

Final CIT payment should be made no later than the date set as the deadline for annual return submission.

Payment of CIT by PE is made annually within a month after the filing deadline.

# *Venezuela*

## *PwC contact*

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## *Significant developments*

In 2010, the General Assembly of Venezuela's Legislative Branch created and amended a variety of legal instruments related to taxation, as detailed below.

### *Anti-drugs contribution*

The Organic Drug Law published on 15 September 2010 stipulates that any company employing 50 or more employees must make an annual 1% contribution from their operating profit. Such corporations that are dedicated to the manufacture or import of alcohol beverages, tobacco, or their mixtures are required to make a 2% contribution from their operating profit. Note that under the definitions established by this Law, operating profit can be understood as the result from subtracting the operating expenses from the income profit in accordance with the accepted Venezuelan general accounting principles.

This contribution will be collected by the National Anti-Drug Fund (FONA) within 60 continuous days counted from the end of the fiscal year.

Note that this contribution can be retrieved if the company performs:

- prevention programs and projects intended for the company employees and their family environment
- prevention programs for children and adolescents, or
- programs to fight drug trafficking.

### *Science, technology, and innovation contribution*

An amendment to the Law on Science, Technology, and Innovation (LOCTI, by its Spanish acronym), dated 16 December 2010, establishes a mandatory contribution to be paid by companies that obtained, in the previously fiscal year, over 100,000 tax units (TU 100,000) in gross income.

The kind of companies that are required to make this contribution include stock companies, limited liability companies, partnerships, communities, irregular associations, associations, foundations, permanent establishments (PEs), or fixed bases located inside or outside the national territory with current activities in Venezuela.



Contributions established in the LOCTI are as follows:

- Companies engaged in activities related to bingos and casinos, alcoholic drinks, or tobacco must annually contribute 2% of gross income.
- Private companies engaged in hydrocarbon activities, including gaseous hydrocarbons, or mining activities must annually contribute 1% of gross income.

- Companies engaged in other economic activities must annually contribute 0.5% of gross income.
- Companies that perform activities with two different percentages will apply the highest one.

The National Fund for Science, Technology, and Innovation (FONACIT) is the entity responsible for the administration, collection, control, verification, and qualitative and quantitative determination of the contributions.

Although the contribution to FONACIT is mandatory, companies can retrieve these resources provided that, in the third quarter of each year, an annual investment in science, technology, and innovation, containing the projects planned for the next year, is made, in line with priority areas and guidelines established by the national authority.

At present, the National Government has given, informally, the following areas as a priority to which projects should focus on in the annual plan:

- Housing and habitat.
- Dynamics, trends, and challenges for urban development.
- Impact of climate change.
- Energy efficiency.

### *Increase in the windfall tax on oil production*
In April 2011, the National Government enacted Decree N° 8.163 that increased the windfall tax on oil prices *(see the Other taxes section for more information)*.

## *Taxes on corporate income*

Corporations resident in Venezuela are subject to corporate income tax (CIT) on their Venezuelan and foreign-source income, whereas corporations resident abroad with a permanent establishment (PE) in Venezuela are levied CIT on only their Venezuelan and foreign-source income attributable to said PE. Corporations are able to claim any similar taxes paid abroad on foreign source income as a tax credit. Non-resident corporations without a PE are subject to CIT only on Venezuela-source income.

Corporate income is taxed at the following progressive rates based on tax units *(see below)* (i.e. Tariff 2):

| Taxable income | | | |
|---|---|---|---|
| **Over (TU)** | **Not over (TU)** | **Rate (%)** | **Subtract (TU)** |
| 0 | 2,000 | 15 | 0 |
| 2,000 | 3,000 | 22 | 140 |
| 3,000 | – | 34 | 500 |

### *Tax units (TU)*
The 1994 Income Tax Law reform established the concept of a taxable unit as an element that reduces the negative effects created by inflation on the determination of the tax rates. The tax code established the initial TU at 1 bolívar fuerte (VEF), with annual basis adjustments according to the variation on the consumer price index (CPI) from the previous year. During 2010, the TU was VEF 65. For 2011, it was VEF 76.

### *Additional rates and considerations*

Income for oil exploitation and certain related activities is taxed at a flat rate of 50%. Related activities are comprised of those such as refinery, transportation, and purchases for the exports of hydrocarbons and by-products for the exploitation. Joint venture corporations are also subject to a 50% CIT rate.

The above indicated regime does not apply to corporations engaged in the exploration and exploitation of non-associated gas (and the processing, refining, transportation, distribution, commercialisation, and exportation of the gas and its components) or companies exclusively engaged in the refining of hydrocarbons or improvement of extra heavy oil, which are subject to Tariff 2.

## *Corporate residence*

According to the Venezuelan tax code, the following companies are regarded as resident:

- Companies incorporated in Venezuela and registered with the Mercantile Registry as established by commercial law.
- Foreign companies registered with the Superintendence of Foreign Investments (SIEX) to be resident in Venezuela as branches duly registered with the Mercantile Registry.

The following companies are non-residents but subject to Venezuelan taxes:

- Foreign companies registered with SIEX to provide technical assistance, technological services, royalty items, and professional services from abroad.
- Foreign banks granting loans to local companies.
- Foreign companies leasing goods to local companies.
- Foreign companies deriving income from economic activities carried out in Venezuela or from assets in Venezuela.

### *Permanent establishment (PE)*

According to the Venezuela Income Tax Law (VITL), generally, a passive party is deemed to be carrying out operations in Venezuela through a PE when:

- The passive party owns, directly or through an agent, employee, or representative in the Venezuelan territory,:
  - an office, fixed place of business, or an activity centre where its activities are totally or partially carried on
  - management head quarters, branches, offices, factories, shops, facilities, warehouses, stores, construction, installations, or assembling works, when the duration thereof exceeds six months, or
  - agencies or representatives authorised (according to the VITL) to contract in the name of or on behalf of the passive party.
- The passive party performs, directly or through an agent, employee, or representative in the Venezuelan territory, professional, artistic activities.
- The passive party possesses, directly or through an agent, employee, representative, or other contracted personnel in the Venezuelan territory, other work places where the operations are wholly or partially performed.

Any agent acting independently shall be excluded from this definition, except if such representative has the power to conclude contracts in the name of the principal.

## Other taxes

### Value-added tax (VAT)

Federal VAT, Impuesto al Valor Agregado (IVA), is a one-time tax payable by the ultimate consumer of all types of products and services. However, each business entity involved in the process from the sale of raw materials to the production and distribution of finished products to the ultimate consumer is required to include the tax on its products to customers (output tax) and to pay the tax on its purchases or imports of goods and services (input tax), crediting the amounts paid against the amounts due on its own activities. The net amount payable by each entity is considered to represent a tax on the value added.

In general, VAT does not represent an additional cost to business enterprises because even though all types of business enterprises, including government departments and agencies (with some exceptions), are required to accept charges of the tax by suppliers on their purchases of goods and services, such amounts are normally deductible from the liability of the business enterprises for the tax on their bills to customers.

There are exceptions, principally when the sales of an enterprise are exempt from VAT, in which case the enterprise is treated as the final consumer and must absorb any VAT charges on its purchases except insofar as its activities are subject to the zero rate *(see below)*. However, input tax paid on goods or services used to produce items that are exempt from VAT may be deducted for CIT purposes.

#### Taxable transactions

In general, VAT is payable on all sales, rental, and importation of goods, and rendering of services executed or used in the country, although a number of significant exceptions are provided by law.

#### Sales of goods

The law defines a sale as any transmission of tangible goods, including those made on a conditional basis or through an irrevocable trust. The taxable amount of a sale includes the sale price as well as other amounts charged to the purchaser for other taxes, duties, interest, or surcharges of whatever nature. VAT becomes payable when the goods are invoiced or shipped to the customers or when the price is paid in full or in part.

Exempt sales include the following:

- Certain foods and other products for human consumption.
- Fertilisers as well as any natural gas used in the manufacturing thereof.
- Some products for animal consumption.
- Medicine.
- Products derived from hydrocarbons and some raw materials intended to improve the quality of gasoline.
- Wheelchairs.
- Books, magazines, newspapers, and the paper used in producing these products.
- Vehicles, aircraft, and trains for passenger transport.
- Machinery and equipment for agribusiness.
- Scientific equipment purchased by the government.

#### Services

Taxable services are those rendered within Venezuela by one person to another on an independent basis, transportation of passengers or goods, agency activities, technical assistance, and transfer of technology. VAT is payable to service providers at the time the invoice is issued, the service is rendered, or the fee becomes demandable, whichever comes first. The taxable amount includes not only the price of services, but also charges to the customers for other taxes, interest, etc.

Exempt services include the following:

- Domestic land and maritime transportation of passengers.
- Educational services.
- Accommodations for students and persons with disabilities.
- Healthcare and dental services, surgery, and hospitalisation.
- Theatres, sports, and cultural events.
- Food services for employees and students.
- Certain utilities (e.g. electricity, water).
- Housecleaning.
- Transport services for hydrocarbon-derived fuels.
- Services involving livestock, poultry, and other minor species including breeding and production.

**Exports**

Exports are zero-rated. Consequently, VAT is not payable on exports, including exports of in-bond processing companies, technical fees to foreign residents, and sales to in-bond processing companies and companies that export their entire production. Sale of natural hydrocarbon by joint ventures regulated by the Hydrocarbon Law to Petroleos de Venezuela S.A. (PDVSA) and affiliated companies are also taxable at 0%. Though exporters do not collect VAT on export sales, they may recover VAT charges on their purchases of goods and services by means of a refund certificate. This certificate may be used to pay other tax obligations. If such exporters carry out sales in the country, they will be entitled to recover only input VAT related to foreign sales.

Additionally, a zero rate applies to independent personal services provided by residents in Venezuela that are used solely by and for the benefit of persons abroad without a PE or fixed base in Venezuela.

**Tax rates**

The rate may change every year, within the range of 8% to 16.5%. Currently the general VAT rate is 12%.

An additional tax rate of 10% is applicable to the sale and imports of luxury products (e.g. vehicles valued at more than USD 30,000, motorcycles with a cylinder capacity of 500 cc, nickel or token game machines, aircraft used for recreational or sport purposes, fighting bulls, trained horses, caviar, jewellery with precious stones valued at a price exceeding USD 500).

An 8% VAT applies to the following transactions:



- Goats, sheep, and minor species for slaughter or breeding.
- Meats in their natural state, or refrigerated, frozen, or salted meats, or meats in brine of goats, sheep, and poultry.
- Shortening.
- Rendering of professional services to any government entity, in any level or branch of government, provided such services do not involve any commercial transactions but rather predominantly intellectual work or efforts.
- Domestic air passenger transportation.

### Payment and collection
Excess VAT charged or chargeable to customers over VAT paid to vendors or customs authorities — Servicio Nacional Integrado de Administración, Aduanera y Tributaria (SENIAT) — including the correspondent payment, must be remitted to SENIAT within the first 15 days of the following month.

### VAT exoneration
Among the fiscal policy measures applicable pursuant to the conjuncture, sector, and regional situation of the country's economy, the National Executive is entitled to exonerate the import and sales of goods and the rendering of services set forth in the respective decree from the payment of VAT.

### Refunds/special regime for industrial projects
The VAT law stipulates a special regime for taxpayers engaged in the execution of industrial projects, whose duration exceeds six taxable periods. Pursuant to this regime, taxpayers will be able to suspend the use of input VAT generated during their operating stage, until such time as they begin generating fiscal output VAT.

Taxpayers engaged in the execution of industrial projects aimed at exporting or generating foreign currency may (with prior consent of the tax authorities), choose to recover the tax supported in construction operations involving the project, provided that they are carried out during the pre-operating stage of such project.

Input VAT subject to recovery must be determined after computing output VAT. In other words, input VAT originated from purchases of goods and reception of services is not subject to recovery if output VAT was not subtracted.

### VAT withholding regimes
Taxpayers qualified by the tax administration as special taxpayers and public entities are designated as liable parties in their capacity as withholding agents in regard to payment of the VAT generated in their purchase of tangible goods or services received by providers that are regular taxpayers for VAT purposes.

The amount to be withheld on the part of the agents will be equal to multiplying the invoiced price of the taxed goods or services by 75% of the tax rate, except for those cases in which the VAT does not appear separately from the price, when the respective invoice does not comply with the formalities or requirements set forth in the tax law, or when the supplier is not registered for tax purposes. In these latter cases, 100% of the generated tax is to be withheld.

Suppliers may discount the VAT withheld from the tax liability determined for the period in which the VAT was withheld, provided that they have the receipt issued by the withholding agent. In those cases in which the tax withheld from the taxpayer exceeds the taxpayer's VAT liability corresponding to the relevant tax period, such taxpayer may discount the tax withheld from VAT liability corresponding to the following tax periods until their total exhaustion.

## *Municipal business licence tax*
Companies and business entities, as well as individuals and unincorporated companies, are subject to municipal tax on gross income from industrial or trade activities carried on in the municipality during the fiscal year. The rates range from 0.1% to 10.0%, depending on the activity and the municipality.

### Urban Property Tax
The Urban Property Tax is a local or municipal tax payable by any person who owns property rights or any other real rights on urban real estates. The taxable basis is the value of the urban real estate. For these purposes, the fair market value of the real estate is provided as a point of reference. The applicable rate varies according to each municipality.

### Other municipal taxes
Municipalities also tax vehicles, public entertainment, legal bets, and commercial advertisements. There also are various municipal tariffs and fees.

### Excise taxes
#### Tax on alcohol and alcoholic beverages
In general terms, the manufacture, commercialisation, and importation of alcohol and alcoholic beverages are subject to excise taxes. The Law of Tax on Alcohol and Alcoholic Beverages provides for three main types of excise taxes:

- Tax on the national production and importation of alcohol and alcoholic beverages, which is established on the basis of TU per litre and varies depending on the type of product.
- Additional excise tax per litre for national and imported beer and for other alcoholic beverages is levied on the sale of those products to the public, which is also provided on the basis of TU per litre, depending on the type of product.
- In addition to the above, another excise tax is imposed on the importation or local sale of national and imported alcoholic beverages to the public, which is levied on the sales price, which is provided on the basis of a percentage on the price of sale to the public and varies depending on the type of product.

#### Tax on cigarettes and manufacturing of tobacco
The importation and national production of cigarettes and tobacco to be consumed in Venezuela is subject to an excise tax. This proportional tax is levied at a rate of 70% on the retail price of cigarettes, tobacco, and its derivates.

### Customs duties
As a general rule, the importation of goods into Venezuela is subject to customs duties. These duties are generally levied on the cost, insurance, and freight (CIF) value of the product being imported, excluding VAT.

Custom duty rates generally range from 5% to 35%. The duty rates vary depending on the product involved. In general, import tariffs are 5% for capital goods, 10 to 15%for raw materials and intermediate goods, and 15 to 35% for finished products. In addition, all imports are subject to customs handling charge, a duty import, and VAT.

### Gift tax
Overall, the Inheritance and Donations Tax Law, published on 1999, stipulates the taxes attributable to inheritances left by individuals. Nonetheless, this Law provides regulation about donations, which are significant to corporations. Subject to payment of the gift tax are the beneficiaries of gifts in the form of movable or real property, rights, or shares located in the country.



For tax calculation purposes, the progressive tax rate (up to 55%) set forth in the Law will be applied to the donated good. Both donors and donees are jointly liable for the tax generated from the gift.

The gift tax is applicable from the time in which the donors manifest before the National Treasury their will to donate and must be paid before the registration of any document formalizing or evidencing the authenticity of the gift. Should the donation not be perfected due to express will of the donor or rejection on the part of the donee, the obligation to pay the tax will be eliminated and reimbursement may be requested of the amounts paid in this connection.

Under the transfer pricing rules contained in the Venezuelan Income Tax Law, the tax authorities are empowered to impute income in inter-company transactions at a price reflecting the fair market value of the property being transferred.

Before the introduction of transfer pricing rules, under the Inheritance and Donations Tax Law, the tax authorities could and still can presume in transactions involving a sale, assignment, barter, or transfer, the existence of a donation if, for instance, the price stipulated in such transaction does not reflect the real value of the property being transacted. In such a case, a gift tax may be imposed on the difference between the fair market value of the property being transacted and the consideration received in return.

Also, a cancellation of a debt gives rise to gift tax issues. In this regard, the Inheritance and Donations Tax Law provides that the total or partial forgiveness or cancellation of a loan must be viewed as a gift and, as such, subject to gift tax.

### *Increase of the windfall tax on oil production*

Decree N° 8.163, dated 18 April 2011, provides for the increase of the windfall tax on oil companies. The aforesaid Decree abrogates the regulations on the tax published on April 2008. According to the enacted Decree, the tax is provided in the following terms:

- The contribution on extraordinary oil prices is a 20% tax on the difference in price when the internationally quoted price per barrel exceeds the budgeted price per barrel (for purposes of the Venezuelan Annual Budget Law), provided that the quoted price per barrel is equivalent or lower than USD 70 per barrel (i.e. the maximum basis is the difference between USD 70 per barrel and the current budgeted price of USD 40).
- The contribution on exorbitant oil prices is comprised of the following:
  - 80% tax on income generated by quoted oil prices between USD 70 and USD 90 per barrel (i.e. 80% on the range from USD 70 to USD 90 quoted price per barrel).
  - 90% tax on the difference in the quoted oil prices between USD 90 and USD 100 per barrel.
  - 95% tax on the difference over the threshold of USD 100 per barrel.

The tax is payable by oil companies exporting with sale purposes. Also, the Decree provided that the mixed companies (empresas mixtas) created in accordance with the Master Hydrocarbons Law that sell oil and by-products to the state-owned company (PDVSA), or any of its affiliates, are also obliged to pay the above described tax.

On the other hand, tax exemption is provided for the following cases:

- For mixed companies working on the execution of projects on the development of new oil fields and those projects aimed at boosting oil production as declared by the Ministry of the Popular Power for Oil and Energy, until they have recovered their total investment. Parameters to determine the recovery of investment are to be separately established by the aforesaid Ministry by Resolution.
- Exports executed in connection with cooperation or financing international agreements.

- Exonerations may be granted by the National Executive Power for exports executed under economic or international cooperation measures.

The tax is payable on a monthly basis in foreign currency. Other terms of payments are to be regulated by Resolution.

The Decree also establishes USD 70 per barrel as the maximum price to be used as calculation basis for the payment of royalties, extraction tax, and export registration tax provided for in the Master Hydrocarbons Law.

### *Hydrocarbons Organic Law*

The state is entitled to 30% of the volume of hydrocarbons extracted from any deposit, by way of royalties. The National Executive can reduce this within certain limits, when it is shown that certain types of deposits are not economically exploitable.

Persons conducting activities related to hydrocarbons must pay the following taxes:

#### Surface tax

For the portion of the surface area granted that is not under development, the equivalent of 100 TU for each square kilometre or portion of a square kilometre for every elapsed year is due as a surface tax. This tax will increase annually by 2% during the first five years and 5% during the following years.

#### Tax on own consumption

10% of the value of each cubic metre of hydrocarbon byproducts produced and consumed as fuel in wholly-owned operations, based on the price of the end consumer, is due as a tax. In the case that said product fails to be sold in a domestic market, the Ministry of Energy and Mines shall provide the price.

#### General consumption tax

For every litre of hydrocarbon byproducts sold in the domestic market, a tax id due at the rate of between 30% and 50% of the price paid by the end consumer, whose aliquot should be implemented annually between the two extremes under the Budget Law. This levy to be paid by the end consumer should be withheld at the supply source, to be handed over to the National Treasury on a monthly basis.

The National Executive may waive, in whole or in part, by the time specified, the general consumption tax, in order to encourage certain activities of public or general interest. The National Executive can also reinstate this levy to its original level when the causes for the waiver cease to exist.

### *Gaseous Hydrocarbons Organic Law*

The Gaseous Hydrocarbons Organic Law establishes a system of royalties, determinable by the volumes of gaseous hydrocarbons extracted from any deposit and not re-injected. The state is also entitled to a 20% share for this item.



The exploitation companies of gaseous hydrocarbons shall pay for the gaseous hydrocarbons consumed like fuel, the taxes settle down on the matter by applicable laws.

### *Stamp duties*

The Stamp Duties Law establishes a number of stamp duties on the issuance of official documents (e.g. certificates, permits, authorization, registrations). Stamp duties may be levied at fixed amounts (ranging from TU 0.01 to TU 10,000) or at a rate based on the value of the transaction or work in question.

### *Public registry tax*

Commercial companies are registered with the Mercantile Registry Office and are subject to a tax levied upon incorporation of a company and registration of capital increases. The tax is 1% of the amounts of subscribed or increased capital.

The sale of a going concern is also registered in the Mercantile Registry Office and is subject to a tax levied upon the total amount of the sell. The tax is 2% of the amount.

### *District Capital stamp tax*

On December 2010, a new District Capital Stamp Law was published. Under their own interpretation of the Law, Mercantile Registries of the District Capital are charging 10% of the amount of subscribed or increased capital of companies and 20% for the sale of a going concern.

### *Payroll taxes and other contributions*

Contributions applicable to resident companies in Venezuela:

| Contributions | Basis | Contribution basis (cap) | Employer contributions (%) | Employee contributions (%) | Notes |
|---|---|---|---|---|---|
| Mandatory social security regime contribution | Wages (normal or regular wages) | Up to five minimum salaries for urban workers | 9/10/11 | 4 | (1, 2, 5) |
| Employment benefit regime contribution | Wages (normal or regular wages) | Up to ten minimum salaries for urban workers | 2 | 0.5 | (1) |
| Housing regime contribution | Total monthly (or integral) salary | No cap (5, 6) | 2 | 1 | (5) |
| Employee training contribution (INCES) | Total salaries paid by the employer for purposes of the employer's contribution. | No cap | 2 | 0.5 (4) | (3, 4) |
| Workplace prevention, conditions, and environment contribution (LOPCYMAT) | Total salaries paid to employees | No cap is established | From 0.75 to 10 | N/A | (6),(7) |

Notes

1. As of 1 May 2011, the minimum monthly metropolitan salary amount was increased to VEF 1, 407.47. As of 1 September 2011, it will be increased to VEF 1,548.21.
2. According to the current system, the employer's contribution to social security will depend on the company's risk qualification (minimum risk, middle risk, or maximum risk).
3. Regarding Instituto Nacional de Capacitación y Educación Socialista (INCES) contribution, the employer must contribute 2% of the total wages and salaries paid to employees.
4. Employers are also required to withhold 0.5% of the annual profit-sharing bonus paid to employees.
5. According to the Ley Orgánica del Sistema de Seguridad Social (LOSSS), the general rule for contribution basis for the new systems may not exceed ten minimum salaries. The transition rules establish a contribution basis of five metropolitan minimum salaries for urban workers for social

security purposes. No cap is expressly established in the transition rules for the housing system and work, security, and health regime.
6. Contributions to be made to this regime are exclusively for the employer and vary depending on the risk associated to the company. A company's risk is to be determined by the Instituto Nacional de Prevención, Salud y Seguridad Laborales (INPSASEL). To date, INPSASEL has not been created and employers will continue making their contributions to the Venezuela Social Security Institute.
7. Ley Orgánica de Prevención, Condiciones y Medio Ambiente de Trabajo (LOPCYMAT) regulations do not establish a cap for the contribution. However, as mentioned, the LOSSS establishes a maximum of the minimum urban salaries. For this reason, there are several contrary interpretations on whether a cap should be applied in this case.

| Other contributions | Basis | Contribution basis (cap) | Employer contributions (%) | Employee contributions (%) |
|---|---|---|---|---|
| Science, technology, and innovation contribution (LOCTI) (1) | Total annual income | N/A | 0.50/1/2 | N/A |
| Anti-drug contribution (LOD) (2) | Operating profit | N/A | 1/2 (3) | N/A |

Notes

1. Ley Orgánica de Ciencia, Tecnología e Innovación (LOCTI)
2. Ley Orgánica de Drogas (LOD)
3. 2% in the case of companies that manufacture or import alcohol beverages or tobacco. 1% for all other companies.

## *Branch income*

Branches of foreign corporations are subject to the same tax rules as Venezuelan corporations. Inter-branch income and deductions must be eliminated. The positive difference between a branch's annual book and taxable income is deemed to be remitted to the branch's head office (branch profits tax). Such remittances are subject to the 34% flat dividend tax *(see Dividend tax in the Income determination section for more information)* regardless of whether there is an actual payment unless the branch can provide proof of reinvestment of its profits for a five-year period. If such proof is established, no deemed remittance is assumed.

A Venezuelan taxpayer has to recognise, annually on an accrual basis, income generated in a company or other legal entity it controls which is located in a jurisdiction with low fiscal taxation (JLFT). Further, investments in JLFT must be declared to the SENIAT.

## *Income determination*

### *Inventory valuation*

Inventories may be valued at cost or the lower of cost or market value. Any method generally accepted for accounting purposes can be accepted for tax purposes.



### *Capital gains*

Capital gains are taxable as ordinary income, and capital losses are deductible from ordinary income. Note that capital losses resulting from the sale of stock, capital reduction, or liquidation of a company are only deductible if they meet one of the following conditions:

- The cost of the capital stock was not in excess of the price quoted on a stock exchange or an amount with a reasonable relationship to the book value of the capital stock.

- The holding period of the investment was for at least two years immediately preceding the date of the sale.
- The stockholder proves that the company selling the shares carried on economic activities for at least two years, preceding the date of sale.

At present, the tax law contains two different rulings relevant to the deductibility of losses incurred through operations on the Venezuelan Stock Market, one of which has been described above. The second ruling pertains to income obtained from operations on the local market. This income is subject to a final 1% tax that is withheld at the source. Losses in this kind of operation are not deductible against other income. Corporate shareholders not domiciled in Venezuela may not deduct such losses from other taxable income other than dividends arising from Venezuelan sources.

Gains upon liquidation or reduction of capital are taxable to the liquidating entity.

### *Dividend income*

A dividend tax is levied at a flat rate of 34% on the positive difference between book income and tax income generated after 2000. Book income is understood to be that approved at a shareholders' meeting and based on the financial statements prepared pursuant to generally accepted accounting principles. To determine the applicable difference, a last in first out (LIFO) method applies. The tax is triggered when dividend is paid and shall be remitted via withholding. Withholding is to be made at the moment a dividend is declared or credited to the account a recipient. The 34% (domestic) rate can be mitigated under tax treaties.

Dividends obtained from companies incorporated or resident abroad or incorporated abroad and resident in Venezuela are taxed at a flat 34% rate.

### *Stock dividends*

Dividends of stock are subject to payment of the aforementioned dividend tax. Moreover, stock dividends are subject to an advanced payment of dividend tax equivalent to 1% of the dividend distributed. Stock dividends have no cost for tax purposes.

### *Foreign income*

Extraterritorial income is subject to Venezuelan CIT based on the concept of worldwide income taxation, according to which:

- Resident companies must pay a tax on total income whether from national or foreign source.
- Non-resident companies with PE in Venezuela will pay tax on their income, whether of national or foreign source, attributable to the Venezuelan PE.
- Non-resident companies will pay taxes on their income originated or caused in Venezuela.
- Resident companies as well as non-resident companies with PE in Venezuela may credit the tax paid abroad for earnings of an extraterritorial source against the income tax payable in Venezuela, subject to limitations.
- In general terms, taxation of foreign-source income is ruled by domestic provisions on taxation of territorial-source income. Foreign source dividends are taxable when dividends are received. However, in case of investments located in JLFT, anti-deferral rules in the international fiscal transparency regime apply *(see below)*.

### Foreign technical assistance and services
Taxable income of foreign taxpayers providing technical assistance or technological services from abroad to individuals or entities that use them in Venezuela or assign them to third parties is presumed to be 30% of gross income for technical assistance fees and 50% of gross income for technological service fees. If the contract does not specify the proportion in which the services are rendered, the law provides that 60% of the technical assistance and technological service fees are deemed to be rendered abroad (i.e. foreign-source), with the other 40% deemed to rendered in Venezuela. The law also provides that 75% of the entire income related to technological services and 25% of that related to technological assistance is rendered abroad if not otherwise specified in the contract. *See the Withholding taxes section for more information.*

### International fiscal transparency regime
A regime of international fiscal transparency is created for the purpose of establishing special standards of fiscal control, governing capital investments in countries classified as JLFT, or tax havens. Under certain conditions, a Venezuelan taxpayer may be required to recognise income generated in its JLFT subsidiary on an accrual basis in its tax return.

## *Inflation adjustment*
A system for the adjustment of non-monetary assets, non-monetary liabilities, and shareholder's equity has been established. 'Non-monetary assets' include land, construction, machinery, vehicles, installations, inventories, and investments other than in securities (e.g. bonds and stocks).

There are two phases to the adjustments: (i) initial adjustments and (ii) annual adjustments. Both phases are mandatory adjustments for taxpayers engaged in commercial, industrial, financial, and insurance operations, and in the exploitation of mines and hydrocarbons. The annual adjustment is optional for taxpayers performing non-business activities.

### Initial adjustment
The initial adjustment on depreciable fixed assets requires a registration tax of 3% on the amount of the adjustment.

The initial adjustment must be filed at the closing date of any fiscal year ending after 1 January 1993. This adjustment is applicable to all non-monetary assets and non-monetary liabilities.

The initial adjustment is calculated by applying the variations between the CPI of the Caracas Metropolitan Area prevailing in the month in which the non-monetary assets were acquired and the month corresponding to the initial adjustment. Assets acquired before 1950 are deemed to have been acquired in January 1950.

A registry tax of 3% is applied exclusively to the initial revaluation adjustment of depreciable fixed assets. For payment, taxpayers must be registered with the Asset Revaluation Registry, maintained by the tax administration. The resulting tax may be paid in three consecutive annual instalments, beginning on the date of registration.

Companies in the pre-operating stage, deemed to end with the first invoice, must determine and pay a 3% tax once the pre-operating period has ended.

Depreciation or amortisation on the revaluation adjustment is allowed, based on the original estimated life of the asset.

### Annual adjustment

The annual adjustment is applied each year in determining taxable income. The adjustment factor must be applied to the following balance sheet items at the closing date of the fiscal year. The resulting adjustment will increase or decrease taxable income.

| Balance sheet items | Adjustment factor | Tax effect |
|---|---|---|
| **Non-monetary assets:** | | |
| Inventories (including inventories in transit) (2) | Annual variation of the CPI | Increase taxable income |
| Fixed assets (3) | Annual variation of the CPI | Increase taxable income |
| Other assets, trademarks, patents, production licenses, other rights, and investments in stock not registered in the Superintendencia Nacional de Valores (SNV) and deferred charges (except interest). | Annual variation of the CPI | Increase taxable income |
| Investments in shares registered in the SNV | Adjusted to the share market value at the end of the year | Increase taxable income |
| **Non-monetary liabilities:** | | |
| Deferred credits (except interest) | Annual variation of the CPI | Decrease taxable income |
| **Equity:** | | |
| Tax initial equity (1) | Annual variation of the CPI | Decrease taxable income |

Notes

1. Tax initial equity is defined as the difference between assets and liabilities at the beginning of the tax year, less accounts receivable from administrators, affiliated, and related companies. In order to determine the initial tax equity, assets not located in the country as well as goods, debts, and liabilities entirely applied to the production of deemed, exempt, or exonerated income are excluded.
2. Inventories are to be valued at historical cost for purposes of applying the CPI. The provisions of the income tax law detail the procedures for applying the CPI. The revaluation of inventories in the tax year is included as part of the initial inventories of the following year.
3. The annual revaluation adjustment of fixed assets is considered part of the cost when the assets are sold.

Net losses arising from the annual adjustment that have not been offset may be carried forward only to the next tax period (one year).

Gains or losses originating from the adjustment of accounts receivable or investments, as well as debts and liabilities in foreign currency or with a re-adjustability clause, are deemed to be carried out during the fiscal year in which they become demandable, collected, or paid, whichever comes first.

## *Deductions*

### *Depreciation*

Depreciation is generally computed on a straight-line basis although any other generally accepted method for accounting purposes is also accepted. Depreciation is not allowed on real estate used as rental property. Depreciation on the stepped-up portion of assets revalued by any method other than the inflation adjustments *(see the Income determination section)* is not permitted. In principle, useful lives of assets shall be consistent with the parameters used in accordance with accounting principles.

### Charitable contributions
Deductions for allowable charitable contributions are limited to 10% of taxable income (before deducting contributions) when taxable income does not exceed TU 10,000. When taxable income exceeds TU 10,000, charitable contributions are limited to 8% of taxable income. For oil extraction companies, the deduction is limited to 1% of the pre-contribution tax amount.

### Taxes
Municipal, state, and local taxes are deductible in determining taxable income. Corporate taxes are not deductible.

### Other significant items
Payments required by the labour law, such as profit sharing (generally between 15 days and four months' salary) and severance indemnity accruals are also deductible. In cases of unjustified dismissals, double severance indemnities must be paid. However, accruals for such additional indemnities are generally not deductible until paid.

### Net operating losses
Losses may be carried forward for three years. Losses may not be carried back. Note that losses from inflation adjustments may be carried forward only one year.

Foreign losses may be offset only against foreign profits.

### Payments to foreign affiliates
A Venezuelan corporation may claim a deduction for royalties and technical assistance and for technical service fees paid to foreign affiliates, subject to the following conditions:

- The contract is registered within 60 days of execution with the Superintendence of Foreign Investments (SIEX).
- Income tax payable by the recipient is withheld at the source.
- Transfer pricing requirements are met.
- In the case of technical assistance and technological services fees, the expenses may be deducted if such services cannot be otherwise provided in Venezuela.

Foreign companies domiciled in Venezuela are allowed to deduct royalties paid to parent companies or foreign affiliates. Companies must notify the SIEX of payments made within 60 days *(see the Withholding taxes section for more information)*. Branches of foreign companies, however, may not deduct such payments to head offices or related parties.

## Group taxation

Group taxation is no longer possible in Venezuela.

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### Transfer pricing
Taxpayers that carry out operations with related parties abroad must calculate their income, costs, and deductions by applying a defined methodology of transfer pricing. This regime is applicable to imports, exports, and interest paid to recipients abroad as well as technical assistance, technological services, and royalty fees.

### Thin capitalisation
With the amendment of the 2007 income tax law, Venezuela introduced thin capitalisation rules that limit the deduction of interest from debt with related parties in excess of a 1:1 debt-to-equity ratio. Under these rules, if the average of a taxpayer's debt (with related and unrelated parties) exceeds the average amount of its equity for the respective fiscal year, the excess debt is treated as equity for income tax purposes. Consequently, the ability to deduct interest on related-party loans may be affected.

## Tax credits and incentives

### Capital investment
A special 10% investment tax credit is granted on the value of new investments in fixed assets (excluding land) made by those legal entities obtaining income from industrial and agro-industrial activities, construction, electricity, telecommunications, science, technology, and generally any industrial activity that represents an investment in advanced technology. This tax credit may be taken if such new investments are dedicated to effectively improving the productive capacity or creating a new enterprise.

The tourist sector is entitled to a 75% investment tax credit on the amount of new investments. The agricultural sector enjoys an 80% investment tax credit.

An additional 10% tax credit is granted on the amount of investments in assets, programmes, and activities aimed at the preservation and protection of the natural environment.

Investment tax reductions may be carried forward up to three years.

### Other incentives
Customs duty incentives are also available, such as drawbacks on the import of materials used for exporting products. This may take the form of a tax refund certificate issued by the Ministry of Finance. The certificate is a negotiable bond and will be accepted by the Treasury Funds Office for payment of national taxes. Determination of the amount of the refund will take into account the import duties effectively paid at the time the materials used in the manufacture of the exported product were received in Venezuela.

### Foreign tax credit
Foreign income tax paid on taxable foreign income may be offset by the payable Venezuelan tax up to the proportion of Venezuelan payable tax related to foreign-source income. Taxpayers must keep documentation of foreign tax. No carryforward rules are provided for in domestic regulations.

## Withholding taxes

Resident corporations making certain types of payments must withhold taxes. T2 refers to Tariff 2. These include the following:

| | Resident (%) (1) | | Non-resident (%) | |
|---|---|---|---|---|
| | Corporation | Individual | Corporation | Individual |
| Commissions (2) | 5 | 3 | 5 | 34 |
| Royalties (3) | 5 | 3 | T2 on 90 | 34 on 90 |

| | Resident (%) (1) | | Non-resident (%) | |
|---|---|---|---|---|
| | Corporation | Individual | Corporation | Individual |
| Interest to foreign financial institutions | N/A | N/A | 4.95 | N/A |
| Other interest | 5 | 3 | T2 on 95 | 34 on 95 |
| Professional fees | 5 | 3 | T2 on 90 | 34 on 90 |
| Technical assistance fees (3) | 5 | 3 | T2 on 30 | 34 on 30 |
| Technological service fees (3) | 5 | 3 | T2 on 50 | 34 on 50 |
| Real estate rentals | 5 | 3 | 5 | 34 |
| Tangible personal property rentals | 5 | 3 | 5 | 34 |
| Contractor and subcontractor services | 2 | 1 | T2 | 34 |
| Film and TV exhibition rights | 5 | 3 | T2 on 25 | 34 on 25 |
| Insurance and reinsurance premiums | N/A | N/A | 10 on 30 | N/A |
| Payments to international media organisations | 5 | 3 | T2 on 15 | N/A |
| Acquisition of Venezuela commercial funds | 5 | 3 | 5 | 34 |
| Payments to non-domiciled international transportation companies (4) | N/A | N/A | T2 on 5 | N/A |

Notes

1. Withholding taxes (WHT) constitute prepayments against final tax liabilities as determined by the income tax return when filed.
2. Includes commissions earned in instances other than through a dependent relationship (e.g. employer/employee). Commissions are subject to withholdings in the same manner as salaries and wages.
3. The rates for non-residents are similar to those rates applicable for payments to a non-domiciled corporation not resident in a treaty country and rendering services from abroad with no PE in Venezuela.
4. Excludes payments exempted under international shipping agreements.

### *Tax treaties*

There are currently comprehensive treaties for the avoidance of double taxation with the following countries:

| Recipient | Interest (%) | Dividend (%) | Royalties (%) |
|---|---|---|---|
| Austria | 4.95/10 | 5/15 | 5 |
| Barbados | 5/15 | 5/15 | 10 |
| Belarus | 5 | 5/15 | 5/10 |
| Belgium | 10 | 5/15 | 5 |
| Brazil (not in force) | 15 | 10/15 | 15 |
| Canada | 10 | 10/15 | 5/10 |
| China | 5/10 | 5/10 | 10 |
| Cuba | 10 | 10/15 | 5 |
| Czech Republic | 10 | 5/10 | 12 |
| Denmark | 5 | 5/10 | 10 |
| France | 5 | 0/15 | 5 |
| Germany | 5 | 5/15 | 5 |
| Indonesia | 10 | 10/15 | 20 |
| Iran | 5 | 5/10 | 5 |
| Italy | 10 | 10 | 7/10 |
| Korea | 5/10 | 5/10 | 5/10 |
| Kuwait | 5 | 5/10 | 20 |

| Recipient | Interest (%) | Dividend (%) | Royalties (%) |
|---|---|---|---|
| Malaysia | 15 | 5/10 | 10 |
| Mexico (not in force) | 4.95/15 | 5 | 10 |
| Netherlands | 5 | 0/10 | 5/7/10 |
| Norway | 5/15 | 5/10 | 12 |
| Portugal | 10 | 10 | 12 |
| Qatar | 5 | 5/15 | 5 |
| Russia | 5/10 | 10/15 | 15 |
| Spain | 10 | 0/10 | 5 |
| Sweden | 10 | 5/10 | 7/10 |
| Switzerland | 5 | 0/10 | 5 |
| Trinidad | 15 | 5/10 | 10 |
| United Kingdom | 5 | 0/10 | 5/7 |
| United States | 4.95/10 | 5/15 | 5/10 |

| Recipient | Technical Services (%) | Technical Assistance (%) | Capital gains on movable property (%) | Capital gains on immovable property (%) |
|---|---|---|---|---|
| Austria | 5 | 0/5 | 0 | 34 |
| Barbados | 10 | 10 | 10 | 34 |
| Belarus | 5/10 | 0/10 | 0/10 | 34 |
| Belgium | - | - | - | 34 |
| Brazil (not in force) | 15 | 15 | 15 | 34 |
| Canada | 5/10 | - | - | 34 |
| China | 10 | 10 | 10 | 34 |
| Cuba | 5 | 5 | 5 | 34 |
| Czech Republic | 12 | 12 | 12 | 34 |
| Denmark | 10 | 5 | 5 | 34 |
| France | - | - | - | 34 |
| Germany | - | - | - | 0/34 (1) |
| Indonesia | 20 | 10 | 10 | 34 |
| Iran | 5 | 5 | 5 | 34 |
| Italy | 10 | 10 | 10 | 34 |
| Korea | 5/10 | 0/10 | 0/10 | 34 |
| Kuwait | 20 | 20 | 20 | 34 |
| Malaysia | 10 | 10 | 10 | 34 |
| Mexico (not in force) | 0/10 | 10 | 10 | 34 |
| Netherlands | - | - | - | 0/34 (1) |
| Norway | 12 | 9 | 9 | 34 |
| Portugal | 12 | 10 | 34 | 34 |
| Qatar | - | 5 | 5 | 34 |
| Russia | 10/15 | 10 | 10 | 34 |
| Spain | 5 | - | - | 0/34 (2) |
| Sweden | 7 | 7 | 7 | 34 |
| Switzerland | 5 | - | - | 34 |
| Trinidad | 10 | 10 | 10 | 34 |
| United Kingdom | 5 | - | - | 34 |

| Recipient | Technical Services (%) | Technical Assistance (%) | Capital gains on movable property (%) | Capital gains on immovable property (%) |
|---|---|---|---|---|
| United States | - | - | 0 | 34 |

Notes

1. Capital gains on shares of real estate companies are not subject to taxation in Venezuela.
2. Capital gains on shares of real estate companies are not subject to taxation in Venezuela provided that real estate is incorporated to the generation of income.

The treaties with Brazil, Mexico, and Vietnam have been published in the Official Gazette and signed by the contracting parties but have not entered into force since diplomatic notes have not been exchanged.

Treaties with other countries outside the countries listed above are being negotiated.

## *Tax administration*

### *Returns*

Final tax returns must be filed within three months following the end of the tax year. The system is one of self-assessment.

### *Payment of tax*

The total amount of tax due must be paid at the time of filing the annual return. Estimated tax payments must be paid consecutively in six monthly instalments. Companies engaged in mining, hydrocarbon exploitation, and related activities must make 12 equal monthly estimated tax payments.

### *Corporate tax calculation*

| | | |
|---|---|---|
| Taxable income (manufacturing company) | VEF | 260,000.00 |
| Divided by the value of the TU (VEF 76/1 TU) | VEF | 76 |
| Taxable income in TU | TU | 3,421.05 |
| Tax thereon: | | |
| Tariff 2: 34% | TU | 1,163.16 |
| Subtract (per tax table) | TU | (500) |
| Total Tax | TU | 663.16 |
| Less: Withholding taxes | TU | (100) |
| Less: Advance payments | TU | (100) |
| Net income tax payable in TU | TU | 463.16 |
| Net Income tax payable in VEF* | VEF | 35,200.16 |

*Multiplied by the TU value, (i.e. VEF 76/1TU)



## *Other issues*

### *Exchange control*

In January 2003, the Venezuelan government and the Venezuelan Central Bank restricted the free trade of foreign currency and established an Exchange Control Regime, which is characterised by the following aspects:

- The Venezuelan Central Bank (VCB) centralises the purchase and sales of foreign currency.
- All foreign currency derived from the export of goods, services, and technology must be sold to the VCB, through the financial system and at the official exchange rate. Exporters are to be registered with the Users Registry and are to consign certain documentation certifying good fiscal status. Likewise, the sale of every foreign currency, introduced in the country for various concepts, including direct foreign investment, to the VCB is mandatory. In such case, said foreign currency is to be registered with the SIEX for re-exportation and remittance purposes. The acquisition of foreign currency for imports is also subject to application for 'Foreign Currency Authorisation', which is subject to certain conditions.
- As of 14 June 2010, a new mechanism was put in place which regulates the purchase of securities denominated in foreign currency through the System of Transactions with Securities stated in Foreign Currency (SITME by its Spanish acronym) which is regulated and controlled by the Venezuelan Central Bank. The aforesaid mechanism is limited to certain transactions, and companies are allowed to purchase until USD 350,000 per month, this is, USD 4,200,000 per year.

The Law on Foreign Exchange Crimes is in effect, thereby establishing the actions that constitute exchange crimes and their respective penalties. Said penalties may be both criminal and pecuniary.

# Vietnam

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## Significant developments

At the beginning of 2011, the Ministry of Finance issued a new circular partly amending the corporate income tax (CIT) regulations. The new circular provides the following new guidance:

- Costs of damaged goods due to expiration or natural spoilage are tax deductible, subject to satisfaction of stipulated conditions.
- The condition that bonuses be of a 'salary nature' for tax deductibility has been abolished. The condition remains that bonuses and the entitlement criteria must be set out in employment contracts, collective labour agreements, or internal policies.
- The tax deductible cap applicable to clothing benefits (cash and/or non-cash) increased from 1.5 million Vietnamese dong (VND) to VND 5 million.
- A tax deduction is allowed for year-end salary accruals of not more than 17% of the actual salary costs of the year, provided that the company is not in a loss position.
- Refunds of import duty or export duty (ID/ED) related to the current year should be offset against deductible expenses. A refund of ID/ED paid in previous years shall be treated as other income. However, if the ID/ED relates directly to incentivised activities, the refund should be included in the profits eligible for such incentives.
- Tax losses incurred in a quarter are now allowed to be carried forward to the following quarters of the same tax year for CIT provisional payment purposes.

## Taxes on corporate income

### Standard rates

All taxes are imposed at the national level. There are no local, state, or provincial taxes. The standard CIT rate is 25%. Enterprises operating in the oil and gas industry will be subject to CIT rates ranging from 32% to 50%, depending on each project.

There is no concept of tax residency for CIT. Business organisations established under the laws of Vietnam are subject to CIT and taxed on worldwide income. 25% CIT shall be applicable to foreign income. There are no provisions for tax incentives for such income.



Foreign organisations/individuals carrying out business in Vietnam without setting up a legal entity in Vietnam and/or having Vietnam-sourced income are considered foreign contractors, irrespective of whether the services are performed inside or outside Vietnam. Payments to foreign contractors are subject to foreign contractor withholding tax (FCWT), which consists of VAT and CIT elements. *See the Withholding taxes section for more information*.

### *Preferential rates*
Preferential CIT rates of 10% and 20% are available where certain criteria are met. *See the Tax credits and incentives section for more information.*

### *Calculation of taxable profits*
Taxable profit is the difference between total revenue, whether domestic or foreign sourced, and deductible expenses, plus other assessable income.

Taxpayers are required to prepare an annual CIT return which includes a section for making adjustments between accounting profits and taxable profits.

## *Corporate residence*

There is no concept of tax residency for CIT. Enterprises established under the law of Vietnam are subject to CIT in Vietnam. In addition, Vietnam has a broadly worded permanent establishment (PE) definition.

### *Permanent establishment (PE)*
In Vietnam, a PE is defined as "a fixed place of business through which a foreign enterprise carries out part or the whole of its business or production activities in Vietnam and earns income. The permanent establishment of a foreign enterprise shall include:

- A branch, an operating office, a factory, a workshop, means of transportation, a mine, an oil and gas field, any place relating to the exploitation of natural resources in Vietnam.
- A building site; a construction, installation, or assembly project.
- An establishment providing services including consultancy services through its employees or other persons.
- An agent for a foreign enterprise.
- A representative in Vietnam where [one] has authority to sign contracts under the name of the foreign enterprise, or where [one] does not have authority to sign contracts under the name of the foreign enterprise but regularly delivers goods or provides services in Vietnam."

Foreign enterprises with their PEs in Vietnam shall pay tax on the taxable income earned in Vietnam (irrespective of whether it relates to the PE) and on the taxable income generated out of Vietnam and related to operations of the PEs.

Where a treaty on avoidance of double taxation to which Vietnam is a signatory contains different provisions relating to PE, such treaty shall apply.

## *Other taxes*

### *Value-added tax (VAT)*
VAT is applied to goods and services used for production, trading, and consumption in Vietnam (including goods and services purchased from abroad), with certain exemptions. Depending on the category of goods or services, the VAT rates are as follows:

- A 0% rate applies to exported goods, including goods sold to enterprises without PEs in Vietnam (including companies in non-tariff zones), goods processed for export,

goods sold to duty free shops, exported services, construction and installation carried out abroad or for export processing enterprises, aviation, marine, and international transportation services.
- A 5% rate applies generally to areas of the economy concerned with the provision of essential goods and services. This includes clean water, fertiliser production, teaching aids, books, foodstuffs, medicine and medical equipment, husbandry feed, various agricultural products and services, technical/scientific services, rubber latex, sugar and its by-products.
- The 10% 'standard' rate applies to activities not specified as exempt or subject to the 0% or 5% rate.

When a supply cannot be readily classified based on the tax tariff, VAT must be calculated based on the highest rate applicable for the particular range of goods which the business supplies.

Taxpayers must file monthly VAT returns and remit the VAT payable no later than the 20th day of the following month.

### *Special sales tax (SST)*
SST is a form of excise tax that applies to selected goods and services, such as alcohol, imported automobiles having less than 24 seats, motorcycles, airplanes, boats, petroleum, air-conditioners up to 90,000 British thermal units (BTU), cigarettes, playing cards, discotheques, massages, karaoke, casinos, gambling, golf clubs, and entertainment with betting and lotteries. For goods, SST is charged at the production or importation stage.

The SST rates are as follows:

| Products / services | SST rate (%) |
|---|---|
| Cigar/cigarette | 65 |
| Spirit/wine | 25 to 45 |
| Beer | 45 |
| Automobiles having less than 24 seats | 10 to 60 |
| Motorcycle of cylinder capacity above 125cm3 | 20 |
| Airplane | 30 |
| Boat | 30 |
| Petrol | 10 |
| Air-conditioners (not more than 90,000 BTU) | 10 |
| Playing cards | 40 |
| Votive paper | 70 |
| Discotheques | 40 |
| Massage, karaoke | 30 |
| Casinos, jackpot games | 30 |
| Entertainment with betting | 30 |
| Golf | 20 |
| Lottery | 15 |

### *Production royalties*
Production royalties in the form of a natural resource tax (NRT) are payable in industries exploiting natural resources such as oil and gas, other minerals, forests,

fisheries, and natural water. The tax rates vary depending on the natural resource being exploited, ranging from 1% to 40%, and are applied to the production output at a specified taxable value per unit. Various methods are available for the calculation of the taxable value of the resources, including cases where the commercial value of the resources cannot be determined.

### Property taxes
The rental of land use rights by foreign investors (if not contributed as capital) is, in effect, a form of property tax. It is usually known as land rental, and the range of rates is wide depending upon the location, infrastructure, and the industrial sector in which the business is operating.

### Customs duties
Import duty rates are classified into three categories: ordinary rates, preferential rates, and special preferential rates.

Preferential rates are applicable to imported goods from countries that have most-favoured-nation status with Vietnam (MFN, also known as normal trade relations). The MFN rates are in accordance with Vietnam's World Trade Organization (WTO) commitments and are applicable to goods imported from other member countries of the WTO.

Special preferential rates are applicable to imported goods from countries that have a special preferential trade agreement with Vietnam.

Import duty exemptions are provided for encouraged projects and goods imported in certain circumstances.

Export duties are charged only on a few items, basically certain natural resources. Rates range from 0% to 30%.

## Branch income

Branches of foreign entities are subject to the same CIT regime as entities incorporated in Vietnam.

## Income determination

### Inventory valuation
At present there are no provisions for valuing inventories or determining inventory flows. The tax treatment follows the accounting treatment.

### Asset revaluation
Gains from the revaluation of assets for the purposes of capital contribution or transfer upon division, demerger, consolidation, merger, or conversion of business are subject to 25% CIT.

### Capital gains
Gains made by a foreign investor on the transfer of an interest (as opposed to shares) in a limited liability company are subject to 25% CIT. The assignee is required to withhold the tax due from the payment to the assignor, and account for this to the tax authorities.

Gains earned by a foreign investor from selling securities (i.e. bonds, shares of public joint-stock companies, irrespective of whether they are listed or non-listed) are subject to CIT at a deemed rate of 0.1% of the sales proceeds. 25% CIT will apply to any gains earned by a foreign company (not incorporated in Vietnam) upon a sale of shares in a non-public joint-stock company.

### *Dividend income*

Dividends received from investments in other companies in Vietnam are from after tax profits and are not subject to CIT.

### *Other income subject to CIT*

The following other income items are subject to 25% CIT and are not entitled to tax incentives (including preferential tax rate and exemption/reduction):

- Income from transfer of real estate.
- Income from royalty, leasing of assets.
- Income from transfer of assets.
- Interest income.
- Income from trading of foreign currency.
- Reversal of provisions.
- Collected written off debts.
- Unidentified payables.
- Difference between penalties and compensation for breaching economic contracts.
- Gain from the revaluation of assets.

### *Foreign income*

Foreign income, under the domestic tax law, is subject to 25% CIT with tax credits available *(see Foreign tax credit in the Tax credits and incentives section)*.

Foreign income shall be taxed when earned. There are no provisions for tax deferral or preferential tax rates for foreign income.

## Deductions

### *Depreciation and amortisation*

Tax depreciation may differ from accounting depreciation. Depreciation in excess of the rates specified in the regulations on tax depreciation is not deductible. These regulations specify maximum and minimum permissible effective lives for various classes of assets, including intangibles. Current straight-line tax depreciation rates are as follows:

| Asset | Rates (%) |
|---|---|
| Buildings | 2 to 16.67 |
| Office equipment | 10 to 20 |
| Automobiles | 3.33 to 16.66 |
| Machinery and equipment | 5 to 33.33 |
| Intangible assets | Not more than 5 |

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### *Interest expenses*

Interest on loans corresponding to the portion of charter capital not yet contributed is not deductible.

Interest on loans from non-economic and non-credit organisations exceeding 1.5 times the interest rate set by the State Bank of Vietnam is not deductible.

### *Charitable contributions*
Donations are generally non-deductible, except certain donations for education, health care, natural disasters, or building charitable homes for the poor.

### *Taxes*
Creditable input VAT, CIT, and other fees/charges are not deductible for CIT purposes.

### *Other non-deductible expenditures*
The following other expenditures are specifically stated to be non-deductible:

- Depreciation of fixed assets which is not in accordance with the prevailing regulations.
- Employee remuneration expenses which are not actually paid or are not stated in a labour contract or collective labour agreement.
- Life insurance premiums for employees.
- The portion of costs of raw materials, materials, fuel or goods which are used in excess of the reasonable consumption levels.
- Reserves for research and development (R&D) not in accordance with the prevailing regulations.
- Provisions for stock devaluation, bad debts, financial investment losses, product warranties, or construction work which are not in accordance with the prevailing regulations.
- Advertising, promotion (except certain items), conferences/parties, commissions, prompt payment discounts exceeding 10% of total other deductible expenses (this cap is increased to 15% for newly-established enterprises for the first three operating years).
- Unrealised foreign exchange gain/losses due to the revaluation of foreign currency items other than account payables at the end of a financial year.
- Management expenses allocated to PEs in Vietnam by the foreign company's head office which are not in accordance with the regulations.
- Administrative penalties and fines.

For certain businesses (e.g. insurance companies, securities trading, lotteries), the Ministry of Finance provides specific guidance on deductible expenses for CIT purposes.

### *Net operating losses*
Losses may be carried forward fully and consecutively for a maximum of five years. Carryback of losses is not permitted.

### *Payments to foreign affiliates*
There are no special restrictions on the deductibility of royalties, loan interest, and service fees paid to foreign affiliates (except for those paid by branches). However, the payment must be defendable on an arm's-length basis as required by transfer pricing regulations *(see Transfer pricing in the Group taxation section)*. Certain contracts for the transfer of technology and foreign loans must be registered with the competent authorities.

## *Group taxation*

There is no provision for any form of consolidated filing or group loss relief in Vietnam.

### Transfer pricing

Vietnam has transfer pricing regulations which outline various situations where transactions will be considered as being between related parties and the mechanisms for determining the market 'arm's length' transaction value (e.g. comparable uncontrolled price, cost plus, resale price, comparable profits, and profit split).

Under the wide ranging definition of associated parties, the control threshold is lower than in many other countries (20%), and the definition also extends to certain significant supplier, customer, and funding relationships between otherwise unrelated parties.

Compliance requirements include an annual declaration of related party transactions and transfer pricing methodologies used, which is required to be filed together with the annual CIT return.

Companies which have related party transactions must prepare and maintain contemporaneous transfer pricing documentation.

### Thin capitalisation

There are no thin capitalisation requirements in the tax legislation. However, the level of permitted debt funding will be limited by virtue of licensing requirements. The maximum amount of debt funding is the difference between the licensed investment capital and charter capital.

## Tax credits and incentives

### Inbound investment incentives

Tax incentives are granted based on regulated encouraged sectors and difficult socio-economic locations. The sectors which are encouraged by the Vietnamese Government include education, health care, sport/culture, high technology, environmental protection, scientific research, infrastructural development, and computer software manufacture.

The two preferential rates of 10% and 20% are available starting from the commencement of operating activities. When the preferential rate expires, the CIT rate reverts to the standard rate.

Criteria for preferential tax rates are as follows:

- 10% tax rate for 15 years shall be applied to the newly-established enterprises which:
  - operate in regions with specially difficult socio-economic conditions, in economic zones, and high technology zones
  - invest in high technology, science research and technology development, development of water plants, power plants, water supply, and drainage systems; bridges, roads, railways; airports, sea ports, river ports; airfields, stations, and other especially important infrastructure facilities decided by the Prime Minister, or
  - invest in production of computer software.
- 10% tax rate for the duration of operations is available for the income earned from activities in the fields of education/training, vocational training, public health, culture, sport, and environment (socialised fields).
- 20% tax rate shall be applied for ten years to new enterprises established from investment projects in regions with difficult socio-economic conditions.

- 20% tax rate for the duration of operations is available for the income earned from agricultural service cooperatives and people's credit fund.

***Tax holidays***
Investors may be considered for tax holidays and reductions. The holidays take the form of a complete exemption from CIT for a certain period beginning immediately after the enterprise first makes profits, followed by a further period where tax is charged at 50% of the applicable rate. However, where the enterprise has not derived profits within three years of the commencement of operations, the tax holidays/tax reduction will start from the fourth year of operation. Criteria for eligibility to these holidays and reductions are set out in the CIT regulations as follows:

- Four years of tax exemption and nine subsequent years of 50% reduction shall be applied to the newly-established enterprises which:
  - operate in regions with specially difficult socio-economic conditions, in economic zones, and high technology zones
  - invest in high technology, science research and technology development, development of water plants, power plants, water supply, and drainage systems; bridges, roads, railways; airports, sea ports, river ports; airfields, stations, and other especially important infrastructure facilities decided by the Prime Minister
  - invest in production of computer software, or
  - operate in the socialised fields and in regions with difficult or especially difficult socio-economic conditions.
- Four years of tax exemption and 50% tax reduction for five subsequent years shall be given to new enterprises operating in the socialised fields and in regions not included in the list of regions with difficult or especially difficult socio-economic conditions.
- Two years of tax exemption and four subsequent years of 50% reduction shall be applied to newly-established enterprises operating in regions with difficult socio-economic conditions.

***Employment incentives***
Additional tax reductions may be available for engaging in manufacturing, construction, and transportation activities which employ several female staff, and/or ethnic minorities. CIT reduction must correspond with the actual payment for those employees.

***Research and Development fund***
Business entities in Vietnam are allowed to set up a tax deductible Research and Development fund. Enterprises can appropriate up to 10% of annual profits before tax to the fund. Various conditions apply.

***CIT deferral for small and medium size enterprises***
Eligible small and medium size enterprises (as regulated) can enjoy a one-year deferral of 2011 CIT payments.

***Foreign tax credit***
In respect of Vietnamese enterprises earning income from overseas investment, CIT (or a kind of tax with a nature similar to CIT) paid in a foreign country or paid on behalf by its partner in the country receiving the investment (including tax levied on the dividend) is allowed to be creditable. The credit shall not exceed the CIT amount payable in Vietnam.

The foreign income tax which is entitled to exemption or reduction in accordance with the foreign law shall also be credited.

## Withholding taxes

### Interest

An interest withholding tax (WHT) of 10% applies to payments to an overseas lender. Interest on pre 1999 loans may be exempt from WHT. Offshore loans provided by certain government or semi-governmental institutions may obtain an exemption from the interest WHT where a relevant double taxation agreement (DTA) or Inter-Government Agreement applies.

Interest earned from bonds (except for tax exempt bonds) and certificates of deposit are subject to 10% WHT. The sale of bonds and certificates of deposits are subject to deemed tax of 0.1% of the gross sales proceeds.

### Royalties, license fees, etc.

A 10% royalty WHT applies in the case of payments made to a foreign party for transfers of technology, unless the transfers are contributed as part of legal capital (akin to equity). Transfers of technology are defined very broadly. Certain contracts for the transfer of technology must be registered with the competent authorities.

### Management fees and head office charges

WHT applies on management fees and head office charges at the rates applicable to services *(see below)*.

### Payments to foreign contractors

FCWT on payments to foreign contractors applies where a Vietnamese contracting party (including a foreign-invested enterprise incorporated in Vietnam) contracts with a foreign party that does not have a licensed presence in Vietnam, irrespective of whether the services are provided in Vietnam or overseas.

Foreign contractors can apply to be deduction-method VAT payers if they adopt the Vietnamese accounting system. If accounting records are adequate, the foreign contractor will pay CIT on actual profits, but otherwise on a deemed-profit basis.

For direct (non-deduction-method) foreign contractors, VAT and CIT will be withheld by the contracting party at a deemed percentage of taxable turnover. Various rates are specified according to the nature of the contract performed. For CIT, the WHT rate varies from 0.1% to 10%. For VAT, the effective WHT rate can also range from 3% to 5%. The VAT withheld by the contracting party is an allowable input credit in its VAT return.

A summary of VAT and CIT WHT rates follow:



| Types of payment | Effective VAT rate (%) | Deemed CIT rate (%) |
|---|---|---|
| Trading: distribution, supply of goods, materials, machinery, and equipment in Vietnam. | Exempt (1) | 1 |
| Services | 5 | 5 |

| Types of payment | Effective VAT rate (%) | Deemed CIT rate (%) |
|---|---|---|
| Services together with supply of machinery and equipment | 3 | 2 |
| Construction, installation (2) without supply of materials or machinery, equipment. | 5 | 2 |
| Construction, installation (2) with supply of materials or machinery, equipment. | 3 | 2 |
| Leasing of machinery and equipment | 5 | 5 |
| Leasing of aircraft, vessels (including components) | Not specified | 2 |
| Transportation | 3 | 2 |
| Interest | Exempt | 10 |
| Royalties | Exempt | 10 |
| Insurance | Exempt | 2 |
| Transfer of securities | Exempt | 0.1 |
| Manufacturing, other business activities | 3 | 2 |

Notes

1. On the basis that import VAT is paid.
2. Relates to VAT only.

### *Cross-border leases*

A Vietnam-based lessee is required to withhold tax from payments to an offshore lessor. 5% VAT and 5% CIT is applicable to the rental charge if it is an operating lease. If it is a finance lease, the interest portion will be exempt from VAT and subject to 10% CIT.

### *Tax treaties*

The above WHT rates may be affected by a relevant DTA.

| Recipient | Interest (%) | Royalties (%) |
|---|---|---|
| Algeria (1) | - | - |
| Australia | 10 | 10 |
| Austria (2, 4) | 10 | 7.5/10 |
| Bangladesh (2, 3) | 15 | 15 |
| Belarus (2, 3) | 10 | 15 |
| Belgium (2, 3, 4) | 10 | 5/10/15 |
| Brunei Darussalam (3) | 10 | 10 |
| Bulgaria (2, 3) | 10 | 15 |
| Canada (4) | 10 | 7.5/10 |
| China (3) | 10 | 10 |
| Cuba | 10 | 10 |
| Czech Republic (3) | 10 | 10 |
| Denmark (2, 3, 4) | 10 | 5/15 |
| Egypt (1) | - | - |
| France | 0 | 10 |
| Finland | 10 | 10 |
| Germany (3, 4) | 10 | 7.5/10 |
| Hong Kong (3, 4) | 10 | 7/10 |
| Hungary | 10 | 10 |

| Recipient | Interest (%) | Royalties (%) |
|---|---|---|
| Iceland (3) | 10 | 10 |
| India (3) | 10 | 10 |
| Indonesia (2, 3) | 15 | 15 |
| Israel (2, 3, 4) | 10 | 5/7.5/15 |
| Italy (3, 4) | 10 | 7.5/10 |
| Ireland (2, 3, 4) | 10 | 5/10/15 |
| Japan (3) | 10 | 10 |
| Korea (South) (2, 4) | 10 | 5/15 |
| Korea (North) (3) | 10 | 10 |
| Kuwait (1) | - | - |
| Laos | 10 | 10 |
| Luxembourg (3) | 10 | 10 |
| Malaysia (3) | 10 | 10 |
| Mongolia (3) | 10 | 10 |
| Morocco (1) | - | - |
| Mozambique (1) | - | - |
| Myanmar (3) | 10 | 10 |
| Netherlands (2, 3, 4) | 10 | 5/10/15 |
| Norway (3) | 10 | 10 |
| Oman (3) | 10 | 10 |
| Pakistan (2) | 15 | 15 |
| Philippines (2) | 15 | 15 |
| Poland (2, 3, 4) | 10 | 10/15 |
| Qatar (1) | - | - |
| Romania (2) | 10 | 15 |
| Russia (2) | 10 | 15 |
| Saudi Arabia (1) | - | - |
| Seychelles (2,3) | 10 | 10 |
| Singapore (2, 3, 4) | 10 | 5/15 |
| Slovakia | - | - |
| Spain (3) | 10 | 10 |
| Sri Lanka (2, 3) | 10 | 15 |
| Sweden (3, 4) | 10 | 5/15 |
| Switzerland | 10 | 10 |
| Taiwan (2, 3) | 10 | 15 |
| Thailand (2, 3) | 10/15 | 15 |
| Tunisia (1) | - | - |
| UAE (1) | - | - |
| Ukraine (3) | 10 | 10 |
| United Kingdom (3) | 10 | 10 |
| Uzbekistan (2) | 10 | 15 |
| Venezuela | - | - |

Notes

1. The treaty is not yet in force
2. In some cases, the limits set by the treaty are not lower than the present withholding rate under domestic law. Therefore, the domestic rates will apply.
3. Interest derived by certain government bodies is exempt from WHT.
4. Royalty WHT rates vary for certain types of royalties.

## Tax administration

### Returns

The annual finalisation return and the audited financial statements must be filed within 90 days of the end of the financial year. The standard tax year is the calendar year. However, different accounting year-ends can be used if approval is obtained from the authorities.

### Payment of tax

CIT shall be declared and paid provisionally on a quarterly basis (based on actual revenues and expenses of each quarter). Quarterly CIT returns and payment must be made no later than the 30th day of the next quarter.

### Statute of limitations

The general statute of limitations for imposing tax administration penalties is two years. The tax authorities can collect under declared and unpaid tax at any time.

### Audit cycle

Tax audits are carried out regularly and often cover a number of tax years. Prior to an audit, the tax authorities send the taxpayer a written notice of time and scope of the audit inspection.

### Penalties

There are detailed regulations setting out penalties for various tax offences. These range from relatively minor administrative penalties through to tax penalties amounting to various multiples of the additional tax assessed.

In practice, imposition of penalties has been arbitrary and inconsistent. However, in recent periods there has been a much tougher stance adopted by the tax authorities. Hence, where tax is paid late (e.g. as a result for of a tax audit investigation), there is a significant likelihood of penalties being imposed. Notably, where tax adjustments are made at a tax audit, any resulting additional taxable profits are not eligible for any CIT incentives to which a company may be entitled.

## Other issues

### Foreign investment restrictions

In several fields, foreign investment will not be licensed or will only be licensed under special conditions. The List of Conditional Investment Sectors include television, production and publishing cultural products, telecommunication, transportation by all means, cigarette production, exploring and processing natural resources, real-estate business, education, medical services and distribution.

### Exchange controls

All buying, selling, lending, and transfer of foreign currency need to be made through credit institutions and other financial institutions authorised by the State Bank of Vietnam (SBV).

Outflow of foreign currency by transfer is authorised for certain transactions such as payments for imports and services abroad, refund of loans contracted abroad and payment of interest accrued thereon, transfer of profits and dividends, and revenues from transfer of technology.

All monetary transactions in Vietnam must be undertaken in Vietnamese dong. Exceptions are applicable to payments for exports made between principals and their agents, and payments for goods and services purchased from institutions authorised to receive foreign currency payments such as for air tickets, shipping and air freight, insurance, and international communications.

### *Forms of doing business*

According to the Law on Enterprises, a foreign-invested enterprise may be established as either a single member limited liability or a limited liability with more than one member, a joint-stock company, or a partnership.

### *Intellectual property*

Intellectual property rights are protected by the Civil Code (1995 and 2005), the Law on Intellectual Property (2005), and a host of subordinate legislation.

Vietnam is signatory to the Paris Convention, the Madrid Agreement on International Trademark Registration, and the Patent Cooperation Treaty and is a member of the World Intellectual Property Organisation. Vietnam has entered into an agreement on copyrights with the United States. According to the Vietnam- US Bilateral Trade Agreement, Vietnam is further under the obligation to adhere to the Berne Convention.

# Zimbabwe

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## Significant developments

Zimbabwe's annual budget presentation was held on 25 November 2010 by the Minister of Finance, the Honorable Tendai Biti, and the proposed changes have been promulgated into law.

The announcements relating to corporate tax can be summarised as follows.

### Value-added tax (VAT)

Beginning 1 January 2011, it is mandatory for all registered operators with an annual turnover exceeding USD 240,000 to use electronic fiscal registers (EFRs) that can be linked to the Zimbabwe Revenue Authority (ZIMRA). However, the actual availability of these registers has been delayed.

Beginning 1 January 2011, un-beneficiated chrome exports, which were previously standard-rated, are subject to an increased VAT rate of 20%.

### Income tax

There have been no significant corporate income tax developments in Zimbabwe during the past year.

## Taxes on corporate income

The corporate tax rate for companies (other than mining companies with special mining leases, but including branches) continues at 25.75%. This rate includes a base rate of 25% plus a 3% AIDS levy.

Zimbabwe presently operates on a source-based tax system. This means that income from a source within, or deemed to be within, Zimbabwe will be subject to tax in Zimbabwe unless a specific exemption is available. The specific circumstances of a transaction should always be considered to determine whether the transaction gives rise to taxation in Zimbabwe.

Income earned by foreign companies from a source within, or deemed to be within, Zimbabwe will be subject to tax in Zimbabwe. In such a case, one should determine whether the foreign entity is obliged to register a local entity. A company is required to register a branch if it has established a place of business or is otherwise considered to be trading in Zimbabwe. A local subsidiary company may be registered as an alternative to a branch operation.

Non-residents who do not have a place of business in Zimbabwe may, however, be subject to withholding tax (WHT). *See the Withholding taxes section for additional details.*

Note that Zimbabwe is currently considering a move to a residence-based tax system.

## *Corporate residence*

Currently, the Zimbabwean tax system is based on source and not on residency. Zimbabwe is moving towards a residence-based taxation system, but the details are still to be announced. Income derived, or deemed to be derived, from sources within Zimbabwe is subject to tax.

Source is the place where income originates or is earned, not the place of payment. If goods are sold pursuant to a contract entered into within Zimbabwe, the source of income is deemed to arise in Zimbabwe, regardless of the place of delivery or transfer of title.

Certain types of income arising outside Zimbabwe may, in the hands of a domestic company, be deemed to arise in Zimbabwe and be taxed as such. Examples include interest and certain copyright royalties arising outside Zimbabwe. Where the income is deemed to be from Zimbabwe, relief of the foreign tax suffered, up to a maximum of the Zimbabwe tax, may be allowed as a tax credit.

### *Permanent establishment (PE)*

In the event that Zimbabwe has entered into a double taxation agreement with the country where the foreign company resides, the entity will only be taxable in Zimbabwe if it operates through a PE, which, in most cases, includes a fixed place of business. The establishment of a local entity or branch will usually create a PE, although the provisions of the related tax treaty should be considered. If a PE exists, only the portion of the income attributable to the PE will be subject to tax in Zimbabwe.

Otherwise, and except for the PE concept embodied in the tax treaties, corporate residence is of little tax significance.

## *Other taxes*

### *Value-added tax (VAT)*

VAT is a transaction tax, and the implications will vary for different transactions. Some transactions are taxed at a rate of 15% or 0% while other transactions are exempt from VAT. Input tax deductions may be claimed, subject to certain provisions. Advice on VAT implications of specific transactions related to corporate operations should be obtained prior to execution of transactions.

VAT shall be levied on every taxable supply by a registered person. A taxable supply means any supply of goods or services in the course or furtherance of a taxable activity. A taxable activity means any activity that is carried on continuously or regularly in Zimbabwe which involves the supply of goods or services for consideration.

VAT is payable on all imports for home consumption into Zimbabwe, subject to certain exemptions (e.g. in terms of a technical assistance agreement, donations to the state, goods of which the local supply is zero-rated). Import VAT is payable on the import value plus the applicable customs duty.

A company/branch is required to register for VAT if it supplies goods or services on a regular basis for consideration and if its taxable supplies (standard-rated and zero-rated supplies) exceed USD 60,000 in any 12-month period.

A registered VAT vendor is entitled to deduct input tax credits paid in the course of taxable supplies made to such person, provided that a tax invoice is available to support the input tax deduction. It is also important to take note of deemed input tax deductions and prohibited input deductions. Import VAT paid may only be deducted as input tax if the import was in furtherance of a taxable activity and the required documentation (e.g. stamped customs entries) is held by the importer.

### *Customs and excise duties*

Zimbabwe is a member of Southern African Development Community (SADC) as well as Common Market for Eastern and Southern Africa (COMESA). Customs duties are payable according to the general customs tariffs that are legislated for in Zimbabwe. Preferential duty rates apply on imports from SADC or COMESA countries while goods may be imported free of customs duties from Namibia in terms of the Zimbabwe-Namibia Free Trade Agreement.

Excise duties are levied on local production of excisable products and are included on most excisable products imported from other countries. Examples of the excise products and applicable rates include the following:

- Cigarettes: 40% + USD 5 per 100
- Spirits: USD 2 per litre
- Wine: USD 0.50 per litre

Excise and fuel levies are also levied on petrol, diesel, and illuminating kerosene.

A security deposit is required by Customs on all temporary importations to cover import VAT and customs duties (if applicable).

It is possible to import goods that are subject to customs duties into registered Customs' bonded warehouses, where goods are kept for later use. In this case, the payment of duties may be deferred until the goods are taken out of the bonded warehouse for home consumption or acquitted if the goods are subsequently exported.

### *Capital gains tax*

It should be noted that capital gains tax is payable in Zimbabwe on the disposal of immovable property or shares that are held in listed (on the Zimbabwean Stock Exchange) or unlisted companies at the following rates:

#### Acquired pre-February 2009

- Listed securities: 1% of proceeds.
- Property: 5% of proceeds.
- Unlisted securities: 5% of proceeds.

#### Acquired post-February 2009

- Listed securities: 1% of proceeds.
- Property: 20% of capital gain.
- Unlisted securities: 20% of capital gain.

### *Stamp duty*
Certain transactions may attract stamp duty. The amount of stamp duty payable will differ and will be based on the nature of every individual transaction.

The basic transactions can be summarised as follows.

| Transaction | Stamp duty |
|---|---|
| Bonds | 0.4% (USD 0.40 for every USD 100 or part thereof) |
| Brokers notes – purchase of securities | 0.25% (USD 0.25 per every USD 100 or part thereof) |
| Brokers notes – purchase / sale of any movable property other than a security | 0.10% (USD 0.10 per every USD 100 or part thereof) |
| Brokers notes – purchase / sale of any immovable property | 1% (USD 1.00 per every USD 100 or part thereof) |
| Off market share transfer instruments | 2% or USD 2 |
| Cheques | 0.05% (USD 0.05) |

Tax advice should be obtained for major transactions in respect of the transactions mentioned above in order to ensure that the correct stamp duty implications are considered.

### *Transfer duty*
Transfer duty is payable on the acquisition value of property acquired at the following rates.

| Value of the property (USD) | Rate of transfer duty |
|---|---|
| 0 to 5,000 | 1% |
| 5,001 to 20,000 | 2% of the value above 5,000 |
| 20,001 to 100,000 | 3% on the value above 20,000 |
| 100,001 and above | 4% of the value above 100,000 |

Transfer duty is normally payable by the buyer, but the agreement for the sale of the property will determine the person liable to pay these costs. In addition, conveyance costs of up to 3% (plus 15% VAT) must be added on.

## *Branch income*

Branch income that is received or has accrued from a source within, or deemed to be within, Zimbabwe is taxable in Zimbabwe in terms of the normal corporate tax rules.

A branch is regarded as an extension of its foreign head office. A branch may therefore not deduct fees paid to its foreign head office (unless a tax treaty makes provision for such deduction) as it is argued that a branch cannot transact with itself. Reimbursement of actual expenses may, however, be deducted, subject to the normal deduction rules.

A 20% WHT is imposed on any payments made in respect of head office charges.

The amount of fees charged by the head office to the Zimbabwe branch is also subject to a limitation, usually based on a maximum of 1% of total expenditure (excluding the charge itself and any capital allowances). Exchange control regulations also limit the remittability of administration and management fees to 2% of turnover.

## *Income determination*

The Zimbabwe Income Tax Act (Act) tax base for corporate taxes is taxable income rather than profits. The source and nature of the income determines whether the amount is taxable or not. In addition to amounts received or accrued from actual Zimbabwean sources, there are deeming provisions that bring income from foreign sources into Zimbabwean taxable income.

In general, all receipts from a Zimbabwe source are taxed, excluding amounts that are proven by the taxpayer as being capital receipts. Most expenditure items and some specified exemptions are deductible against income. Capital expenditure is generally not deductible, with amounts on specific items being deductible by way of annual allowances spread over a period.

### *Inventory valuation*
The legislation permits three methods of inventory valuation: historic cost, cost of replacement, or net realisable value.

### *Capital gains*
*See Capital gains tax in the Other taxes section.*

### *Dividend income*
Dividends received from Zimbabwe incorporated companies are tax exempt. When received from non-Zimbabwe companies, they are taxed at a flat rate of 20%; however, relief is granted by allowing any foreign tax suffered as a tax credit.

### *Interest income*
Interest accruing from 'financial institutions' is subject to a 15% WHT and thereafter is exempt from corporate tax (the WHT becomes a final tax). Interest from other local or foreign sources is included in gross income and is taxed at the normal corporate tax rate. Relief will be granted for any foreign tax paid, up to the maximum Zimbabwe tax rate.

### *Partnership income*
The partnership itself is not taxed directly; however, the taxable income of the partnership is calculated in the same way as corporate income and is then allocated amongst the partners in accordance to their agreed profit sharing ratios. This income is taxed in their hands at the basic corporate tax rate.

### *Rent/royalties income*
Rents and royalties are generally treated as normal taxable income and are taxed at the basic corporate rate. Rent arising in respect of land and buildings situated outside of Zimbabwe, however, is exempt from local tax.

### *Foreign income*
Where income (including business profits) is deemed to be from a Zimbabwe source, it will form a part of the local company's taxable income and will be subject to tax at the basic corporate rate. Relief in respect of foreign taxes suffered will be granted unless it is clear that the true source of the income is, in fact, Zimbabwe.

## Deductions

The Act makes provisions for specific deductions. Some of the deductions, such as the deduction of foreign exchange losses, development and exploration costs, hire purchase allowances, and manufacturing allowances can be more complex.

### Capital allowances

The cost (including finance charges) of machinery, implements, and other articles used by the taxpayer in the production of income is deductible in four equal annual allowances. No apportionment is required where the asset was held for less than 12 months.

Industrial buildings (including hotels) constructed and used by the taxpayer in the production of income qualify for an initial allowance of 25% of construction cost in the year they enter service. Thereafter, an annual allowance of 25% is deductible for each year following the year of construction. Additions to existing buildings (not alterations or repairs) qualify for the same deductions. It is important to note that the allowance is calculated on the cost of construction and not the cost of acquisition. In the latter case, the allowances are set at 5% of the cost.

A mining exploration expenditure incurred before commencement of production is deductible in full in the first year of production against income derived from the mine. Subsequent development expenditure is presently written off in the year expended. Note that this aspect of Zimbabwe's mining legislation is currently under review.

Capital allowances may also be deducted with respect to patents, trademarks, and leasehold improvements.

A recovery or recoupment of allowances previously claimed should be included in the gross income of a taxpayer in the event that the allowance is recovered or recouped by way of disposal. The recoupment is presently calculated on the capital allowances previously granted.

### Net operating losses

Assessed tax losses may be carried forward (but not backwards) for up to six years provided the company continues to trade. This restriction does not apply to mining companies. Tax laws do not allow for losses to be transferred to other group companies, and anti-avoidance provisions may be triggered by transactions designed to transfer or exploit assessed losses.

Assessed losses are reduced in the event of a compromise agreement with creditors.

### Payments to foreign affiliates

The law prohibits the deduction of amounts incurred in excess of specified limits in respect of management and general administration expenses as well as interest. This applies to branches or subsidiaries of both local and foreign companies.

The limit on management and general administration expenses is based on such expenses exceeding 1% and 0.75% respectively for a company already in production and prior to production of total tax-deductible expenses.

## Group taxation

No taxation of combined operations is allowed in Zimbabwe, including where operations are conducted by more than one company.

### Transfer pricing

No detailed transfer pricing legislation is currently in place in Zimbabwe. The law does, however, allow the Commissioner General to substitute a new sales price for a transaction in which he considers the declared sales price to be too high or low.

### Thin capitalisation

The limit on the deductibility of interest is based on a company incurring interest charged by a subsidiary, a fellow subsidiary, or a holding company when the debt to equity ratio exceeds 3:1.

## Tax credits and incentives

It has been announced by the Minister of Finance that Zimbabwe is moving away from taxation incentives; however, the following are still available.

Note that this is a high-level summary, and certain conditions should be met in order to utilise these incentives.

| Person for whom incentive is available and duration of incentive | Tax incentive | Tax treatment for normal taxpayers |
|---|---|---|
| Taxpayers operating at designated growth point areas. | The capital allowance is calculated as 25% of the cost of construction of a commercial or industrial building in growth point areas in the year when the building enters service and 25% during the three years that follow the year of construction. | Capital allowances are calculated as 25% of the cost of construction of industrial building in the year when the building enters service and 25% during the three years that follow the year of construction. |
| Taxpayers operating at designated growth point areas. | Deduction of an investment allowance at 15% on cost of specified assets. | No investment allowance granted. |
| For all taxpayers in build, own, operate, and transfer (BOOT) or build, operate, and transfer (BOT) arrangements. | First five years – Taxed at 0%.<br>Second five years – Taxed at 15%.<br>Thereafter – Taxed at normal rate. | Taxed at 25%. |
| Exporting taxpayers. | An additional allowance of 100% of cost incurred in an export country in order to export Zimbabwean goods to such country may be deducted. | Export expenditure incurred is deductible for tax purposes. |
| For all manufacturing taxpayers exporting 50% or more of output (by volume). | Taxed at a reduced rate of 20%. | Taxed at 25%. |

| Person for whom incentive is available and duration of incentive | Tax incentive | Tax treatment for normal taxpayers |
|---|---|---|
| Mining company holding a special mining lease. | Taxed at a reduced rate of 15%. | Taxed at 25%. |
| Operator of a tourist facility in a tourist development zone. | First five years – Taxed at 0%. Thereafter – Taxed at normal rate. | Taxed at 25%. |
| Industrial park developer. | First five years – Taxed at 0%. Thereafter – Taxed at normal rate. | Taxed at 25%. |

## *Withholding taxes*

WHTs are applicable where dividends and royalties or similar payments are declared or distributed to non-Zimbabwean residents (and Zimbabwean residents in some instances).

### *Dividends*

Dividends declared by a Zimbabwean company to a non-resident holding company will be subject to non-resident shareholders tax (NRST), a WHT. NRST is payable at a rate of 15% unless treaty relief is available. Dividends from companies listed on the Zimbabwe Stock Exchange have a rate of 10%. NRST is payable within 10 days after declaration of the dividend.

### *Royalties or similar payments*

WHT on royalties are payable once a Zimbabwean company pays a royalty to a non-Zimbabwean resident. WHT is levied at a rate of 15% and is payable within 10 days of the date of payment.

A royalty includes payment for the use or right to use any patent or design, trademark, copyright, model, pattern, plan, formula or process, or any other property or right of a similar nature. It also includes the imparting of any scientific, technical, industrial, or commercial knowledge or information for use in Zimbabwe. The nature of the amount payable should therefore be carefully considered in order to determine whether the relevant amount represents a royalty.

### *Fees*

Fees are defined to include amounts that are technical, managerial, administrative, or consultative in nature; costs are paid externally. There are some exceptions, but the definition is broad and brings in most costs that may be charged to a Zimbabwean person.

WHT is levied at a rate of 15% and is payable within 10 days of the date of payment.

### *Interest*

WHT of 15%, calculated on the gross amount of interest, is payable on interest accruing to any person resident in Zimbabwe. This applies to interest arising from a registered banking institution or unit trust scheme. The tax withheld is a final tax, and the financial institution is responsible to withhold the tax.

Non-resident investors, however, are exempt from any WHT on interest.

# Zimbabwe

### *Summary of WHT payable*

The non-residents WHT rates and treaty relief for Zimbabwean double tax agreements can be summarised as follows. It should be noted that the tax treaties contain certain requirements that should be met before the reduced tax rate may be applied.

The definitions of dividends, royalties, and interest in the various treaties should also be considered.

| Recipient | Dividends (%) | Royalties (%) | Fees (%) | Interest (%) |
|---|---|---|---|---|
| Zimbabwe tax legislation | 15* | 15 | 15 | 15** |
| Bulgaria | 10 | 10 | 10 | N/A |
| Canada | 10 | 10 | 10 | N/A |
| France | 10 | 10 | 10 | N/A |
| Germany | 10 | 7.5 | 7.5 | N/A |
| Malaysia | 10 | 10 | 10 | N/A |
| Mauritius | 10 | 15 | 15 | N/A |
| Netherlands | 10 | 10 | 10 | N/A |
| Norway | 15 | 10 | 10 | N/A |
| Poland | 10 | 10 | 15 | N/A |
| South Africa | 15 | 15 | 15 | N/A |
| Sweden | 15 | 10 | 10 | N/A |
| United Kingdom | 5 | 10 | 10 | N/A |

* Applies to unlisted companies. The rate for companies listed on the Zimbabwe Stock Exchange is reduced to 10%.

** Resident persons have a 15% WHT on interest arising from financial institutions. Interest from other sources is taxed at the corporate tax rate.

'N/A' means that the provisions of the tax treaty limited the rate to a rate that is higher than the local Zimbabwean rate. It should be noted that a treaty can only provide tax relief and cannot impose a higher tax rate.

These are payable within ten days of the date of distribution or accrual.

Zimbabwe has either negotiated, or is currently negotiating, tax treaties with the following countries:

| | | |
|---|---|---|
| Botswana | Jamaica | Tanzania |
| Democratic Republic of Congo | Namibia | Tunisia |
| Indonesia | Serbia and Montenegro | Zambia |
| Iran | Seychelles | |

## *Tax administration*

The due dates for filing of returns can be summarised as follows.

| Return | Due date |
|---|---|
| Income tax return | By the end of April in the following year. |
| Provisional tax return – first payment of 10% | 25 March of the respective tax year. |

| Return | Due date |
|---|---|
| Provisional tax return – second payment of 25% | 25 June of the respective tax year. |
| Provisional tax return – third payment of 30% | 25 September of the respective year. |
| Provisional tax return – fourth payment of 35% | 20 December of the respective year. |
| Employees' tax return (PAYE monthly return) | By the third of the month following the month to which the PAYE relates. |
| PAYE reconciliation return | Within 30 days from the tax year-end for individuals, i.e. 31 January each year. |
| VAT return | By the tenth day following the month to which the VAT relates. |
| Import VAT | At the time that the goods are imported. Can be deferred over a period of 90 days on application to the Commissioner. |
| VAT on imported services | Within 30 days of receipt of payment or issuance of an invoice (whichever is earlier). |
| Various amounts subject to withholding taxes | Within 10 days from the date of distribution or accrual. |

### *Anti-avoidance*

Please note that Zimbabwe legislation contains basic anti-avoidance sections that empower the Commissioner General to disregard the implications of a transaction or scheme if it can be proven that:

- such a transaction or scheme had been entered into to avoid or postpone the payment of any duty or levy imposed by the Zimbabwe Income Tax Act
- it was entered into or carried out by means or in a manner that would not normally be employed in the entering into or carrying out of a transaction, operation, or scheme of the nature of the transaction, operation, or scheme in question, or
- it has created rights or obligations that would not normally be created between persons dealing at arm's length under a transaction, operation, or scheme of the nature of the transaction, operation, or scheme in question

The Commissioner General may at his sole discretion impose this legislation on any transaction or scheme, which will place the burden of proof on the taxpayer to prove that any/all of the requirements noted above will not be applicable to the transaction or scheme.

## *Other issues*

### *Exchange control*

Zimbabwe has been operating a multi-currency system since February 2009. The Zimbabwe dollar (ZWD) was demonetarised effective April 2009. This has had a significant impact on the country's exchange control regulations.

The Exchange Control Handbook in Zimbabwe is not available to the public; only banking institutions have access to these regulations.

Transactions that involve the transfer of funds to countries outside Zimbabwe are generally subject to Bank approval.

The issue of shares in a Zimbabwe company to persons residing outside of Zimbabwe requires specific exchange control approvals. Under recent legislation, a limit of 49% is available for non-residents. A 51% local shareholding by indigenous persons is a requirement. Applications may be made for increased levels; each case will be decided on its own merits.

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Market turmoil, intense competition, and global expansion have sparked unprecedented levels of regulation which companies need to keep up with.

PwC is the leading provider of tax services worldwide[1] - we have representation in every major city across six continents. And the depth and breadth of our resource – encompassing both industry and business competencies – allows us to deploy specialist expertise to solve any tax issue wherever in the world they are needed.

[1]The Global Tax Monitor (GTM) recognises PwC as the leading tax adviser globally, by reputation, with a very strong lead over the competition. These results are based on the year-ending Q1 2011 figures, with a sample size of 3,336 primary buyers of tax services globally.

Launched in 2000, the GTM is an independent survey conducted by research agency TNS, that examines the competitive position of the top firms in the tax advisory market - globally, regionally, nationally and on an industry basis. It provides a comprehensive measure of firm reputation, client service and brand health, gained currently from just over 3,000 telephone interviews annually with key decision makers (CFOs and Tax Directors) in 32 key markets.

In addition, our range of services and industry expertise enable us to bring a holistic and integrated approach to your issues. Our size and scale gives us the confidence to say that we will serve you with real specialists across all our services, whether you need that support locally, nationally, or internationally.

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Clients engage us because we understand the business and economic environment and combine this with specialist tax knowledge. We help you navigate complexity to:

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- improve business and operating efficiency through tax efficiency and understand and manage the total tax contribution your business makes to governments

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Employees are probably your organisation's greatest asset and your biggest challenge. The PwC Human Resource Services (HRS) network helps you create value by helping you actively manage your people. We have one of the world's largest human resource (HR) advisory networks with solid grounding in areas such as HR transformation, compensation, benefits, pensions, HR transactions, labour law, HR data metrics and deploying talent around the world. We can put together the team that is right for you to give you all the support you need. And our 6,000 professionals in over 100 countries follow the same multi-disciplinary approach to people management to give you the consistency that is so important when working across borders.

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*It's this combination of local and global expertise that gives you real insight*

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The pressures on business to manage tax across borders, along with growing regulation and the need to stay competitive in a global market, means that a local perspective on international tax is not enough. With specialists experienced in complex international tax matters across the world, our network is well positioned to give you top quality advice. It's this combination of local and global expertise that gives you real insight into managing tax across borders.

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Whether you're buying, selling or merging, it's vital to extract as much value as possible from a transaction. With an international network of almost 1,000 Mergers and Acquisitions (M&A) specialists, experienced in every type of transaction, we know how to help you structure and finance the transaction to your best advantage. Our M&A Tax specialists support you through every stage of the transaction. They work closely with our transactions services, corporate finance and legal teams, so that all aspects of the transaction are covered by experienced specialists.

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*Advice that anticipates what legislative and policy changes are likely to happen*

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Sustainability and climate change continues to evolve as a business issue.

Momentum is building. As such, you need more than advice on the current state – you need advice that anticipates what legislative and policy changes are likely to happen. You need that advice to help you to predict how these developments will impact your business. You also need to understand how your organisation is changing to address sustainability and climate change as a business issue and how existing taxes impact on those changes. Our Sustainability and Climate Change Tax network helps businesses and investors in two ways: it helps them stay on top of global trends and developments in climate change related policy; and it helps businesses address the tax implications of climate change related policy and their own organisation's response to the business issue.

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*We think being effective is about more than just knowledge; it's about having an insight into what could happen next*

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By giving you insight into your company's risks and exposures across different territories and disciplines, we can be the effective option to help you deal with tax disputes, audits, and examinations, from prevention through to management and resolution. Our specialists also use their experience to help businesses put in place consistent and defensible practices and policies, so they know what to expect in the future. The Tax Controversy and Dispute Resolution network brings together former revenue authorities and government officials, accountants, economists, international tax litigators, and industry sector specialists, in all areas of direct and indirect tax, as well as customs duties, employment taxes, and tax fraud. We think being effective is about more than just knowledge; it's about having an insight into what could happen next, so we build strong relationships with governments and policy makers worldwide. That way, we're close to the people who are setting the dispute agenda, and know how to work with them to get the right results.

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*Insight and credentials that help teams navigate today's business changes*

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Today, when it comes to managing taxes, many businesses find that the approaches they've taken in the past are no longer optimal nor sustainable to manage risks and the dynamics of today's operating environment. This could be due to changes in their industry or organization, changing legislation, structural transformations, pressure from shareholders and regulators, or budget pressures. Our global Tax Management and Accounting Services (TMAS) network has the experience to help you define and implement an operating model that works for your business, so that you retain effective control over your global taxes. PwC's TMAS group can provide insight and credentials that help teams navigate today's business changes and build efficient, effective and adaptable tax functions to support global tax management responsibilities. In addition to assisting you in building internal capabilities, we can also coordinate the outsourcing of your compliance -- enabled by software that gives you central control and visibility to the status of your compliance across borders -- for direct and indirect taxes, statutory financial statement production and tax reporting.

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# Transfer Pricing

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The scrutiny of transfer pricing by tax authorities worldwide has intensified and our network of 2,000 transfer pricing specialists in over 75 countries has extensive experience in dealing with revenue authorities around the world. Using their expertise in accounting, economics, dispute resolution and your industry, they can help you prepare for the challenges this scrutiny will present. As a network of specialists, we help companies develop sustainable arm's length pricing, tax efficient structures, help make them more compliant with legal requirements and help them respond quickly to an audit and resolve transfer pricing disputes. More importantly, we work to ensure they're less exposed to transfer pricing risks in the future

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