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WTS Alliance

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International Tax News

Welcome to Issue No. 1 of WTS Alliance International Tax News which provides you with recent tax developments across the globe. If you seek more information about a specific topic raised in this issue please contact the person named under the respective article. International Tax News is published on a quarterly basis by WTS AG in Germany. If you have any comments or suggestions concerning WTS Alliance International Tax News, please contact Silke Koehler, by email at silke.koehler@wts.de or by phone on +49 (0) 89 2864 6224.

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CHINA

IMPLEMENTATION MEASURES OF SPECIAL TAX ADJUSTMENT (TRIAL)

On January 8, 2009, the State Administration of Taxation formally issued the "Implementation Measures of Special Tax Adjustment (Trial)".

The measures have brought out a Chinese systematic rule on Transfer Pricing areas such as preparation of Contemporaneous Documentation (CPD), Transfer Pricing method, general anti-avoidance rules, Thin Capitalization, Controlled Foreign Corporations, Cost Sharing Agreements and Advanced Pricing Agreements (APA). Here are highlights of the measures:

1. Enterprises satisfying one of the following conditions may be exempted from providing CPD

- The annual amount of related-party purchase and sale is no more than 200 million RMB and amount of other related-party transaction is no more than 40 million RMB;
- The related-party transactions are in the scope of an APA;
- Foreign-owned equity is less than 50%, and meanwhile all of the related-party transactions are conducted with domestic related-party companies.

2. Time Limit of Providing Documentation

Enterprises are required to prepare CPD for the fiscal year by May 31 the following year. The measures allow the deadline for 2008 Transfer Pricing Documentation to be extended to December 31, 2009.

3. Transfer Pricing Investigation and Adjustments

According to the Measures, transfer pricing investigations shall focus on enterprises with the characteristics such as significant amounts or numerous types of related party transactions, long-term losses, low profitability, or fluctuating pattern of profits/losses etc.

When the tax bureaus analyze enterprises' profit level with inter-quartile method, the profit level must be no less than the medium. Or otherwise, the level shall be adjusted.

4. Legal Liability

Enterprises which fail to provide or provide the false CPD and related material on intercompany transactions shall be imposed a fine to maximum RMB 50,000.

Interest should be paid on levied income tax of the related-party transactions happened after January 1, 2008 at the benchmarking RMB lending rate plus additional 5%. If the enterprise can provide the CPD and related materials, the additional 5% can be avoided.

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FRANCE

YEAR-END CHANGES IN FRENCH TAX LAW

French Legislator did pass the yearly tax amendment law on December 17th, 2008. The main changes for enterprises are the cancellation of the minimum corporate tax, the admission for deduction of foreign losses and the limitation of the deductibility of director's remunerations.

1. Cancellation of minimum corporate tax

Until now the minimum corporate tax was amounting from EUR 1,300 to EUR 110,000 per year depending on the turnover of the company. Companies with a turnover plus financial income of less than EUR 400,000 were exonerated. This tax is progressively cancelled until 2011. In 2009, companies realizing a turnover plus financial income of less than EUR 1,5 million are exonerated. In 2010 this limit is raised to EUR 15 million. In 2011 the tax is totally cancelled.

2. Foreign losses

Until now, corporate income tax was levied only on income realized in France. Correspondingly, only losses generated in France were deductible. The new rules applicable since January 1st, 2009, allow the deduction of losses generated by foreign branches and subsidiaries, the latter need to be directly held at 95% minimum and liable to foreign corporate tax (comparable to French corporate tax). Subsidiaries and branches must be located in member states of the European Union or other countries having concluded a double tax treaty with the French Republic including clauses concerning exchange of information and assistance in the collection of taxes. The deduction is limited to companies having less than 2,000 employees. The deficits deducted are added back as far as the foreign branch or subsidiary is realizing benefits in the five following fiscal years. The amount of foreign losses to be deducted is determined in application of foreign tax laws. These rules are submitted to the Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid. Accordingly, the advantage out of these rules shall not exceed EUR 500,000 per company over any period of three fiscal years (this limit will be reduced to EUR 200,000 on January 1st, 2010).

3. Deduction of the remuneration of directors

Payments made to directors in the frame of termination of their functions are only fiscally deductible up to a limit of six times the assessment ceiling for certain social security contributions per beneficiary. This assessment ceiling is adjusted yearly. In 2008, the deduction limit is EUR 199,656, EUR 205,848 in 2009. This rule applies for fiscal years ending after December 31st, 2008.

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GERMANY

TRANSFER OF ASSETS ABROAD

In case an asset out of a company's business assets is transferred from Germany abroad, the hidden reserves shall – according to the Federal Fiscal Court's opinion – not automatically be taxed. With its judgment dating 17 July 2007 (file number: I R 77/06), the Federal Fiscal Court thereby has abandoned its long-standing and steady jurisdiction regarding the theory of the so-called "final withdrawal".

In the case at hand, a German GmbH & Co KG had transferred a 100% participation in a US Inc. to an Austrian affiliated partnership. The Federal Fiscal Court had decided that the transfer into a foreign business does not result in a taxation, since the asset was not withdrawn for any non-business purposes and a taxation of the hidden reserves was still possible after the transfer.

The judgment applies to the legal situation until 2005. Regarding the subsequent period, the final withdrawal is codified in the Income Tax Act. However, the question comes up whether the latest judgment of the Federal Fiscal Court is opposed to this new regulation. At least with regard to transfers into an EU member state, the new regulation could be against EU-law.

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INDIA

THE VODAFONE CASE

Taxation of capital gain in India on sale of shares of a foreign company

The tax authorities in India issued a notice to Vodafone, a company resident of Netherlands, to show cause as to why it should not be held to be an “assessee in default” for having failed to withhold tax from the sale consideration paid to Hutchinson Telecommunications Limited (HTIL), a Cayman Island company. The sale consideration was in respect of shares of another Cayman Island company. The tax department was of the view that the transaction in question was exigible to capital gain tax in India.

The Cayman Island company whose shares were sold by HTIL held through a number of subsidiaries located outside India the shares of Hutchinson Essar Limited (HEL), an Indian company. HEL held telecom licenses issued by Government of India for mobile phone services in various jurisdictions in India.

The tax department’s case for capital gain taxation was that in real fact, the capital asset which was transferred were the shares of HEL, an Indian company and the controlling interest in HEL also stood transferred on the sale of shares of the Cayman Island company. Further apart from the acquisition of controlling interest, Vodafone acquired a beneficial interest in the license, other interests, assets situated in India.

Vodafone filed a writ in the Mumbai High Court challenging the show cause notice issued by tax department contending that the transaction in question was not chargeable to tax in India and accordingly provisions for withholding tax were not applicable to the facts of the case.

The High Court took notice of the fact that the Share Purchase Agreement had not been made available to the tax department, which required to be looked into.

The High Court dismissed the writ petition challenging the “Show cause Notice” and held that prima-facie HTIL had earned income liable to capital gains as it had transferred its business/economic interest.

It further held that-

1. The Cayman Island company whose shares were transferred was a shell company as it was not even considered in the enterprise value of the sale of shares.
2. The transaction resulted not only in extinguishing of HTIL’s rights in HEL, the Indian company but the extinguishment of its asset vis-à-vis its interest in HEL.
3. Subject matter of transfer between the parties is not only the shares of the Cayman Island company but the interest / asset situated in India.
4. Divestment of interest results in acquisition of asset in India.

The Court, therefore, held both prima-facie and substantially that the transaction in question between two non-residents of sale and purchase of shares of another non-resident company was exigible to capital gain tax in India.

However, having more or less given their verdict on the chargeability to tax of the transaction, the court stated that it could not be determined on the basis of affidavits and counter affidavits in a writ proceeding and that there was an alternate remedy available to the tax payer. On this basis the



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Court finally restored the jurisdiction of the case to the tax authorities for deciding the issue after examination of relevant agreements.

The prima-facie observations made by the High Court regarding chargeability of tax, on transfer of shares between non-resident companies outside India, would result in tax department attempting to tax capital gain, which was hitherto not considered liable to tax in India on such facts. It is to be seen how the tax department applies this position where sale transaction is effected by a resident of a country with which India has a tax treaty having an Article dealing with the taxation of capital gain. Vodafone filed a petition in the Supreme Court against the High Court judgment.

The Supreme Court on 23rd January 2009 took up the petition for consideration of admission and dismissed the same with a direction that the tax department should decide the issues based on the examinations, interpretation of the agreement in question and in accordance with law.

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SWEDEN

LIMITED INTEREST DEDUCTIONS ON INTER-COMPANY LOANS

On January 1, 2009 new tax provisions concerning certain restrictions to the right of deduction for interest payments made between affiliated companies came into force in Sweden. The Swedish government justifies the new provisions by stating that the purpose is to mitigate specific tax planning for the purpose of reducing the Swedish tax base. Consequently, the aim is to affect procedures that, rather than having a business purpose, have an overall purpose of achieving tax advantages. The Swedish Tax Agency did, prior to the new legislation, try to tackle the tax planning procedures concerned by arguing that it was a question of tax evasion/avoidance. However, the Swedish Supreme Administrative Court has in two judgments¹ from 2007 concluded that the arrangements could not be eliminated by invoking tax evasion/avoidance.

The estimated loss of tax revenues, as a result of the tax planning procedures concerned, is according to the Swedish Tax Agency amounting to approximately 1 billion EUR. The following scenario may serve as an example: A Swedish limited liability company, or a permanent establishment belonging to a foreign corporation, is admitted deduction for interest payments while, on the other hand, the corresponding income of interest paid to an affiliated company is not being taxed. The interest-bearing receivable is a result of an intra-group acquisition of shares, and the vendor will not, in accordance with the Swedish participation exemption regime, be liable to pay tax on the capital gain. Thus, a combination of the participation exemption regime, the almost unrestricted right of deduction for interest payments and the ongoing internationalization, resulting in an increased number of cross-border transactions, are the main factors relevant for causing the tax planning procedures concerned. According to the Swedish legislation then in force, Swedish tax law admitted an almost unlimited right for companies to deduct their interest payments. The right to deduct was not dependent on whether or not the receiver of the interest payment was being taxed for the income. In addition, Sweden did not have any thin-cap rules which may result in a restriction or a re-classification of certain interest payment, neither did there exist any withholding tax on interest payments made to foreign companies.

The current provisions now in force since January 1, 2009 result in some restrictions to the right of deduction for interest payments between affiliated companies. In addition, also foreign companies are covered by the provision. Consequently, the provisions cover the scenario of a foreign company having a permanent establishment in Sweden if e.g. the permanent establishment has made interest payments to an affiliated company. Companies are deemed as affiliated if one company, direct or indirect, has the decisive influence of another company, or if the companies concerned are mainly under the same management. The interest payments covered by the provisions are those payments that are caused by debts occurred as a result of the acquisition of shares from an affiliated company.

Interest payments would still be deductible if the income, corresponding to the interest payment, is subject to a tax rate of minimum 10 % in the state of which the beneficial owner of the income has its domicile. Consequently, the company considering the deduction will have to make a hypothetical test and by that determine whether or not the income is object to the specific tax rate. However, deduction will always be admitted if the acquisition of shares, as well as the debt causing the interest payment, is motivated by business reasons. Hence, even if the income is not being taxed with a minimum of 10 % the payment is still deductible if the main part, e.g. at least 75 %, of the arrangement is motivated by business reasons. An overall assessment of all relevant factors will be made when evaluating whether or not the last mentioned exception is applicable.

¹ RÅ 2007 ref. 84 och RÅ 2007 ref. 85.



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