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International Tax News

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WTS Alliance

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International Tax News

Welcome to Issue No. 2 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.

Contents

Denmark IQ Tax A/S	Significant changes in the Danish tax system	2
Germany WTS AG	Effectiveness of the amendment of a profit transfer agreement	3
	VAT Group – Economic and Organizational Integration	3 - 4
Iran A.M. Mahallati & Co.	Taxation Regime - an Introduction	5
The Netherlands WTS World Tax Service BV	Dutch Supreme Court rules in partnership case and closes theoretical discussion	6
IN-DEPTH		
Argentina Luna Requena / Fernandez Borzese Abogados Tributaristas	Stamp Tax drastically expanded in the City of Buenos Aires	7 - 9

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DENMARK

Significant changes in the Danish tax system

Significant changes in the Danish tax system are proposed by the Government. As the bill is currently debated changes will likely occur until the law is finally enacted. However, the following changes are proposed:

- Lowering of personal income taxes,
- Danish companies can sell shares tax free and receive dividend tax free regardless of ownership period, provided a holding of at least 10% of the share capital,
- Danish companies are subject to taxation on dividend and capital gains on shares if the holding is less than 10%. Gains and losses are calculated according to the mark-to-market principle.

Further comments will be provided when the law is enacted.

1. Mandatory joint taxation for group companies

As from 2005 Danish companies and foreign permanent establishments in Denmark controlled by the same Danish or foreign entity are compulsorily taxed jointly. In general terms control exists when more than 50% of the voting power is held, regardless of the percentage of share capital. Danish companies and Danish P/E comprised by the rules must prepare a consolidated joint taxation computation containing all Danish entities. The tax is calculated on the consolidated income and the tax allocated between the companies proportionally.

The top Danish holding company is appointed as Administration Company and handles all payments to and from the Danish Tax Authorities and between the companies.

Larger groups may not be aware of these rules and we therefore recommend reviewing Danish structures in order to comply and potentially benefit from the rules – as profit and losses are pooled.

2. Thin capitalization rules for companies

Danish companies and foreign permanent establishments are comprised by Danish thin capitalization rules. For jointly taxed group, cf. above, the calculation is done on a consolidated basis. In general the following thin cap rules are applicable.

1. Debt/equity ratio must be at least 4/1. Only controlled debt is comprised. Only if controlled debt exceeds mDKK 10 interest expenses may be attacked,
2. Tax ceiling rule: Finance expenses cannot be deducted for tax purposes if they exceed 6.5% (2009) of certain qualifying assets. All debt is comprised.
3. EBIT-80%: Taxable income cannot be reduced with more than 80% of EBIT arising from interest expenses. All debt is comprised.

For the “tax ceiling test” and “EBIT-80 test” a threshold of mDKK 21.3 (2009) exists, i.e. if net finance income is less than the threshold no restriction exists. A number of special provisions and exceptions exist.

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Germany

Effectiveness of the amendment of a profit transfer agreement

As is generally known, strict formal (legal) requirements apply in order for a fiscal unity concept (Organschaft) to be accepted for (German) corporate tax purposes. Any violation of such requirements regularly results in a so-called "unsuccessful" fiscal unity with significant tax consequences. In its decision dated October 22, 2008, the BFH (Federal Tax Court) unmistakably reinforces the adverse necessity to adhere to these civil law requirements. Not only when the fiscal unity is set up, but also in case an existing profit transfer agreement is amended it is essential that the profit transfer agreement has been entered into the commercial register and the shareholders' meeting of both companies have approved the agreement.

The regulations of the AktG (Companies Act) being applicable for stock corporations apply analogically for the GmbHs (limited liability companies). This means inter alia that any modification of the profit transfer agreement, even if it might be regarded as being immaterial, is subject to registration and approval requirements. Only the question (being not relevant to the issue) whether an approval of the controlling company's shareholders' meeting is necessary if the company is not a stock corporation, was left unanswered by the BFH.

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VAT Group – Economic and Organizational Integration

Anyone who independently carries out any commercial or professional activity is a taxable person acc. to Art. 2 para 1 sentence 1 UStG (Value Added Tax Act). However, acc. to Art. 2 para 2 no. 2 UStG, the function is not exercised independently, if a legal entity is incorporated financially, economically and organizationally into another entity (VAT group) in general view of the actual circumstances.

As a consequence, a VAT group is deemed to be one single taxable person for the purpose of VAT. Therefore only one VAT return is submitted by the parent company for the entire group (parent companies, subsidiaries and sub-subsidiaries). Transactions between the members of the VAT group are deemed to be non-taxable and therefore do not trigger any VAT. A VAT group is limited to the territory of the specific country.

Financial integration is deemed to exist where a specific person holds the crucial majority of the shares in the concerned company which enables the implementation of decisions.

An economic integration is given if the company is economically operating within the framework of the whole enterprise – and that in close connection with it – according to the taxable person's intention.

An organizational integration is given if the parent company ensures by use of organiza-

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tional means that its will is indeed executed in the controlled entity. This happens for instance in the case of a personal union of managers in both companies.

The Bundesfinanzhof - BFH (Federal Fiscal Court) recently had to rule on one case regarding economic integration and in three cases regarding organizational integration.

With regard to the economic integration, the BFH decided as follows: If the financial and organizational integration is clearly developed, the economic integration and thus a VAT group may even exist if the business relations are more than just insubstantial. The existence of a reasonable economic link in terms of an economic unit, cooperation or integration between controlling company and the subsidiary company is sufficient for this. The functions merely need to be coordinated and thus assist or complement one another.

The cases of organizational integration each dealt with corporate law structures with minority shareholders, which occasionally also had the right to appoint managers at the corresponding subsidiary. The BFH ruled on all three cases that the organizational integration is not present, since it is not verified that the will of the majority shareholder is indeed executed, e.g. that a differing will can be prevented.

In practice, the judgment means no tightening of the current legal status with regard to the economic integration. However, rulings on organizational integration are calling for an increased sensitivity and verification. This does not only apply in cases of minority shareholders, but also in case of 100 % participation. An alleged VAT group can entail administrative and VAT consequences, especially the additional payment of interest.

The parent company MU supplies goods to the subsidiary TU. Since the parent company MU assumes the existence of a VAT group, it will issue an invoice without VAT to TU. If it becomes apparent that there is no VAT group after all, the parent company MU owes the VAT in the amount of 19 %, whereas the subsidiary, for lack of a proper invoice, is not entitled to deduct input VAT. The VAT therefore results in a cost factor. This case can be cured if the parent company MU now issues a proper invoice including VAT. However, this treatment triggers administrative expenses and late payment interests towards the parent company MU.

And finally, the notice that a VAT group is mandatory if all three integration characteristics are fulfilled. There is no option in this case. This aspect as well was again clearly stated by the BFH.

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IRAN

Taxation Regime - An Introduction

The taxation regime in Iran is regulated by two principal tax legislations. One being the Direct Taxation Act, which covers all direct taxes such as taxes on; capital, properties, income (real estate, agriculture, salaries , professionals, corporate and incidental) and the other being Value Added Tax Act which follows the same principle as a standard VAT legislation.

1. Direct Taxation Act

- The Act itself is an advanced piece of legislation but what makes it complicated and somewhat unpredictable is the numerous interpretations made by various bodies within the Taxation Organization. These interpretations and internally generated regulations are frequently challenged by taxpayers and subsequently nullified by the Administrative Justice Tribunal (the highest body within the Judiciary).
- The Act, amongst other matters, deals with allowances, exemptions, withholding taxes, corporate taxation, contracting operations, assessment and appeal procedures.
- The corporate tax rate is fixed at 25% which is in line with emerging markets corporate tax rates. However what makes this seemingly good rate somehow unattractive is the attitude of the Tax Authorities towards business expenses, the disallowance of which results in a much higher effective tax rate. Personal taxation rates are reasonable at progressive rates of 10 to 35%.

2. Value Added Tax

This legislation is in line with the general model of such indirect taxes and follows the same principles. The rate is 3 percent applicable to all relevant goods and services and is made up of two components of Value Added Tax at 1.5% and Municipality Levy of 1.5%, collectively referred to as VAT.

3. Double Taxation Treaties

There are over fifty double taxation treaties concluded with various countries. The text and the form follows the OECD Model Tax Convention. However there are a profound lack of awareness of the provisions, implications and interpretations of these very treaties by the Taxation Organization, and their preparedness to comply therewith leaves a lot to be desired. We at A.M.MAHALLATI & CO. embarked on a task of treaty awareness some years ago by communicating with the Taxation Organization and through our presentations to various tax appeal tribunals for various clients and also by submitting regular articles in professional magazines. This apparently is yielding the required results and we are confident that we shall soon witness full compliance with the provisions of the Treaties.

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The Netherlands

Dutch Supreme Court rules in partnership case and closes theoretical discussion

On 27 February 2009 the Dutch Supreme Court ruled in a case concerning capital duty. Though capital duty has been abolished in the Netherlands since 2006, the case contained an interesting detail that went further than the capital duty issue. In a side-remark, the Supreme Court seems to have decided a decennia-long dispute regarding the criteria for determining whether a Dutch limited partnership ("CV") is regarded as "open" (non transparent) or "closed" (transparent). Clarity on this issue is also important when determining whether a foreign limited partnership should be regarded as transparent or non-transparent for Dutch tax purposes.

1. Open or closed?

A special provision in Dutch tax law provides that a Dutch limited partnership is considered "open" when, except in the event of an inheritance or a bequest, partners can enter the partnership or replace a partner without the consent of all partners (all general and limited partners taken together). In Dutch tax science two schools of thought have developed over the years. One side argues that this provision means to say that a CV is only "open" if none of the partners have to give consent. If the consent of one or more partners is required, then the CV is "closed". The other school of thought holds the position that a CV is "open" if the consent of not all partners is required. This means that a CV is only "closed" if the consent of all partners is required. If only one partner does not have to give consent, the CV is "open". The Dutch tax authorities belong to this second school of thought.

2. Relevant facts of the case and lower court ruling

CV, a Dutch limited partnership, has one general partner and 130 limited partners. Until 1 October 2001 the articles of association of CV provided that for a new partner to enter the partnership or for a partner to be replaced by another partner, the consent of all the partners was required. Since 1 October 2001, the articles of association were changed: for new partners to enter the partnership or for partners to be replaced only the consent of two-thirds of the partners was required. The Dutch tax inspector took the position that the change in the articles of association converted the CV from a "closed" CV into an "open" CV. Furthermore, he argued that –being a non transparent entity- the CV had "issued" equity and thus became liable for capital duty. The Dutch lower court decided in favor of the inspector.

3. Supreme Court ruling

In the case before the lower court, the CV tried to argue that the general provision regarding a CV being "open" or "closed" did not apply for capital duty purposes. The lower court had swept this argument aside. Before the Supreme Court CV no longer argued along that line so it was not in dispute (anymore). The Supreme Court overturned the lower court's decision and decided that the conversion from a "closed" into an "open" CV did not constitute a taxable event for Dutch capital duty purposes. Before rendering judgment, however, the Supreme Court commented in an aside that "rightly so" it was not in dispute between parties that CV is to be regarded as an "open" limited partnership since changing its articles of association. This can only mean that the second school of thought (not requiring the consent of all partners is enough to make a limited partnership "open") is the right one.

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In-Depth

Argentina

Stamp Tax drastically expanded in the City of Buenos Aires

I. Introduction: The Stamp Tax

The Stamp Tax is a provincial duty levied upon the execution in writing of non-gratuitous acts or contracts. The existence of a written contract executed by all the parties involved in it is *essential* for the triggering of the taxable event of this tax, so even if the parties may agree on non-gratuitous reciprocal obligations, such an agreement would not be subject to the Stamp Tax until it is reflected in writing.

Although this tax is levied by the Provinces, the Federal Congress passed law 23.548 –known as “*ley de coparticipación federal*”– setting out some general criteria concerning Stamp Tax, such as: the concept of its taxable event and the definition of “taxable document” (*instrumento gravable*). This federal law was enacted by each of the Provinces, thus becoming part of its local Public Law.

It is important to point out that the local jurisdiction entitled to levy this tax is –in principle- the one in which the agreement is signed, or –out of that case- the one in which the agreement produces its effects. The term “*effects*” have not been expressly defined by legislation but includes the execution of the relevant obligations and rights of the agreement.

One of the taxable events of the Stamp Tax foreseen in the provincial legislations was that of written contracts entered into by correspondence. In these cases, local regulations foresee that correspondence agreements are subject to the Stamp Tax upon the formal acceptance of a written offer. In this connection, a written offer would be regarded formally accepted when one of the following conditions is met:

- (i) reproduction of the written offer, or reproduction of its main clauses;
- (ii) signature of the offer by the party receiving the offer.

The general Stamp Tax rate normally varies between 0.6% and 3.3% depending on the Provincial jurisdiction and the type of agreement being levied, and is assessed on the total value of the relevant agreement, or the value of the transaction which has effects in the province, in case the written agreement is signed out of the respective jurisdiction. As a consequence of the above, similar business executed on written agreements may have different tax rates in different jurisdictions.

II. Amendments introduced by the City of Buenos Aires

The City of Buenos Aires was the only local jurisdiction of Argentina in which the application of the Stamp Tax was strictly limited to certain acts/transactions involving real estate; out of that limited taxable event, this tax was not applicable, and the City was regarded –for Stamp Tax purposes- a tax haven.

Truth is that in 1993 the Federal State and the Provinces entered into a Fiscal Agreement (“*Pacto Fiscal para la Producción, el Empleo y el Crecimiento*”) under which every Province committed to abrogate the Stamp Tax (Section 1.1). But the Pact was ignored and no Province –with the exception of La Rioja- actually resigned the application of said tax. The City of Buenos Aires was –together with La Rioja- the only jurisdiction that partially observed the Pact up to now that has decided to join the Provinces in the implicit repudiation of such federal agreement.

Given the radical importance of this jurisdiction for the economy of the country, the amendment of the law is something to be considered carefully.

In this connection, local Law N° 2.997 enacted by the Congress of the City of Buenos Aires expanded the taxable event of the Stamp Tax to almost all agreements signed or producing effects in the City, as of January 12st. 2009¹ only establishing certain exemptions. General rate is 0.8% of the total amount involved in the transaction and payment of the tax must be performed before the 15 (fifteen) days following the execution of the agreement.

The taxable base for the application of the Stamp Tax shall be determined by the total amount of the agreement, which should be assessed by the parties. Regulations set forth vicarious liability of the parties as regards the payment of the tax.

Section 373 provides that if the amount of the agreement cannot be assessed, a fixed amount of AR\$1.000 may be paid by the parties. That notwithstanding, the local Tax Authority is entitled to scrutinize the assessment made by the parties in this respect, and might issue an *ex-officio* assessment on the basis of the same standards referred to hereinabove, if they considered prior assessment inaccurate. If such administrative assessment is higher than the one previously done by the parties, they would be legally forced to pay the outstanding amount.

Section 369 of Law N° 2.997 sets forth that if an agreement does not foresee a certain period of duration and is to be successively executed, it will be considered to have a 5 year period of duration.

Therefore, in virtue of the above, the parties should apply the 0.8% rate on the average amount estimated for the agreement in a five year period, unless the parties decide to establish a shorter period for the agreement.

III. Alternatives to avoid the Stamp Tax application

We would like to stress that, although this tax is levied by local jurisdictions (Argentine Provinces and the City of Buenos Aires), the Federal Congress passed federal law 23.548 -known as "*ley de coparticipación federal*"- setting out some general criteria concerning Stamp Tax, such as: the concept of its taxable event and the definition of "taxable document" (*instrumento gravable*).

One of the taxable events if the Stamp Tax foreseen in the provincial legislations was that of written contracts entered into by correspondence. In these cases, local regulations foresee that correspondence agreements are subject to the Stamp Tax upon the formal acceptance of a written offer.

In this regard, Section 349 of City of Buenos Aires Stamp Tax Law provides that a written offer would be subject to this tax if it is formally accepted adopting one of the following mechanisms:

- (iii) Reproduction of the written offer, or reproduction of its main clauses;
- (iv) Formal signature of the offer by the addressee party.

With the legitimate purpose of avoiding the above-described taxable event, it would be feasible to design a contracting structure consisting of a written offer sent by a party "A", in which it was stated that the offer would be regarded accepted by party "B" if the latter performed certain act, such as e.g. the deposit of a certain amount of money in a specific bank account before a given period of time. This mechanism is known as contracting by means of a written offer tacitly accepted.

Other companies receiving an offer of agreement in writing choose to evidence its acceptance by remitting a letter to the bidder simply stating "*I accept your offer dated [__]*", without signing the offer itself and without reproducing its main clauses.

The fact that the acceptance of the offer is tacit –not in writing- or that its written response does not reproduce the main clauses of the offer, allows the parties not to fulfill the conditions described above in (i) and (ii), thus legitimately avoiding the taxable event of the Stamp Tax for correspondence agreements.

¹By means of Resolution 18/2009, the Provincial Tax Authority interpreted that the Stamp Tax would be applicable to agreements entered into since January 12, 2009.

On April 15, 2004, the Argentine Federal Court of Justice settled the matter by virtue of its ruling issued *in re* "Yacimientos Petrolíferos Fiscales S.A. v. Tierra del Fuego", "Shell Compañía Argentina de Petróleo S.A. v. Neuquén" and "Transportadora de Gas del Sur S.A. v. Santa Cruz".

The Argentine Federal Court of Justice ruling on the matter can be summarized as following:

- (i) Local regulations of Stamp Tax clearly foresee certain objective conditions to be fulfilled by correspondence agreements: (a) reproduction of the written offer, or reproduction of its main clauses; (b) formal signature of the offer made by the addressee party.
- (ii) Since federal law 23,548 provides the legal meaning of "taxable document", the Provinces are not entitled to depart from such legal definition by virtue of local laws and regulations.
- (iii) The "substance over form" principle is almost irrelevant as regards the Stamp Tax, since the existence of the document in the manners foreseen by the law is essential to trigger its taxable event.
- (iv) The honest intention to legally avoid the tax by means that are out of its scope is not reprehensible.

As a consequence of the above case law, parties could legally avoid the Stamp Tax application by adopting this mechanism of written offer tacitly accepted. However, due to a recent precedent of the Federal Court that restricts the possibility of litigating before the federal courts as regards local taxes (*in re* "Papel Misionero", 05/05/2009), it is yet to see if Provincial Courts will stick –as they should– to the above-mentioned case law.

IV. Conclusion

The new legislation of the City of Buenos Aires on Stamp Tax will have considerable impact in the companies doing business in this jurisdiction, and forces to take into account the new scenario in order to plan the most efficient way to deal with this tax.

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