

Issue 3 - October 2011

# European Tax Brief

Tax

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## Editorial

Welcome to the third issue of *Moore Stephens European Tax Brief*. This newsletter summarises important recent tax developments of international interest taking place in Europe and in other countries within the Moore Stephens European Region. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information

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## Cyprus

### Austerity measures introduced

Cyprus has enacted a package of tax increases (but also a special régime for expatriates) as part of the austerity package gazetted on 31 August 2011. The measures include:

- a new top rate of personal income tax of 35%, payable on the slice of taxable income exceeding EUR 60 000, retroactive from 1 January 2011;
- the special defence contribution (final income tax on investment income of individuals) on interest is increased from 10% to 15%, with effect from 31 August 2011;
- the special defence contribution on dividends is increased from 15% to 17% for individuals resident in Cyprus, also effective from 31 August 2011;
- new rates of immovable property tax, to have effect from 1 January 2012. The new rate structure is reproduced in Table 1. The previous top rate was 0.4%, payable on the slice of taxable value exceeding EUR 854 300.73;
- a special contribution of up to 3.5% (dependent on income) is to be charged on the salaries of public-sector employees and pensioners for a two-year period beginning on 1 September 2011;
- a proposal to increase the standard rate of VAT from 15% to 17% has been deferred; and
- non-residents coming to Cyprus to work for a Cypriot employer for a salary greater than EUR 100 000 will be eligible for a 50% exemption on their Cyprus-source income as from 1 January 2012. The exemption will remain in force for a five-year period.

**Table 1**

Value of property (EUR)	Rate of tax
First 120 000	0%
Next 50 000	0.4%
Next 130 000	0.5%
Next 200 000	0.6%
Net 300 000	0.7%
Above 800 000	0.8%

NB: it should be noted that for the purposes of this tax, properties are valued at their approximate market value on 1 January 1980.

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## European Union

### Commission proposes Europe-wide financial transactions tax

During the course of a hard-hitting speech on the future of the European Union, delivered to the European Parliament on 28 September, the President of the European Commission, José Manuel Barroso, announced that the Commission had that day adopted a legislative proposal for a European-wide financial transactions tax (FTT).

The tax would apply to all financial transactions to which at least one party is established in an EU Member State, but 'normal' financial activities carried out by individuals or small businesses, such as mortgage lending, bank lending, consumer credit and insurance contracts would be exempt. The tax is aimed at transactions on financial instruments

between financial institutions. The precise rate of the tax would be at the discretion of the Member States, but the minimum chargeable on derivatives transactions would be 0.01% and on other taxable transactions the minimum rate would be 0.1%. The revenues from the tax (which the Commission estimates would be approximately EUR 57 000 million per year) would be shared between the Member States and the European Union itself. It is envisaged that FTT would commence to be charged on 1 January 2014.

The Commission gives two main reasons for proposing the tax. The first is to ensure that the financial sector makes a fair contribution at a time of fiscal

consolidation. It points to the EUR 4.6 million million that European taxpayers have had to contribute in aid and guarantees to the banking sector since the financial crisis broke in 2008 and to what it sees as the under-taxation of the sector (for instance by the exemption of financial transactions from VAT). Second, the Commission sees the FTT as strengthening the single market by harmonising existing taxes on financial transactions (which are levied by 10 Member States already, in some form or other).

The Commission concedes that FTT would have a negative impact on GDP of about 0.5% in the long run and that there is a risk of delocalisation (i.e. the removal of financial transactions outside the



### Capital gains on the sale of private properties

Gains derived from the sale of French properties other than the main residence are currently subject to tax at the rate of 19% (plus social contributions when applicable). However, the gain may be reduced by 10% for each full year of ownership after the fifth, leading to a full tax exemption when the property is sold after 15 years.

Under the new legislation, a full capital gains tax exemption will only be available if the property has been held for 30 years. The taxable gain will still be reduced for each full year of ownership after the fifth, but at a much less steep rate, namely by:

- 2% for each year of ownership between the 6th and the 17th (maximum: 24%);
- 4% for each year between the 18th and 24th year (maximum: 28%); and
- 8% for each year between the 25th and the 30th year (maximum: 48%).

Almost all other features of the French capital gains taxation of real property remain unchanged.

The new tax regime is applicable to sale transactions that are notarised starting on 1 February 2012. Owing to the standard deadlines of 3 to 4 months to close a real property deal, this leaves very little time to take advantage of the current tax regime.

For sales transactions closed after this date, only properties acquired in or before 1982 will benefit from the full exemption if they are sold in 2012. For all properties purchased after 1982, the gain would be subject to tax.

### Increase of social security contributions on investment income

Investment income (dividends, capital gain, rental income etc.) is

currently subject to social security contributions at an aggregate rate of 12.3%. The new legislation increases the aggregate rate to 13.5% for investment income arising from 1 January 2011. This is the consequence of the increase of the *prélèvement* social element of the contributions from 2.2% to 3.4%.

### Sales of shares in real property companies

The new legislation imposes a general obligation to notarise the shares in French or foreign real-property companies in France when the transaction is concluded out of France. That is to say, the deed of transfer will have to be signed before a French notary.

The purpose of the new rule is to make sure that a transfer of shares of real-property companies that is carried out outside France is nevertheless subject to French taxes. Sales of shares in French or foreign real property companies, i.e. companies more than 50% of whose assets consist of French real property, are subject in France to a transfer tax of 5% and capital gains tax, whether the transaction is carried out in or out of France.

### Other measures

The other measures of the austerity plan will be included in the Finance Act 2012, which the Government submitted to Parliament on 29 September 2011 and are listed below:

- introduction of an exceptional tax of 3% payable by all individuals with taxable income exceeding EUR 500 000 (EUR 1 000 000 for a married couple);
- abolition of the 33.33% exemption for profits earned in the overseas departments (DOMs - *Départements d'outre-mer*) in relation to accounting periods ending after 30 December 2011. This incentive was due to end in 2017.

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## Germany

### Trade tax interest add-back is lawful

The European Court of Justice has upheld the provision in Germany's trade tax legislation that required 50% of the interest expense to be disallowed.

Trade tax (*Gewerbesteuer*) is payable by both corporate and unincorporated businesses on adjusted profits. The starting point is the taxable income of

the business for the purposes of corporate tax or personal income tax, but certain adjustments are made, the one in question being an add-back for a proportion of the taxpayer's interest payments. At the time covered by the facts of the case, 50% of all interest payments, whether made to related or unrelated parties, on long-term loans had

to be added back so as effectively to increase the income chargeable to trade tax. Currently, the required add-back is 25% of interest on all loans.

The case (*Scheuten Solar Technology GmbH v Finanzamt Gelsenkirchen-Süd*, Case C-397/09) involved a German company (Scheuten) manufacturing solar



panels. Scheuten's sole shareholder was a Netherlands company, to which it paid interest on a loan that the Netherlands company had advanced to Scheuten. Fifty percent of that interest was duly added back in the company's trade tax assessment. The company contested the add-back, arguing that the EC Interest and Royalties Directive (2003/49/EC) prohibits the taxation of interest paid by a qualifying company in one Member State to an associated qualifying company in another Member State. The relevant German court referred this question to the European Court.

The European Court rejected Scheuten's argument. It noted that the Interest and Royalties Directive was designed to prevent double taxation of cross-border payments within the European Union by preventing the Member State of source from taxing those payments. However, the double taxation intended was taxation to the detriment of the beneficial owner of the interest, i.e. the creditor. The Directive did not address the question of taxation of the payer of the interest (i.e. the debtor). The interest add-back in Germany's trade tax increased the tax burden of the debtor not of the

creditor, and thus the Interest and Royalties Directive was of no application.

The judgment is of interest beyond Germany, because of the potential effect that a decision in favour of the taxpayer could have had on several Member States' interest expense restrictions for corporate tax purposes. No less than nine Member States made submissions to the court in support of the German tax authorities.

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## Jersey

### Proposed changes in the tax law for wealthy residents

The States of Jersey have recently adopted an amendment to the tax law for new wealthy residents to encourage such individuals to bring their business to Jersey.

The current régime for wealthy residents taxes all Jersey income at 20%, which discourages them from investing in Jersey because they are taxed more heavily on their Jersey income than on similar investments outside the Island.

#### The original position

A housing consent for wealthy residents may be granted where the Jersey Housing Minister is satisfied that it is in the best interests of the community or that there are sufficient social or economic grounds for doing so. The relevant regulation is commonly referred to as Regulation 1(1)(k).



When considering whether an individual is eligible for a 1(1)(k) consent it must be demonstrated that the individual is able to generate sufficient income so that, at the present rate of tax, his or her annual contribution is at least GBP 125 000. A lower amount may be considered where there is seen to be an economic benefit to the Island in granting the consent. Other than the individual's tax contributions, the Minister will take into account the following factors when considering an applicant:

- the business/social background of the applicant and the associated benefit that could arise for Jersey as a result of the individual's taking up residence on the Island;
- the applicant's intention to carry on business activities in the Island which may result in future local employment, training, diversification and potential increased tax revenues;
- any other benefits that the Island may obtain if the applicant takes up residence in the Island; and
- any clear undesirable factors in an applicant's background such as a criminal record.

If a person is granted consent, the property must have the appropriate 1(1)(k) conditions attached and will become the individual's principal private residence.

Currently, all Jersey-source income is taxed at 20%, the first GBP 1 million of non-Jersey income is taxed at 20%, the next GBP 500 000 is taxed at 10% and the balance is taxed at 1%. This discourages high-net-worth individuals from investing in the Island as they are taxed more heavily on their Jersey income than on similar investments outside the Island.

Any person who is granted a 1(1)(k) consent and does not wish to avail of it will be liable to tax on his or her worldwide income at the standard rate of 20% in the same way as any other Jersey-resident taxpayer.

### The proposed changes

The recently adopted amendment to the tax law for new 1(1)(k) residents is to encourage high-net-worth individuals to bring their business to Jersey.

This régime will remove the distinction between income earned within and outside Jersey.

Under the new rules the first GBP 625 000 of income will be taxed at 20% and all income thereafter at 1%. This change will bring Jersey income into line with foreign income being taxed at 1% and would apply to any application made on or after the date on which the amendment comes into force. Income derived from land and buildings in Jersey will continue to be taxed at the rate of 20%.

The Treasury Minister hopes that the changes will encourage high-net-worth individuals to bring their business and investment to Jersey, boosting the economy and increasing tax revenues.

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## Netherlands

### Government publishes fiscal agenda

On 15 September, the Government of the Netherlands published its Fiscal Agenda 2012 as part of the budgetary process. The Fiscal Agenda contains a number of legislative proposals, the most significant of which we summarise below. The Government's chief goal is to create a simpler, more robust and more fraud-resistant tax system.

#### Personal income Tax: 30% rule

Specialist employees from abroad who work in the Netherlands may qualify for the so-called 30% rule. The additional housing cost may be reimbursed tax-free but one can also opt for a free allowance of 30%. This equates to a substantial tax benefit, since only 70% of the salary is taxed.

The regime has become so popular that the qualifying conditions have been reassessed:

- the period for which the 30% rule is applicable will now be reduced by reference to previous periods of residence or employment in the Netherlands in the past 25 years. Until now, only periods of residence or employment in the previous 10 or 15 years have been taken into account;
- foreign workers who come to work in the Netherlands and have their permanent residence no further than 150 km away from the Netherlands border are no longer eligible for the 30% rule; and
- the 30% rule will now also apply to foreign doctoral students who have completed their doctorates in the Netherlands and who will continue to work there. Their stay in the Netherlands prior to the work placement does not compromise their right to apply for the 30% rule. For PhD candidates there is a separate, lower salary standard. In 2011 this lower salary standard amounts to EUR 26 605.



### Corporate Income Tax: Limitation of interest deduction for acquisition holdings

As from 1 January 2012, an interest-deduction restriction will be applicable for acquisitions in the financial years commencing after 31 December 2011 if the acquisition is financed with loan capital whereby the acquirer and the target enter into a fiscal unity (tax group) for corporate income tax purposes.

Please note that the new provision is applicable on all interest payments, thus also on interest relating to third-party loans. The limitation of interest deduction only applies to the interest amount exceeding the highest of the thresholds mentioned below:

- an amount of EUR 1 000 000;
- the amount of profit achieved by the acquiring party before the deduction of acquisition interest and excluding the profit of the target company that has to be added to the fiscal unity. If in the past the fiscal unity financed acquisitions with loan capital, the profits resulting from these acquisitions may not be included in the acquiring party's own profit; and
- if the debt-to-equity ratio of the fiscal unity stays within a certain margin. This ratio amounts to 2:1, whereby the value of all the participations held by the fiscal unity are deducted from the equity as are the tax reserves. Payables and receivables are not set off when applying the ratio. On the other hand, the goodwill gap (as a result of the fiscal unity consolidation) is corrected in determining the total equity for this measure, whereby the goodwill is depreciated in ten years.

Acquisition interest that is non-deductible in one year is transferred to the following year and will again be subject to the interest-deduction limitation of that year. With respect to the amount of transferred interest from previous years the EUR 1 000 000 threshold and the debt-equity ratio are not taken into consideration. Transferred non-deductible

acquisition interest is only deductible in the following year from the holding company's 'own' profit during that following year.

Transitional rules apply for existing fiscal unities. The limitation of interest deduction does not apply to the financing of acquisitions included in a fiscal unity prior to 1 January 2012.

The above will mutatis mutandis also be applicable if fiscal consolidation is realised through a legal merger or a statutory demerger.

### Current general interest-deduction restriction (thin cap)

The current general limitation of the interest deduction (the so-called 'thin cap regulation') will remain in effect and unchanged.

### Exemption for foreign branch income

The present system whereby a loss suffered by a foreign permanent establishment of a Netherlands company is set off against the company's taxable profits, whereas the profit generated by a permanent establishment is exempt from Netherlands corporate income tax will be replaced by a source exemption, as of 1 January 2012. The foreign permanent establishment's assets and debts will remain part of the taxpayer's balance sheet for corporate income tax purposes, but the result relating to the permanent establishment will be eliminated from the taxable profit. As a consequence, losses incurred by foreign permanent establishments will, in principle, no longer be tax-deductible except where there is a permanent cessation of the foreign permanent establishment's activities. This also applies to interest paid on loans relating to a foreign permanent establishment. This measure is accompanied by various anti-abuse supporting measures, comparable to those applying to the liquidation loss rules for participations. Transitional

measures apply for unrelieved or recaptured foreign results as at 31 December 2011.

### R&D tax relief

Next year (2012) innovative entrepreneurs will receive extra support from the Government with a new R&D allowance (RDA). The new regulation allows the innovative entrepreneur to deduct some of the R&D expenses, excluding salaries, from taxable income. With respect to the labour costs of research and development (R&D) there is already the possibility of tax reduction. For the year 2012, the Government will increase the R&D budget by a one-off EUR 149 million. In 2012, a partial deduction will also be available for R&D investments and operating expenses. In addition, the innovation box for corporate income tax purposes will become even more attractive.

### Dividend withholding tax

Dividend distributions made by cooperatives are currently not subject to dividend withholding tax. However, the Agenda proposes levying dividend withholding tax if a cooperative is interposed in order to avoid dividend withholding tax or foreign taxes.

### Tax simplification

The following taxes disappear: waste tax, groundwater tax, tax on chewing and snuff tobacco, alcoholic beverages tax, water tax, the packaging tax and the Euro vignette. The first two are abolished with effect from 1 January 2012 and the remainder from 1 January 2013.

The exemption from motor vehicle tax (MVT) for highly fuel-efficient cars will expire on 1 January 2014 for both new and existing passenger cars. As from 2014, the MVT will be based solely on weight. From 2013, the Chamber of Commerce due payable by entrepreneurs will be abolished.

## Spain

### Wealth tax reintroduced

Wealth tax, abolished in 2008, has been temporarily reintroduced for the 2011 and 2012 tax years.

The tax is payable on an individual's net wealth as at 31 December in the tax year. There is a fixed amount of tax to pay on the first band, plus variable rates on further wealth bands. The tax will be the responsibility of the Regions, which



may legislate over the standard exemption, tax rates and reliefs. In the absence of regulation by the Region or with application to non-resident individuals, nationally set rules will be applicable.

The current national maximum tax for 2011 has been set at EUR 183 670.29 + 2.5% on wealth in excess of EUR 10 695 996.06. However, there are significant changes from the previous régime. There is now an exemption for the first EUR 300 000 of the value of the taxpayer's main residence and there is a standard exemption (applicable after any specific deductions or reliefs have been applied) of EUR 700 000.

Non-residents are liable to wealth tax on all of their assets situated in Spain.

Returns for 2011 are due in May and June 2012.

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## Switzerland

### Bank account tax agreement signed with the United Kingdom

See under 'United Kingdom'.

## Ukraine

### Changes to the Tax Code

On 7 July 2011 the Parliament of Ukraine (*Verkhovna Rada*) passed a law (Law No 3609-VI) making material changes to the newly adopted Tax Code of Ukraine (TCU) (see *European Tax Brief* Issue 2). Although not all the amendments can be considered as helpful, on balance the new legislation nevertheless represents a step forward in the process of further harmonisation and stabilisation of the Ukrainian tax system. A brief outline of the main changes made by Law No 3609-VI follows.

#### Tax rulings

Law No. 3609-VI establishes the notion of a 'generally applicable tax ruling', which are to be published from time to time by the tax administration. The Law also establishes that from now on taxpayers who act on the basis of a generally applicable tax ruling are to be exempt from tax penalties to the extent that they rely on the ruling. Previously, exemption applied only to taxpayers who acted on the basis of individual tax rulings (i.e. tax rulings provided by the

tax authorities upon an individual request from that taxpayer). Individual rulings set out the tax authorities' opinion on the way a particular provision of the tax legislation should apply in that particular taxpayer's case, and in relation to that specific provision and in the taxpayer's own circumstances only. The new Law also clarifies that the tax authorities should respond to a request for an individual ruling within 30 days, where previously no deadline was set.

### International accounting standards

Law No. 3609-VI also prescribes that where the TCU refers to 'accounting standards', these references are to be taken as references to international accounting standards (IAS) in relation to taxpayers who apply IAS under the Bookkeeping and Financial Reporting in Ukraine Act. These taxpayers should therefore base their tax computations and will be assessed on their financial statements prepared in accordance with IAS and not on local accounting standards.

### Adjustment to customs declarations

In accordance with the amendments introduced by Law No. 3609-VI,

taxpayers now have the right to file adjustments to customs declarations they have previously submitted.

### Penalties

Law No. 3609-VI removes provisions from the TCU that allowed penalties to be charged for errors discovered during a tax audit where the tax return shows an overstated tax loss. Penalties will now be charged only where there is an actual understatement of a tax liability.

### Tax-loss carry-forward denied

On 8 September 2011, the Supreme Tax Authority of Ukraine (STAU) published an official position with regard to the carry-forward of tax losses. In its letter No 828/3/ the STAU stated that tax losses

incurred in 2010 and in earlier reporting periods may not be deducted for corporate profit tax purposes in the second quarter of 2011 (tax returns must normally be filed quarterly). Furthermore, the STAU also obliged the local tax authorities to carry out tax audits of loss carry-forward positions.

It is questionable whether this stance by the STAU is in accordance with the law in force.

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## United Kingdom

### Treaty-abuse legislation abandoned

The UK Government announced on 9 September that it would not be proceeding with its intended legislation against abuse of the United Kingdom's tax treaties.

It had earlier (on 1 August) released a technical note and draft legislation for consultation. The legislation would have disappplied treaty benefits (such as exemption from taxation or the application of reduced rates of taxation) from both UK-resident and non-resident persons where there was a scheme in place to obtain those benefits; they would not have been obtainable in the absence of the scheme; and the sole or main purpose of the scheme was to obtain those benefits. Where these conditions were established, the legislation would have enabled the tax authorities to override the treaty provisions

conferring those benefits and apply UK domestic tax legislation regardless of the treaty.

The result of the consultation was such that the Government was persuaded that to continue with the legislation would create significant uncertainty for fully compliant UK businesses and foreign investors. It remains committed to countering specific avoidance schemes that clearly seek to abuse provisions in a treaty as they come to its attention.

The United Kingdom has the world's largest double tax treaty network, extending to some 120 bilateral treaties in all.

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## United Kingdom

### Bank account tax agreement signed with Switzerland

The United Kingdom and Switzerland have signed the agreement on the withholding tax to be levied by Switzerland on accounts held by UK residents in Swiss banks. Agreement in

principle was reached in August, but the text of the agreement itself has just been released (6 October).

Under the agreement, which must be formally ratified by both countries before it comes into force, Switzerland will levy a one-off tax of between 19% and 34% on the Swiss funds held by UK residents as a final settlement of past UK tax liabilities and, from 1 January 2013, an ongoing withholding tax of 48% on interest, 40% on dividends and 27% on capital gains. The tax deducted will be passed to the UK tax authorities.

The new taxes will not be charged if the taxpayer agrees to a full disclosure by the bank to the UK authorities.

There are special provisions for individuals who are resident but not domiciled in the United Kingdom.

More detail will be provided in the next issue of *European Tax Brief*.

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## Currency table

For ease of comparison, we reproduce below exchange rates against the euro and the US dollar of the various currencies mentioned in this newsletter. The rates are quoted as at 6 October, and are for illustrative purposes only.

Currency	Equivalent in euros (EUR)	Equivalent in US dollars (USD)
Euro (EUR)	1.0000	1.3304
Pound sterling (GBP)	1.1517	1.5315

Up-to-the-minute exchange rates can be obtained from a variety of free internet sources (e.g. <http://www.oanda.com/currency/converter>).

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