

Editorial

Welcome to the fourth 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 only and should not be acted upon without

first obtaining professional advice tailored to your particular needs. *European Tax Brief* is published quarterly by Moore Stephens Europe Ltd in Brussels. If you have any comments or suggestions concerning *European Tax Brief*, please contact the Editor, Zigurds Kronbergs, at the MSEL Office by e-mail at zigurds.kronbergs@moorestephens-europe.com or by telephone on +32 (0)2 627 1832.

We take this opportunity to wish all readers the compliments of the season and a prosperous and peaceful 2012.



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European Union

Interest and Royalty Directive to be recast

The European Commission published a proposal on 11 November to amend and recast the Interest and Royalty Directive (2003/49/EC, as amended).

The Directive prohibits Member States from imposing withholding taxes on cross-border payments of interest or royalties between associated enterprises in most cases, subject to temporary derogations for some Member States. Enterprises are associated for this purpose if one directly owns 25% or more of the share capital of the other or the same third person directly owns 25% or more of the capital of both. Member States may adopt voting power as an alternative criterion to share capital. The list of the types of enterprise (broadly speaking, limited companies) to which the Directive applies appears in Annex 1 to the Directive.

Three main changes are proposed in the new draft. First, the 25% direct holding requirement is replaced by a minimum 10% direct or indirect holding, bringing the definition into line with that in the Parent and Subsidiary Directive (90/435/EEC). Second, the list of types of company to which the Directive applies, previously more restrictive than that in the Parent



and Subsidiary Directive, is again aligned with the Parent and Subsidiary Directive, and in some cases, goes beyond it. Third, as an anti-avoidance measure, Member States will now be allowed not to apply the Directive (i.e. allowed to impose withholding tax) where the interest or royalties concerned are exempt from tax in the hands of the beneficial owner in the other Member State.

It should be noted that the draft Directive recasting the Parent Subsidiary Directive (93/435/EEC) was adopted by ECOFIN (the Council of Economic and Finance Ministers) on 30 November.

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Commission acts on double taxation

The Communication also announced further initiatives against double taxation. The Commission intends to propose specific solutions to the double taxation of cross-border inheritance tax and cross-border dividends paid to portfolio investors, and will work on creating an EU forum to develop a code of conduct on double taxation and a binding dispute-resolution procedure for unresolved double taxation cases.

The Commission will also consult on how to tackle the other side of the coin — double non-taxation.

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Origin principle to be abandoned for VAT

The European Commission has announced its future intentions for VAT, following the consultation process initiated by the Green Paper on the future of VAT. Moore Stephens Europe's VAT Community was one of the respondents to the consultation.

According to the Commission, "there is a general feeling amongst stakeholders that the fragmentation of the common EU VAT system into 27 national systems is the main obstacle to efficient intra-EU trade and thus prevents citizens from reaping the benefits of a genuine single market. Internationally active businesses consider that the price they actually pay for this lack of harmonisation comes in the form of complexity, extra compliance costs and legal uncertainty. SMEs do not always have the necessary resources to deal with this and therefore refrain from engaging in cross-border activities."

In response, the Commission sets out what it would like to see as the fundamental features of a future VAT system that would continue to raise revenue but also increase the European Union's competitiveness, and lists its priority areas for further action.

The Commission wishes to see a simpler, more efficient and robust VAT system. Simplicity should mean that a taxable person active across the European Union should be faced with a single set of clear



"The Commission wishes to see a simpler, more efficient and robust VAT system."

and simple VAT rules in the form of a VAT Code. The Code would lay down rules adapted to modern business models and standardised obligations making use of up-to-date technology. It also believes that a taxable person should only have to deal with the tax authority of one Member State, however widely that person operates. By efficiency, the Commission would like as few (if any) supplies taxable at reduced or zero rates and a reduction in the scope of exemptions. Broadening the base in this way, it believes, would generate more revenue, reduce complexity and potentially allow for a revenue-neutral rate reduction. A robust system would rely on modern methods of collection and monitoring and thereby limit fraud and avoidance.

Significantly, the Commission has finally abandoned its unequal struggle for a VAT system based on the origin principle. The origin principle would require VAT on a cross-border transaction to be charged solely in the Member State of the supplier, just as it would be on a purely domestic transaction. The commitment to work towards an origin system was made in 1967, but the Commission (and indeed the European Parliament) has finally conceded that this is politically unachievable.

Instead, it will now work towards a system based on the destination principle, whereby cross-border transactions would be taxable solely in the Member State of the customer, as already happens with most cross-border supplies of services, for example.

Translating all this into priorities for further work, the Commission lists 26 priorities, including the following:

- ensuring the smooth introduction of the 'mini one-stop-shop' for providers of telecommunications, broadcasting and electronic services by 2015, followed by a managed broadening of the concept over time;
- setting up an EU VAT portal, providing information in several languages on issues such as registration, invoicing, VAT returns, VAT rates, special obligations and limitations to the right of deduction in the different Member States;
- publishing guidelines on EU legislation in 2012 and further publication of explanatory notes on new legislation (as was recently done for the first time with respect to the new invoicing rules) where appropriate;
- setting up a tripartite VAT forum between the Commission, Member States and stakeholders in 2012;
- proposing a standardised VAT return in 2013, to be available in all EU languages and optional for business across the European Union, followed by adopting the same approach to other obligations such as registration, invoicing etc.;
- tabling a quick-reaction mechanism in 2012 to deal with sudden fraud
- launching an assessment in 2012 of the current rate structure with a view to minimising the use of reduced rates, to be followed by proposals by the end of 2013; and
- exploring the possibility of an EU cross-border audit team to facilitate and improve multilateral controls.

In all of this, the Commission acknowledges that it will need the cooperation, and in several cases the resources, of Member States.

Corporate exit tax not precluded in principle

In a judgment delivered on 29 November, the Court of Justice of the European Union (CJEU) held that an exit tax levied by the Member State of departure on companies changing their residence from that Member State to another (by transferring their place of effective management) was not in principle unlawful, even where the tax was levied on unrealised gains, provided that certain conditions were satisfied.

It was established by the European Court in the *de Lasteyrie du Saillant* case (Case C-9/02) that an immediate exit tax on unrealised gains imposed on natural persons changing their state of residence was an unjustified restriction on the freedom of establishment guaranteed by European law (now under Article 49 TFEU). However, it has remained an open question whether the same was true with respect to companies. In a much earlier case, the CJEU held (in *Daily Mail and General Trust*, Case C-81/87) that the UK provision (now repealed) that required the Treasury to consent to the migration of a UK company was not precluded by the freedom of establishment. More recently, in the *Cartesio* case (C-210/06), the Court held that a Member State was not prevented from prohibiting a company from transferring its registered office (or 'seat') to another Member State while retaining its status as a company governed by the law of its country of incorporation.



In the present case (*National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, Case C-371/10), the taxpayer was the Netherlands subsidiary of a UK group. It had the benefit of a sterling-denominated loan to its parent company. In 2000, it transferred its place of effective management (in fact, all its operations, leaving no permanent establishment in the Netherlands) to the United Kingdom. As a result of exchange movements, the loan in Netherlands currency was recording a profit of over NLG 22 million (just over EUR 10 million) at the date of emigration. Under Netherlands law, the company would have remained resident in the Netherlands because incorporated there. Under UK law, however, a company (wherever incorporated) that has its management and control in the United Kingdom is considered to be resident there. The double tax treaty in force at that time between the Netherlands and the United Kingdom provided that a company with its place of effective management in one of the states is considered resident only in that state. It was therefore the case that the taxpayer company ceased to be resident in the Netherlands and became resident in the United Kingdom.

This cessation of residence in the Netherlands triggered a 'final resettlement tax' on the company under Netherlands law, requiring immediate payment of tax, with interest, on the undisclosed reserves and goodwill (principally, in this case, the unrealised foreign-exchange gain). The company appealed on the grounds that this form of exit tax was an unjustified restriction on its freedom of establishment. The appeal was eventually referred to the European Court.

The CJEU was effectively required to answer three questions:

- 1) Can a company transferring its place of effective management from one Member State to another call the freedom of establishment in aid as against an exit tax on unrealised capital gains, which is payable immediately and without the possibility of taking any subsequent losses into account?
- 2) If it can, is such a tax a restriction on the company's freedom of establishment?
- 3) And if so, is such a restriction justified?

On the first question, the European Court held that a Netherlands company transferring its place of management to another Member State could claim protection on the grounds of freedom of establishment, since it retained its status as a legal person under Netherlands law. This ruling should therefore hold good in the case of all Member States that determine residence by reference to incorporation, but may not necessarily apply in Member States using a different principle, such as the 'real seat' or 'place of effective management' principle.

On the second question, the Court held that the Netherlands exit tax was indeed a restriction of that freedom, since a transfer of a place of effective management within the Netherlands would not have resulted in a tax on unrealised gains.

On the third question, however, the Court held that this restriction could in principle be justified by the need to maintain a balanced allocation of taxing powers between the Member States. It still had to be appropriate to achieve that objective and proportionate. In the present case, for the Netherlands to determine the gain definitively at the time of emigration and not take into account subsequent losses was proportionate. It was for the United Kingdom, which had exclusive taxing rights following the emigration, to take such losses into account. This part of the judgment overrules the Court's own judgment in the *N* case (C-470/04, which involved a natural person) and the Advocate-General's Opinion in this case (which sought to make a distinction between easily traceable assets and assets not easily traceable). However, the Court held that it was disproportionate that the tax should be payable immediately,

without the option of deferring the tax (at the additional cost of an interest charge) until the assets were actually realised. It would be lawful for the Netherlands to ask for security in the event that the taxpayer opted for deferment.

Thus, although National Grid Indus wins its case, in the sense that there was and is no provision under Netherlands law for such a deferment option, the European Court appears to have strengthened the hand of Member States with corporate exit taxes of a similar nature. Although we are far from a definitive answer to the question, it may now be more difficult for taxpayers to overturn comparable exit taxes in comparable circumstances. At the same time, the Court has made it fairly clear that an exit tax that did not allow a company the option to defer tax relating to unrealised gains would normally be disproportionate and thus unlawful. No such option exists under the United Kingdom's exit tax, for example.

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Transfer of going concern can include letting premises

The Court of Justice of the European Union has held that where business premises are concerned, the transfer of a going concern (or, in the language of the VAT Directive, the transfer of the totality of assets or part thereof), which Member States may treat as outside the scope of VAT, may involve a lease of premises, and does not require a sale or transfer of the whole title.

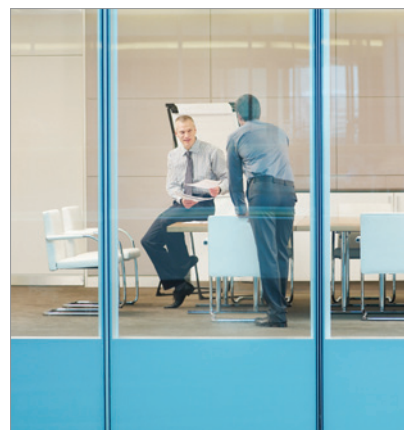
In *Finanzamt Lüdenscheid v Christel Schriever* (Case C-444/10), the taxpayer was a German retailer, operating from a shop that she owned herself. In due course, she transferred the business, in the form of the stock and fittings, to a company, to which she granted a lease of an indefinite term of the premises. The lease was terminable by either party at short notice. In the event, the successor company carried on the business for nearly two years.

The taxpayer did not include the transfer as a supply on her VAT return, on the grounds that this was a transfer of a

going concern as envisaged by [what is now] Article 19 of the VAT Directive (2006/112/EC, as amended). The tax authorities raised an assessment on her, taking the view that the totality of assets had not been transferred because the shop had not been sold, merely leased. The case was eventually referred to the European Court.

The Court held that whether the business premises were transferred was irrelevant if the transfer of the stock and fittings was sufficient to allow the economic activity to continue. If a transfer of the premises was essential to continuing the business, then in principle there was no reason why a lease should not constitute a sufficient transfer.

The terms of the lease were relevant to the question of the successor's ability and intention to carry on the business. The Court held that the possibility of a termination at short notice did not necessarily support the contention that the successor intended to liquidate all



or part of the business immediately. The terms of the lease would have enabled the successor to carry on the business indefinitely, and indeed the fact that it did so for nearly two years confirmed that it did not have the intention to liquidate the business in the short term. The taxpayer had therefore been justified in treating the transfer as outside the scope of VAT.

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France

Interest-expense restriction expected

In Issue 3 of *European Tax Brief* (October 2011), we reported on tax measures being introduced in France to assist towards the deficit-reduction programme. We can now report that French lawmakers are also debating the introduction of a restriction on the interest expense companies may deduct on a loan applied to acquire shares in other companies. Although the legislation is not yet final, and hence the detail may change, it is most likely that such a measure will be enacted.

As the proposals stand at the moment, interest related to share acquisitions would be deductible in full only where the new shareholding is managed in France. In this connection, taxpayers would have to prove that decisions on transactions related to the shares were taken in France and that management of the newly acquired company was also carried on in France. Failing this, an amount of the interest would be disallowed each year;

the disallowance being related to the proportion the acquisition price of the shares and hence the amount borrowed bears to the group's overall indebtedness. In this aspect, the rules are somewhat similar to the United Kingdom's worldwide debt cap on interest deductibility.

Exemptions from the rule currently contemplated are a *de minimis* exemption for acquisitions costing EUR 1 million or less and where the company's debt-equity ratio was no greater than that of the group as a whole.

If enacted in their current form, the rules would apply to all debt-financed acquisitions, whenever made, but the interest deduction would have effect from the financial year 2012 only.

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Germany

Transfer of going concern can include letting premises

See under *European Union*.

Gibraltar

European Court overturns tax-reform judgment

The Court of Justice of the European Union has overturned an earlier judgment of what was then the European Court of First Instance (now the General Court) and held that a proposed corporation tax reform in Gibraltar, put forward in 2002, would have constituted unlawful State aid.

Although the reform was later abandoned in favour of a lawful system which imposes a 10 per cent flat rate levy on all profits, the case is still significant, as it represents the latest stage in a battle that may not yet be over and arguably changes the boundaries between what

is and what is not unlawful State aid. State aid can take various forms. It is not limited to a direct subsidy but also includes measures that directly or indirectly reduce the costs incurred by an undertaking. Thus tax treatment that favours a particular sector of taxpayers as against others can constitute State aid.

State aid is unlawful if unauthorised by the European Union and it has certain features, which include material selectivity and regional selectivity. Aid is materially selective if it favours certain undertakings or the production of certain goods in comparison with others in a

comparable factual and legal situation. On the other hand, advantages resulting from a general measure applicable without distinction to all economic operators do not constitute State aid. Aid is regionally selective if it favours undertakings in a certain region over comparable undertakings in the same jurisdiction.

In *Commission and Spain v Gibraltar and the United Kingdom* (Cases C-106/09 and C 107/09), the issue revolved around a general reform of corporate tax proposed by the Government of Gibraltar in 2002. The essential elements of the reform were to replace the corporate tax system



with a payroll tax on each employee employed in Gibraltar by a Gibraltar-registered company, a business premises occupation tax payable by all companies occupying premises in Gibraltar for business purposes, and a company registration tax. Liability to the first two taxes was to be capped at 15% of the company's profits. In 2004, the European Commission ruled that the proposed reform was both materially and regionally selective and must not go ahead. It was regionally selective, the Commission ruled, because under that system companies in Gibraltar were in general taxed at a lower rate than companies in the United Kingdom (of which Gibraltar is legally a part) as a whole. The Commission gave three grounds for finding the proposed system to be materially selective, namely that:

- 1) the requirement to make a profit before either the payroll tax or the premises tax was payable favoured lossmaking companies;
- 2) the profits cap favoured companies with a low profitability in relation to the number of employees and their occupation of business premises; and
- 3) both taxes inherently favoured offshore companies, since they had no real physical presence in Gibraltar and hence no liability to either tax.

The Gibraltar Government and the UK Government appealed against the ruling to the General Court, which delivered its judgment in December 2008 in favour of the appellants on the grounds of both regional and material selectivity and thus quashed the Commission's ruling. In the meantime, however, Gibraltar abandoned the proposed reform and eventually introduced another system, which was not at issue in this case, which concerned the appeal of the European Commission and the Spanish Government against the General Court's decision.

Having revisited the issue, the European Court, while upholding some aspects of the General Court's decision, has now held that the lower Court erred in law on



the question of material selectivity. The General Court had been correct to hold that the requirement to make a profit and the capping of liability by reference to profits were not in themselves grounds for the existence of material selectivity, since they were general measures applicable without distinction to all economic operators and therefore not liable to confer selective advantages. Contrary to the Commission's contention, it did not matter that the profit criterion was alien to the inherent logic of a payroll tax or premises tax.

However, the General Court had been wrong to dismiss the advantages accruing to offshore companies by reference solely to the regulatory framework of the proposed system. Jurisprudence required measures of State intervention to be assessed with reference to their effects, independently of the techniques used. It was apparent that although the bases of assessment of the proposed Gibraltar taxes were of a general nature, in the absence of an alternative basis of assessment, their effect in practice was to exclude offshore companies from taxation from the outset. The outcome of a different tax burden from the application of a general tax régime did not in itself establish selectivity but an essential second factor, present in this case, was that the system characterised recipient undertakings as privileged by virtue of properties that were specific to them.

The proposed system was therefore materially selective and the General Court's judgment had on that basis to be set aside. Given that material selectivity was found, there was no need to consider whether the proposed reform would also have been regionally selective.

The General Court, basing its reasoning on the CJEU's judgment in *Portugal v Commission* (Case C-88/03, which concerned taxes levied in the Azores) had dismissed the regional selectivity argument on the grounds that the correct framework of reference was not the United Kingdom as a whole but Gibraltar, since it possessed the necessary three factors of autonomy, namely institutional autonomy (it had a political and administrative status separate from the United Kingdom), procedural autonomy (the UK Government did not have the power to intervene directly as regards the content of the reform) and economic and financial autonomy (the financial consequences to Gibraltar of the reform were not offset by aid or subsidies from the UK Government).

This judgment stands, and was endorsed by Advocate-General Jääskinen in his Opinion for the CJEU in this case. It therefore follows that Gibraltar remains entitled to have a different and more favourable tax régime than the United Kingdom. Given, however, that the CJEU did not pronounce on this matter, the issue remains open to further litigation.

What, arguably, the judgment does establish is that, although Member States retain sovereignty over their tax systems, those systems may still be vulnerable to challenge on State aid grounds if their overall effect is to favour certain sectors over others. It could, for example, be that tax reliefs or exemption for a certain category of income has the overall effect (even if unintended) of mainly benefiting certain industry sectors over others.

Hungary

Corporate tax and VAT changes

Hungary has enacted several changes to its corporate tax regime, some of which are favourable to taxpayers, others less so.

Corporate tax rate unchanged

An earlier plan to scrap the 19% rate of corporate tax, which applies to all but the first HUF 500 million of taxable profits, in favour of a uniform 10% rate has been abandoned. Rates therefore remain unchanged in 2012: namely, 10% on the first HUF 500 million and 19% thereafter.

Carry-forward of losses

As from 1 January 2012, tax losses brought forward from previous years may reduce current-year taxable profits by no more than 50%. Furthermore, restrictions are placed on the continuity of losses following a change of control or a reconstruction. Following a reconstruction, the successor entity may 'inherit' the predecessor entity's losses brought forward only if two conditions are satisfied:

- the direct or indirect majority shareholder of the successor entity was also the direct or indirect majority shareholder of the predecessor entity (related-party holdings are taken into account); and
- at least one of the predecessor entity's activities are carried on by the successor entity for at least two years after the reconstruction.

Where there is a change in control without a reconstruction, losses brought forward may be utilised after the change only if one or more of the following conditions is satisfied:

- some or all of the company's or the new majority shareholder's shares are listed on the stock exchange; or
- the company and the new majority shareholder or that

majority shareholder's legal predecessor were associated throughout the two tax years preceding the change of control; or

- the company's activities for at least two years following the change are not significantly different from its activities prior to the change.

Thin capitalisation

The deduction for deemed interest on an interest-free loan from a related party will be withdrawn to the extent that the company's debt-equity ratio exceeds 3:1. In calculating the ratio, the company's onward loans and all other cash debtors (receivables) may be deducted from the total debt.

The participation exemption

The reporting deadline for exemption for capital gains on the disposal of significant shareholdings in other companies is being extended from within 30 to within 60 days of migration for foreign companies that move their central management and control to Hungary.

Currently, gains from shareholdings are exempt if they have constituted at least 30% of the share capital for at least one year preceding the disposal and their acquisition has been reported to the tax authorities within 30 days of acquisition.

VAT goes up

From 1 January 2012, the standard rate of VAT is to increase to 27%, the highest in the European Union. Hitherto, Hungary has shared a 25% standard rate with Denmark and Sweden.

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Ireland

2012 Budget proposals

2012 Budget proposals

The Minister of Finance, Michael Noonan TD, delivered his 2012 Budget speech to the Dáil (the lower house of the Irish Parliament) on 6 December. Below are some of the more important tax measures he outlined. Before becoming law, the measures must first be introduced in a

Finance Bill, which may be amended in its passage through Parliament

Personal taxes

- **Mortgage Interest Relief:** The rates of mortgage interest relief have been increased for first-time buyers and for those who purchase property in 2012.

For first-time buyers who purchased property between 2004 and 2008, a rate of 30% mortgage interest relief will apply.

Where a property qualifying for relief is purchased in 2012:

- the first-time buyer can avail of relief at 25% on mortgage interest;

- relief for other purchasers will be at 15%.

House purchases made from 2013 onwards will not qualify for relief. As noted in last year's Budget, relief will be abolished for all from 2018.

- **Special Assignee-Relief Programme:** A Special Assignee-Relief Programme is being introduced which will allow multinational and indigenous companies to attract key people to Ireland so as to create more jobs and to facilitate the development and expansion of businesses in Ireland.
- **Foreign-Earnings Deduction:** A Foreign-Earnings Deduction for temporary assignments is being introduced and will apply where an individual spends 60 days a year developing markets for Ireland in Brazil, Russia, India, China or South Africa – the so called BRICS countries.
- **Universal social charge (USC):** There is an increase in the lower exemption threshold for this social security contribution, from EUR 4004 to EUR 10 036. The calculation of USC is being changed to a cumulative system.
- **Accelerated Capital Allowances:** Investors in accelerated capital-allowance schemes will no longer be able to use any capital allowances (tax depreciation) beyond the tax life of the particular scheme where that tax life ends after 1 January 2015. Where the tax life of a scheme has ended before 1 January 2015 no carry-forward of allowances into 2015 will be allowed.
- **Employer PRSI on pension contributions:** The current relief of 50% of employer PRSI (pay-related social insurance) for employee contributions to occupational pension schemes and other pension arrangements is being removed from 1 January 2012.
- **Investment Income:** Rental and investment income will be brought within the charge to PRSI from 2013.
- **Capital acquisitions (gift and inheritance tax):** The current rate of 25% is being increased to 30%. This increase applies in respect of gifts or inheritances taken after 6 December 2011.



- **Capital gains tax:** The current rate of 25% is being increased to 30%. This increase applies in respect of disposals made after 6 December 2011. A new incentive relief is being introduced for the first seven years of ownership for properties bought between Budget night and the end of 2013, where the property is held for more than seven years. Where such property is held for more than seven years the gains accrued in that period will not attract capital gains tax (CGT). This measure comes into effect after 6 December 2011.
- **CGT Retirement Relief:** An upper limit of EUR 3 million on retirement relief for business and farming assets disposed of within the family is introduced where the individual transferring the assets is aged over 66 years. This will incentivise earlier transfer of farms. (The current unlimited amount applies for a transitional period of two years for individuals currently aged 66 or who reach that age before 31 December 2013.)
The current upper limit of EUR 750 000 for assets transferred outside the family for individuals aged between 55 and 66 years will be maintained. The upper limit for retirement relief for business and farming assets transferred outside the family is reduced from EUR 750 000 to EUR 500 000 for individuals aged over 66 years. (The current upper limit of EUR 750 000 applies for a transitional period of two years for individuals currently aged 66 or who reach that age before 31 December 2013.)
- **Deposit Interest Retention Tax and Exit Taxes on Life Assurance Policies and Investment Funds:** The rate of retention (withholding) tax that applies to deposit

interest, together with the rates of exit tax that apply to life assurance policies and investment funds, are being increased by 3 percentage points in each case and will now be 30% for payments made annually or more frequently and 33% for payments made less frequently than annually. The increased rates will apply to payments, including deemed payments, made after 31 December 2011.

- **Household charge:** A household charge of EUR 100 is being introduced in 2012. The charge is an interim measure pending design and implementation of a full property tax, which will apply from 2014.
- **Domicile levy:** This is a form of wealth tax, or minimum income tax, introduced in 2010. It is currently payable by persons who are Irish citizens and are domiciled in Ireland, wherever they may be resident for tax purposes, who meet all of the following conditions: (1) the value of their property situated in Ireland is greater than EUR 5 million; (2) their worldwide income is greater than EUR 1 million per annum and (3) their liability to Irish income tax in the previous tax year was less than EUR 200 000. The levy is a flat rate of EUR 200 000. The 'citizenship' condition for payment of the levy is to be removed. This will broaden the base for the levy, by making it payable by persons of whatever nationality domiciled in Ireland, and thus make it more difficult to avoid. A set of proposed amendments to the current régime applying to non-residents will be published in early 2012 and put out to public consultation to inform preparation for further changes in 2013.

Value added tax

The standard rate of VAT will be increased by 2 percentage points from 21% to 23%, with effect from 1 January 2012. This increase will apply to all goods and services that are currently subject to VAT at 21 per cent.

Corporation tax

- **Three-year tax relief for start-up companies:** The scheme, which provides relief from corporation tax on the trading income and certain gains of new start-up companies in the first three years of trading, is being extended to include start-up companies that commence a new trade in 2012, 2013 or 2014.
- **R&D tax credit:** A number of changes are being made to the R&D (research and development) tax credit scheme.

The first EUR 100 000 of qualifying R&D expenditure will benefit from the 25% R&D tax credit on a volume basis. The tax credit will continue to apply to incremental R&D expenditure in excess of EUR 100 000 as compared with such expenditure in the base year 2003. This will provide a targeted benefit to SMEs.

- **Outsourcing limits:** At present subcontracted R&D costs are eligible where they do not exceed 10% of total costs or 5% in the case of subcontracting to third-level institutions.

This limit can disproportionately affect smaller companies who may have greater need to outsource R&D work than larger multinationals with greater internal resources. The outsourcing limits for subcontracted R&D costs are being increased to the greater of 5% or 10% as appropriate or EUR 100 000. This will provide a targeted benefit to SMEs.

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Jersey

Amendments to Jersey income tax law for 2012

The recent Budget statement highlighted a number of amendments to income tax law for 2012.

Amendments to the zero/ten tax régime

Under the zero/ten corporate tax régime, most companies will be assessed at the rate of 0%, with the exception of financial services companies and utility companies, which are assessed to tax at the rates of 10% and 20% respectively. Jersey-resident shareholders of a Jersey trading company will be deemed to receive an interim dividend equivalent to 60% of the company's tax-adjusted profits. Final dividends will also be deemed to have been paid to Jersey-resident shareholders of trading companies and financial services companies on the occurrence of certain events such as the shareholder's death or the shareholder's ceasing to be resident in Jersey. For investment companies, Jersey-resident shareholders will be deemed to receive 100% of the profits of these companies.

A proposal was lodged on 17 May 2011 and adopted by the States (the Island's parliament) on 7 July 2011 to remove the deemed distribution and attribution rules with effect from January 2012. This means that zero/ten will remain and that companies will still pay tax at 0% but the elements that have been deemed 'harmful' by the EU Code of Conduct Group will be removed. The result is that a Jersey-resident shareholder with more than a 2% shareholding in a Jersey-resident company will no longer be taxed on the profits of the company personally and will only be liable on dividends received.

The Economic and Financial Affairs Council (ECOFIN) met on 13 September 2011 to consider the proposed changes to the zero/ten régime later in 2011 and have agreed that the



'rollback' proposal would remove the harmfulness of the régime and bring it into line with the Code criteria. This is to be ratified by ECOFIN in December 2011.

The proposed legislative changes have been adopted by the States Chamber, but they also require approval by the Privy Council. Transitional rules will apply for the period ending 31 December 2011 in order to facilitate the change in the legislation.

Goods and services tax (GST)

In response to the increase in GST during 2011, there will be an increase in the fees charged to banks that elect to be International Service Entities (ISEs) from GBP 30 000 to GBP 50 000.

Banks that are listed by the Jersey tax authorities as ISEs are not required to register for GST. Any supplies made by such entities are not taxable supplies and they will not charge GST on their supplies.

Termination and redundancy payments

From 2012 all payments in excess of GBP 50 000 received from the termination of employment are taxable, regardless of whether the payment is contractual, statutory or voluntary.

Previously, a genuine redundancy payment, even if the redundant employee had a contractual right to such a payment, would not be taxed.

In establishing whether the payment falls under the old or new rules, the date that the individual is entitled to be paid the termination payment will be the trigger point. If an agreement is made before 1 January 2012 stating that the individual is entitled

to be paid after 1 January 2012 then the new rules will apply and any payment in excess of GBP 50 000 will be subject to income tax in the year of assessment 2012 and ITIS (salary tax deducted at source) will be deducted by the employer at the individual's relevant rate.

The GBP 50 000 excess does not apply to payments that are remuneration or deferred pay such as pay in lieu of notice, gardening leave or payments while suspended from duties. These payments will continue to be liable to income tax.

Abolition of International Business Company status

In line with Jersey's commitment to the 'rollback' provisions of the EU Code of Conduct for Business Taxation, the International Business Company vehicle was abolished to new entrants with effect from 1 January 2006. Benefits for existing beneficiaries of the International Business Company régime will be progressively extinguished by 31 December 2011.

Broadly, these companies would be subject to tax on their profits from international activities at low rates of tax (2% to 0.5%). Other profits would be subject at 3%.

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Netherlands

Corporate exit tax not precluded in principle

See under *European Union*.

TOMS to be introduced

The Netherlands is to introduce a tour operators' margin scheme (TOMS), with effect from 1 April 2011. This follows infraction proceedings taken by the Commission for the country's failure to provide for such a scheme in its legislation.

A TOMS is mandatory under Articles 306-310 of the VAT Directive. Under the scheme, tour operators charge VAT on the margin between the total VAT-exclusive amount payable by the customer (the traveller) and the actual

cost to the operator of supplies for the direct benefit of the traveller and provided to the operator by other taxable persons.

Hitherto, tour operators in general have charged VAT solely on the basis of distances covered in the Netherlands, while all other supplies for travel outside the Netherlands have been zero-rated (allowing the tour operator to recover the associated input tax).

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Russia

New transfer pricing legislation from 1 January 2012

In July 2011 the Russian government enacted significant changes to Russian transfer-pricing legislation. The new rules come into force from 1 January 2012, but certain provisions will become effective only from 2013 and 2014. In comparison with current transfer-pricing legislation, the new rules provide for additional transfer-pricing methods, reporting and transfer-pricing documentation requirements, regulations in respect of transfer-pricing audits and conditions for entering into advance pricing agreements. The main changes introduced by the new transfer pricing-rules are summarised below.

Controlled transactions

The new transfer-pricing law reduces the list of controlled transactions (e.g. barter transactions are now excluded from transfer-pricing control). In general, most transactions between related parties and certain transactions with third parties will remain subject to transfer-pricing control. The new rules stipulate that transfer-pricing control will apply to the following cross-border transactions:

- all related-party transactions, including supply arrangements utilising third-party intermediaries;
- transactions with goods traded on global commodity exchanges where the aggregate annual amount of income, as a result of all transactions between such parties, exceeds RUB 60 million; and
- transactions with a counterparty resident in any jurisdiction listed on the 'blacklist' of the Ministry of Finance in the event that the transaction amount exceeds RUB 60 million.

The following domestic transactions between related parties will also be controlled:

- transactions between related parties where the total amount of income from such transactions exceeds RUB 3000 million in the calendar year 2012; RUB 2000 million in 2013 and RUB 1000 million from 2014;
- transactions between related parties if the aggregate amount of transactions in a calendar year exceeds RUB 60 million and one of the following conditions is met:
 - the transaction involves operations with objects subject to mineral extraction tax calculated at an *ad valorem* tax rate;
 - one of the parties to the controlled transaction is exempt from paying profit tax, or pays it at a 0% rate, or is registered in a special economic zone (applies from 2014).
- transactions between related parties where the aggregate amount of transactions in a calendar year exceeds RUB 100 million and one of the parties pays unified tax on imputed income or unified agricultural tax.

Related parties

In comparison with the current legislation, the new transfer pricing law incorporates a far wider definition of related parties, and includes 11 categories. However, the underlying criterion used in defining the relationship between parties remains the same – ownership that provides control. Currently the ownership threshold at which direct or indirect control is deemed to exist is 20%, but from 2012 it will be increased to 25%. However, the new rules provide that the courts may deem the parties to be related on any other reasonable grounds.

“In comparison with current transfer-pricing legislation, the new rules provide for additional transfer-pricing methods.”

Transfer-Pricing Methods

The new law introduces five transfer-pricing methods (instead of the three existing methods) for determining the price for controlled transactions:

- Comparable Uncontrolled Price;
- Resale Minus;
- Cost Plus;
- Comparable Profits;
- Profit Split.

All these methods or similar methods are used in international transfer-pricing practice. Nevertheless the comparable-profits and profit-split methods are new to Russian legislation. In most cases the comparable-uncontrolled-price method remains the primary method, but, for example, in the case of resale of goods the resale-minus method is the primary one. If none of the transfer pricing methods can be applied, it is possible to establish the price for a one-off transaction by use of an independent appraisal.

Transfer-pricing documentation requirements

Taxpayers will be obliged to prepare and keep certain documents justifying the transfer-pricing method applied for the calculation of prices for controlled transactions where the aggregate amount of income from all controlled transactions with the same counterparty exceeds RUB 100 million in 2012 and RUB 80 million in 2013. From 2014 these limits will not be applied and it will be necessary to keep documentation for all transactions. The documentation must be presented within 30 days to the tax authorities upon request.

Audit rules

The new transfer-pricing audit rules will come into force in accordance with the following restrictions:

- 2012 transactions will be open for transfer-pricing audits until 31 December 2013 only;
- 2013 transactions will be open for transfer-pricing audits until 31 December 2015 only.

Advance pricing agreements

Only 'large' taxpayers (i.e. those whose annual tax payments exceed RUB 1000 million or annual revenue or assets exceed RUB 20 000 million (USD 667 million) may enter into an advance pricing agreement with the tax authorities (it is possible to use other criteria). Advance pricing agreements will not be available to foreign legal entities.

In general, the new Russian transfer-pricing legislation has become closer to the OECD Transfer Pricing Guidelines as a result of the changes introduced. Nevertheless, certain substantial differences remain; e.g. adjustments of transfer prices made by the taxpayer which result in a decrease of the taxable base are not allowed. It should also be noted that for the purposes of evidence of profitability, the use of information about Russian companies is preferred, which could potentially affect multinational companies.

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United Kingdom

Autumn Statement tax announcements

Although the Autumn Statement, delivered to the House of Commons by the Chancellor of the Exchequer, the Rt Hon George Osborne MP, on 23 November, was largely economic in content, some new forthcoming tax changes were nevertheless signalled in that statement and in announcements made subsequently.

Personal tax

- A new Seed Enterprise Investment Scheme (SEIS) will be introduced from April 2012. This will include an income-tax reduction equal to 50% of the investment by an individual in shares in qualifying companies. These will be small start-up companies, which will be able to raise no more than GBP 150 000 of SEIS investment funds in their lifetime. The maximum an individual may invest in one tax year will be limited to GBP 100 000. The SEIS will exist separately from but alongside the existing venture capital reliefs — the enterprise investment scheme (EIS) and the venture capital trust (VCT) scheme, from which it will also import much of the rules about

what types of investment, what types of individual and what types of company will qualify. There will also be an exemption from capital gains tax on disposals of other assets made in 2012-13 if the proceeds are reinvested in qualifying SEIS shares in the same year.

- There will be further modifications to the EIS and the VCT scheme, including the abolition of the GBP 1 million limit on the amount that a VCT can invest in any one company. These changes are in addition to those announced earlier, increasing investment limits and the size of qualifying companies (see *European Tax Brief*, Issue 1, April 2011).
- Individuals will be able to receive a reduction in their liabilities to income tax and capital gains tax in return for donations to the nation of 'pre-eminent objects' of national, historic, scientific or cultural interest. The reduction will amount to 30% of the object's agreed value. A parallel scheme will operate for companies, but the relief from corporation tax will be 20% of the value.
- The annual exemption for capital gains tax is to be frozen at its 2011-12 value of GBP 10 600 for the year 2012-13.
- As previously announced, the charge for long-term residents who are not domiciled in the United Kingdom and who wish to use the favourable remittance basis of taxation will increase from GBP 30 000 to GBP 50 000 for those who have been resident in at least 12 of the previous 14 years.
- The new statutory definition of residence (see *European Tax Brief*, Issue 3, October 2011) is to be postponed for one year, to April 2013, to allow for more consultation.
- As previously announced, the personal allowance for taxpayers aged under 65 is to increase from GBP 7475 in 2011-12 to GBP 8105 in 2012-13. The allowance is tapered away for individuals with taxable income in excess of GBP 100 000. The level at which the 40% rate of income tax becomes payable will fall from GBP 35 000 of taxable income after deduction of allowances in 2011-12 to GBP 34 370 in 2012-13.

Corporate tax

- A 100% capital allowance (tax depreciation) will be available for investment in plant and machinery incurred between April 2012 and March 2017 in designated assisted areas within six Enterprise Zones.
- The rate of the bank levy on chargeable equity and long-term chargeable liabilities is to be increased from 0.039% to 0.044% and the rate on short-term chargeable liabilities from 0.078% to 0.088% as from 1 January 2012.
- As previously announced, the rate of corporation tax for the financial year beginning 1 April 2012 will be 25%, a reduction of one percentage point from the current 26% rate. Further single-point reductions are still scheduled for the financial years 2013 and 2014.
- The reform of the CFC rules and the introduction of the Patent Box will proceed with effect from 2012 and 2013 respectively (see the following articles).

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Full CFC reform on course

On 6 December, the Government published draft legislation for the Finance Bill 2012, together with explanatory notes and in certain cases draft secondary legislation (Orders and Regulations). The total package ran to over 1100 pages, so it can be anticipated that the Bill will be one of the longest on record. Among the measures for which the draft legislation was thus exposed for consultation was that for the reform of the controlled-foreign-company (CFC) rules.

The CFC rules seek to bring into charge to UK corporation tax the profits of foreign companies controlled by UK corporates and resident in low-tax jurisdictions, by attributing the appropriate percentage of those profits (recomputed according to UK rules) to UK corporate shareholders owning more than 25% of the controlled company. There are a number of exemptions from the rules.

The Government has wished for some time to reform the rules so that they are targeted more precisely at profits that are artificially diverted from the United Kingdom, and is indeed obliged under EU proportionality rules to grant exemption in cases where it can be demonstrated there was a genuine commercial purpose behind the existence of the CFC. Interim changes were made in the Finance Act 2011.

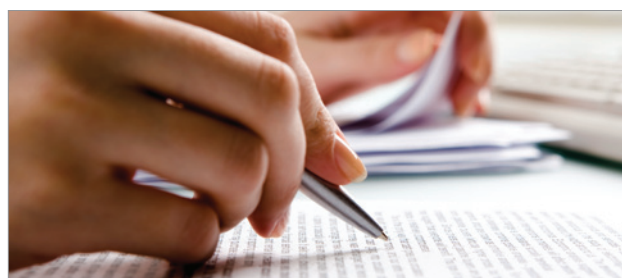
Accordingly, the underlying rationale of the new régime is to exempt from charge to tax any profits that arise from genuine economic activities undertaken abroad, or where there is no artificial diversion of profits from the United Kingdom. Under the new rules, business profits of a foreign subsidiary referred to from now on as a 'CFC' — will be outside the scope of the CFC charge unless they meet the conditions set out in a 'gateway'.

These define what amounts are to be treated for the purposes of the régime as profits artificially diverted from the United Kingdom.

Broadly speaking, the gateway will act so that the CFC charge applies only where each of three conditions is satisfied:

- the majority of the CFC's profits from assets or risks is connected with UK activity, by reference to so-called SPFs (significant people functions);
- the holding of assets or the assumption of risks by the CFC (and hence their separation from the United Kingdom) does not give rise to substantial economic value not attributable to a reduction or elimination of tax; and
- independent companies would not have entered into such an arrangement to separate assets and risks from the United Kingdom.

'Safe harbours' for these gateway conditions are provided, covering general commercial business and incidental finance income, together with some sector-specific rules relating to insurance and captive insurance companies. A foreign subsidiary can rely on these safe harbours to show that some or all of its profits are outside the scope of the régime. Thus, the



CFC's trading income is exempt, provided that five further conditions are satisfied. These relate to the requirement for the CFC to have a substantial presence, both in terms of premises and personnel, in its jurisdiction of residence and to derive most of its income from non-UK sources.

As an alternative to the gateway, the régime also provides various 'entity-level' exemptions, including an excluded-territory exemption and a low-profits exemption. The 'lower level of tax' test, which under the existing rules forms part of the definition of a CFC, will function as an exemption under the new regime. CFCs subject to a level of tax on their profits of no less than 75% of the UK level of taxation will be exempt ('the tax exemption'). Other exemptions are:

- the low-profits exemption — CFCs with accounting profits or profits calculated as for UK tax of no more than GBP 50 000 or of no more than GBP 500 000 with the proviso that non-trading income may not exceed GBP 50 000 will be exempt;
- the low-profit-margin exemption — CFCs whose accounting profits are no more than 10% of their 'relevant operating expenditure' will be exempt; and
- the excluded-territories exemption — CFCs resident in certain 'whitelisted' territories will normally be exempt, provided that their total income falling into certain categories does not exceed the greater of 10% of pre-tax profits and GBP 50 000.

This will not apply where a significant part of any intellectual property that the CFC has was transferred from the United Kingdom within the previous six years.

There is also to be a partial exemption for finance companies, under which 75% of their finance profits would be exempt from the CFC charge.

Special rules apply to insurance companies and banks. Insurance entities may be particularly affected by the proposed introduction of a new anti-avoidance rule, which brings interests in a cell of a protected cell company within the scope of the CFC provisions by treating the cell as if it were itself a non-UK resident company.

Further draft legislation is expected in January 2012 to address such issues as the interaction with the foreign profits exemption and an exemption for the acquisition of a new CFC group. The new rules are expected to have effect for accounting periods beginning on or after the date of Royal Assent to the Finance Act 2012 (probably mid-July) but this is subject to further consultation.

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Income from patent box to be charged at 10%

The draft material for the 2012 Finance Bill also contains legislation for the 'patent box', which will allow companies to elect to apply a 10% rate of corporation tax from 1 April 2013 to profits that are attributable to qualifying intellectual property (IP), whether received as royalties or embedded in the sales price of products.

Qualifying IP includes patents granted by the United Kingdom's Intellectual Property Office and the European Patent Office, together with supplementary protection certificates (SPCs), regulatory data protection (sometimes referred to as 'data exclusivity') and plant-variety rights.

The patent box will apply to existing as well as new IP, and to acquired IP, provided that the company or group has

further developed either the IP or the product that incorporates it.

There are detailed rules to calculate the profits arising from qualifying IP. For companies selling patented products or licensing their patents, the calculation starts with the total profit from the sale of products incorporating the patented invention or from licensing the invention. The full rate of corporation tax will still be charged on a 10% routine return on certain costs and on any part of the identified IP profits which is attributable to marketing intangibles. Companies making smaller claims can choose a simpler calculation that avoids the need to value their brand. All the remaining profit will be eligible for the patent-box rate.

Companies that use their IP to perform processes or provide services will benefit from the patent box up to the level of an arm's length royalty for the use of the qualifying IP.

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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 16 December, and are for illustrative purposes only.

Currency	Equivalent in euros (EUR)	Equivalent in US dollars (USD)
Euro (EUR)	1.0000	1.3027
Pound sterling (GBP)	1.1917	1.5526
Hungarian forint (HUF)	0.0033	0.0043
Russian rouble (RUB)	0.0241	0.0314

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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