

July 2011

# European Tax Brief

Tax

PRECISE. PROVEN. PERFORMANCE.

## Editorial

Welcome to the second 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 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

### New tonnage tax system introduced

The new tonnage tax system was introduced with the Merchant Shipping (Fees & Taxing Provisions) Law, 44(I) of 2010, with retrospective effect as from 1 January 2010.

The new tax régime extends the favourable benefits previously applicable to owners of Cyprus-flagged vessels and ship managers, to owners of EU or foreign flag vessels and charterers. It also extends the tax benefits that previously only covered profits derived from shipping operations to cover profits from the sale of a ship or of the shares of a shipowning company, interest earned on funds used as working capital or for the financing of the operation or maintenance of the ship and dividends paid directly or indirectly from profits derived from shipping-related activities.

The new régime is intended to provide Cyprus with a competitive advantage within and outside the European Union, secure the tax future of Cyprus-based shipping companies and encourage new shipping companies (such as charterers) to set up business in Cyprus.

The tonnage-tax system is available to any 'qualifying shipowner', 'qualifying charterer' and 'qualifying ship manager' who owns, charters or manages a 'qualifying ship' in a 'qualifying shipping activity'.

#### Qualifying ship

A qualifying ship is any seagoing vessel certified under applicable international or national rules and regulations and registered in the ship register of any member of the International Maritime Organisation and/or the International Labour Organisation and recognised by Cyprus.

The régime specifically excludes certain types of ships, such as fishing vessels,

ships used primarily for sports or recreation, river vessels, non-self-propelled floating cranes and tug boats, among others.

#### Qualifying shipping activity

Any commercial activity that constitutes maritime transport, crew management and/or technical management is considered a qualifying activity.

The definition of maritime transport includes the traditional carriage of goods and passengers, as well as ancillary services such as all hotel, catering, entertainment and retailing activities on board a qualifying vessel, the loading and unloading of cargo, the operation of ticketing facilities and passenger terminals, towage and dredging, cable laying, and so on.

#### Qualifying shipowner

Owners of Cyprus-flagged ships automatically fall within the scope of the tonnage tax system. Ship owners of EU-flagged ships and/or third-country-flagged ships may elect to be subject to tonnage tax.

Owners of a third-country-flagged ship must comply with certain requirements in order to qualify for the tonnage-tax election. These include the requirement that at least 60% of their fleet be comprised of EU-flagged ships. This share should not be reduced in the three-year period following the election. In addition, the commercial and strategic management of the fleet must be carried out within the European Union.

Any shipowner electing for tonnage tax must remain in the system for at least 10 years. Early withdrawal will result in penalties, calculated as the difference between the amount of tax paid during the period the shipowner was subject to tonnage tax and the amount that would



have been paid had it been subject to the normal corporation-tax system. Furthermore, the shipowner will lose the right to elect again for tonnage tax until the expiration of the 10-year period from the date of the first election.

The tonnage tax for a qualifying shipowner is calculated on the net tonnage of a ship in accordance with the rates outlined in Tables 1 and 2 below.

#### Qualifying charterers

Any charterer who charters a ship under bareboat, demise, and time or voyage charter is eligible for tonnage tax. There are some additional requirements that need to be satisfied with regard to chartered-in ships, namely that the tonnage of ships under time and/or voyage charter not exceed 75% of the total tonnage of ships chartered and owned for more than three consecutive years. This additional requirement can be increased to 90% provided that the chartered ships are registered in an EU Member State or that their crew and technical management is carried out within the European Union.

#### Qualifying ship managers

A ship manager who provides crew and/or technical ship management is



eligible for tonnage tax, provided that he satisfies the following criteria:

- maintenance of a fully fledged office in Cyprus;
- the employment of a sufficient number of qualified personnel (51% of whom should be from within the European Union);
- management of at least two-thirds of ships managed to be carried out within the European Union whilst the other one-third can be managed from outside the European Union;
- at least 60% of the fleet under management should be carrying the flag of an EU Member State; and
- all ships and crew under management must comply with international standards and EU legal requirements relating to maritime security, safety, training and certification of seafarers and the environment.

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Table 1 summarises the applicable rates for the tonnage tax calculated for qualifying shipowners and charterers.

**Table 1**

Net tonnage				
First 1000	Next 9000	Next 15 000	Next 15 000	Balance over 40 000
€ 36.50	€ 31.03	€ 20.08	€ 12.78	€ 7.30
per 100 NT	per 100 NT	per 100 NT	per 100 NT	per 100 NT

Table 2 summarises the applicable rates for the tonnage tax calculated for qualifying ship managers.

**Table 2**

Net tonnage				
0 - 1000	1001 – 10 000	10 001 – 25 000	25 001 – 40 000	> 40 000
€ 36.50	€ 31.03	€ 20.08	€ 12.78	€ 7.30
per 400 NT	per 400 NT	per 400 NT	per 400 NT	per 400 NT

It will be seen that the annual tonnage tax due for the qualifying ship manager is 25% of that for qualifying shipowners or charterers.

## Denmark

### Expatriate taxation

With effect from 1 January 2011, the rate of taxation on salaries to specialists, research workers etc. coming to work in Denmark from abroad has been adjusted.

Previously, it was possible to choose between a rate of 25% for three years and a rate of 33% for five years. From 1 January, there is a single rate under the expatriate régime — 26% — available for a maximum period of five years.

Employees already taxed at 25% under the existing expatriate régime may extend the period of favourable taxation to five years, but face a tax rate of 26% for all remaining years (not just the additional two). Alternatively, they may opt to remain taxed at 25% but the period will then not be extendible beyond the original three years.

From 2011, the so-called Danish labour market contribution (*arbejdsmarkedbidrag*) of 8% has been converted from a social security contribution to an additional tax on income. This means that a foreign employee will no longer be able to claim exemption from the labour market contribution, even if he or she remains under the home country's social security system. As a result, the effective tax rate for expatriates benefiting from the special régime is 31.9%, as the labour market contribution of 8% is deductible before computing the 26% income tax. The top marginal tax rate for salary taxed according to the ordinary rules is 56%.

To opt for the expatriate régime, the inbound expatriate must have a monthly salary of at least EUR 9333 on average or

be employed as an officially approved research worker. It is also a condition that the salary be paid by a Danish employer for work performed in Denmark, so the expatriate must have at least limited tax liability on his or her salary from the Danish employer.

### Withholding tax on dividends and interest

A big issue in Danish tax practice at the moment is the concept of 'beneficial owner', which is of importance where Danish companies distribute dividends or pay interest on loans from parent companies in other EU jurisdictions owned by companies from outside the European Union and resident in a jurisdiction with which Denmark does not have a double tax treaty. Whereas dividends and interest payable to EU-resident companies are >>

free of Danish withholding tax, this is not the case where the recipient is in a third country without a tax treaty with Denmark.

A couple of cases have already been decided by the Danish National Tax Tribunal (an administrative tax court) in favour of the tax authorities. They successfully argued that an EU parent company to which the income was paid was a conduit and that the income flowed through to the 'beneficial owner', a third-country resident. The taxpayers have appealed.

Furthermore, the Danish parliament has just passed new legislation, under which a cross-border merger between an EU parent company and a Danish company can be deemed to involve a dividend distribution from the Danish company, if the EU parent company is itself owned by a company in a third country with which Denmark has not concluded a double tax treaty. There is a deemed dividend in these circumstances where the beneficial owner is a company outside the European Union; in that case tax must be withheld by the Danish company. According to the ordinary rules, a cross-border merger with

an EU parent company may be effected free of tax without the advance approval of the tax authorities.

If dividend or interest is paid without withholding tax, the Danish payor company will be held liable for the withholding tax if at a later point in time it is established that the beneficial owner was not the EU parent company.

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## European Union

### No 'yellow card' for CCCTB

In Issue No 1 of *European Tax Brief*, we reported on the European Commission's draft directive on the Common Consolidated Corporate Tax Base (CCCTB), issued on 16 March.

Although the issue is highly controversial, the CCCTB has survived its first hurdle, the so-called 'yellow card test'.

Under this procedure, if a sufficient number of Member State parliaments (constituting one third of the aggregate votes) voice a valid objection in time to a draft directive, on the basis that the principle of subsidiarity has been violated, the Commission is obliged to reconsider the proposal. In the case of the CCTB, the deadline was 18 May. The parliaments of Bulgaria, Ireland, Malta, the Netherlands, Poland, Romania, Slovakia, Sweden and the United Kingdom lodged valid objections, but their combined votes fell just short of the required one-third.

As we also reported in April, business is (and remains) largely in favour of the proposal, but a surprise development was the German government's announcement, by way of a Parliamentary answer, that it objected to several key features of the directive, most notably that adoption of the common base would be optional, and not mandatory, and that the consolidation element would entail automatic cross-border loss consolidation. It favours instead a mandatory common base, so that companies and groups operating in more than one Member State would be obliged to have their profits calculated under the same set of rules in each Member State, but separately, so there would be no consolidation and hence no need for reallocation. This new German position is in direct

opposition to business organisations, for which it is precisely cross-border consolidation and the freedom to opt in or opt out that are paramount.

This new stance will undoubtedly make any final agreement more difficult to achieve.

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## France

### Wealth tax changes enacted

In proposals now enacted by Parliament but yet to be signed into law by the President, significant changes have been made to the wealth tax (*impôt de solidarité sur la fortune*). Whereas previously, the government had talked of abolishing the tax altogether, it has settled for a less politically controversial increase in the threshold at which the tax becomes payable, from EUR 800 000 to EUR 1 300 000. Also, the previous six-band rate structure is scrapped in favour of just two bands — 0.25% on total net taxable assets of between EUR 1.3 million and EUR 3 million, and 0.5% on assets of more than EUR 3 million. These are discrete bands, so that once the upper threshold is exceeded, the taxpayer's whole wealth is taxable at the higher rate. Similarly, whereas a taxpayer with taxable assets of EUR 1 300 000 would pay no tax, one with taxable assets of EUR 1 300 001 would in theory pay EUR 3250. To avoid two sudden jumps at both thresholds, there is a smoothing mechanism for taxpayers with taxable assets of between EUR 1.3 million and EUR 1.4 million and also for those with taxable assets of between EUR 3 million and EUR 3.1 million. These new thresholds and rates apply as from 1 January 2012. Existing exemptions and reliefs will still apply, but shareholders' loans to an SCI (*société civile immobilière* — a special type of property-holding company often used to invest in French property, especially by non-residents) will no longer be deductible for wealth-tax purposes.

For 2011, the new EUR 1.3 million threshold also applies, but otherwise the existing rate bands are unchanged. Under the existing rules, rates range from 0.55% to 1.8% and the bands are cumulative. The deadline for returns and payment, normally 30 June, has been extended to 30 September 2011 in the case of 2011 returns.



Wealth tax is payable on a person's net taxable assets as at 1 January of the relevant tax year. For residents of France, the tax extends to worldwide assets, whereas for non-residents, only assets situated in France (second homes, for example) are taxable.

Other changes to personal taxation include abolition of the *bouclier fiscal* ('tax shield') under which a French-resident taxpayer's aggregate liability to income tax, social security contributions on investment income, wealth tax and property tax on the taxpayer's principal residence could not exceed 50% of the previous year's taxable income.

#### **Second-home tax dropped at last moment**

In a surprise move, another element of the tax reform, a new tax on non-resident owners of second and holiday homes in France was dropped from the

Bill before it was presented to the upper house of the French parliament, the Senate. The government announced the decision on 20 June, after the tax had already been approved by the lower house, the *Assemblée Générale*. The new tax would have been charged at 20% of the home's theoretical annual rental value on all non-resident owned property, except for the principal residence. It would have replaced an income tax on three times the annual rental value of French property, payable only by residents of countries outside the European Union which do not have an appropriate tax treaty with France (see also below).

There were doubts as to whether the tax would have been compatible with European law, as there appeared to be no exemption for residents of other EU Member States.

## 3% property tax not in breach of EU Treaty

The 3% property tax referred to in the previous item has been held by the European Court of Justice (ECJ) not to be incompatible with European law as regards indirect ownership of French property by companies established in an 'overseas country or territory' (OCT) belonging to an EU Member State. This is, of course, not the first time that the tax has been the subject of litigation before the European Court.

The *Prunus* case (*Prunus SARL & Polonium SA v Directeur des services fiscaux d'Aix-en-Provence*, Case C 384/09) concerned a French-resident company, Prunus, which owned three properties in Paris during the years 1998-2002. Prunus was the subsidiary of a Luxembourg company that was in turn held by two companies resident in the British Virgin Islands (BVI), which is an OCT for the purposes of European law. During that time, the tax was payable, subject to several other exemptions, by any company that directly or indirectly owned any French immovable property and was neither resident nor effectively managed in France, nor resident in a jurisdiction that had an appropriate tax treaty with France. The British Virgin Islands did not have such a treaty.

Although Prunus and its Luxembourg parent were exempt from the tax, the two BVI companies did not satisfy any of the applicable exemptions, and were assessed to the tax as to 50% each. Furthermore, Prunus, as a French company interposed between the BVI companies and the properties, was served with a notice to pay the tax, as joint and several debtor. Prunus appealed and the case was referred to the European Court. The questions that the Court was required to decide were whether (a) the requirement that as a condition for its exemption from the tax a company had to be resident in a jurisdiction that had a double tax treaty with France containing a non-discrimination or information-exchange provision constituted an unjustifiable restriction on the freedom of movement of capital under [what is now] Article 63 of the Treaty on the Functioning of the European Union (TFEU) and (b) the imposition of joint and several liability for the tax on an interposed company constituted such an unjustifiable restriction.



**“It held in short that the European Treaties apply to OCTs in the same manner as they apply to Member States only where express mention is made of that fact.”**

The European Court first confirmed that Article 63 did indeed apply to movements of capital between a Member State and an OCT, as its scope was unrestricted, including all third countries. Second, previous decisions of the Court had established that cross-border investment in immovable property constituted a movement of capital and that the conditions for exemption from the 3% tax constituted a restriction on that freedom of movement.

However, what is now Article 64(1) TFEU provides that provisions restricting the free movement of capital between Member States and non-Member States which were already in existence at 31 December 1993 could continue in force. The 3% tax had come into force on 1 January 1993. It followed that the Court had to decide whether an OCT was or was not a non-Member State for this purpose.

It held in short that the European Treaties apply to OCTs in the same manner as they apply to Member States only where express mention is made of that fact. Since there was no such mention in Article 63ff, OCTs had to be treated as non Member States as regards the provisions on free movement of capital. Since the legislation on the 3% tax had been in force on 31 December 1993 and had not changed in any significant way by the time covered by the facts in the case, Article 64(1) applied and there was no breach of the Treaty as a consequence. Given that determination, there was no need to answer the second question, as to joint and several liability.

When investing in French real property through interposed companies, specific attention should be paid to the disclosure requirements imposed by the 3% tax legislation. Unlike other taxes, the 3% tax does not purport to bring revenue to the French Treasury but to target individuals hiding behind legal entities owning French properties and subject them to wealth tax and transfer taxes as the case may be. The 3% tax would only be imposed on legal entities that refuse to divulge the coordinates of their members to the French Revenue.

## Ireland

### Corporation tax start-up exemption

A corporation tax start-up exemption is available for companies that commence to trade during 2011. The exemption operates in such a way that the total corporation tax payable for an accounting period does not exceed EUR 40 000. The corporation tax liability of the company will be reduced by the amount of qualifying employers' PRSI (social security contributions) paid (subject to a maximum of EUR 5000 per employee). The value of the tax relief is closely linked with employment creation.

#### Lower employment costs

The Irish government recently announced the Jobs Initiative Programme, which includes a number of incentives to assist with employment generation. In an endeavour to improve Ireland's labour-cost competitiveness, the lower employer PRSI (social security contribution) rate (currently 8.5%) is to be reduced by 50%. This measure will apply in respect of jobs that pay up to EUR 356 per week. The lower rate (4.25%) will come into effect on 1 July and will remain in place until the end of 2013.

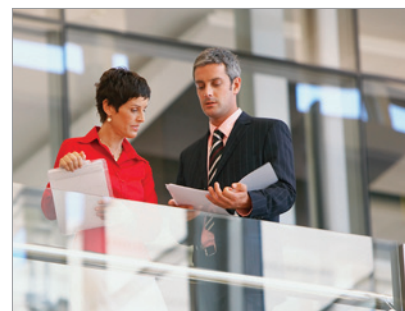
Under a separate scheme, the Employer Job (PRSI) Incentive Scheme, employers can be exempted from paying employer social security contributions altogether. This can represent a cash saving equal to 10.75% of an employee's salary. This exemption can apply for a 12-month period. The scheme is targeted at the employment of the previously long-term unemployed.

#### Research & development

A tax credit of 25% is available in respect of all qualifying incremental research and development (R&D) expenditure undertaken within the European Economic Area. This credit may be offset against the company's corporation tax liability in the period in which the expenditure is incurred and is in addition to the base corporation tax deduction. Consequently, it is possible to obtain a total saving of 37.5%. Should a company have excess R&D credit in a financial period it may opt to (a) carry it forward indefinitely for use in future periods; (b) surrender it to fellow group companies or (c) have the excess

refunded. An additional tax credit is granted on expenditure incurred on buildings or structures used in the research and development process. The Government has recently announced that the R&D tax-credit régime is to be amended to enable companies to account for the R & D credit 'above the line'. Essentially, this approach would enable companies to offset the R&D credit against expenditure incurred. This approach should prove useful to Irish subsidiaries of multinational groups, as it will enable them to compete with other jurisdictions and allow them to present overall project costs net of the credit.

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## Jersey

### Double Tax Agreements and Tax Information Exchange Agreements

The Organisation for Economic Co-operation and Development (OECD) has been aiming in recent years to promote transparency and exchange of information in connection with international tax matters. There has been a political commitment in Jersey to reflect the OECD's principles.

With the OECD's principles in mind Jersey has entered into a number of Tax Information Exchange Agreements (TIEAs) during the last few years. These agreements have helped to improve the transparency and cooperation between international tax authorities and Jersey. The first TIEA to come into force in Jersey was that with the United States, on 23 May 2006.

Jersey currently has a number of TIEAs in force and is also in the process of finalising a number of other agreements. Jersey has also approached a number of other countries and is awaiting a formal response, or has received positive feedback from them. These countries include OECD member states and G20 member states. Jersey, as a vice-chair of the Global Peer Review Group, attaches particular importance to entering into agreements on tax exchange with all G20 member states.

These agreements on the exchange of tax information support the promotion of Jersey as an international finance centre and its commitment to preventing international fiscal evasion and tax abuse by strengthening the information exchange network. >>

Recent developments in the move to create a more transparent tax information exchange system with Jersey have seen an agreement in principle put in place with Japan, which provides for the exemption of tax at source for certain income of individuals (such as pensions) to promote the free movement of people between the two countries. Jersey has also initialled a TIEA with Indonesia, which is a G20 member state, which is still to be signed and ratified before it can be put into force. TIEAs with China, Canada and Portugal are expected to come into force this year.

These improved relationships with other tax jurisdictions have also resulted in a recent development in the treatment of taxation of French residents in receipt of Jersey pensions. The TIEA with France came into force on 11 October 2010. Previously, individuals who were resident in France and in receipt of a Jersey pension would suffer both French income tax and Jersey income tax on the Jersey pension. As of 1 January 2011 individuals may now apply to receive their Jersey pension without deduction of Jersey income tax and will only suffer French income tax. This agreement covers both occupational and private pensions. There are also similar provisions to cover French pensions received by Jersey residents.

Jersey entered into a similar agreement in 2010 with the United Kingdom, which enables Jersey residents in receipt of UK pensions to receive the pension gross without deduction of tax in the United Kingdom. They will thus pay tax on the pension only in Jersey. There are also similar provisions to cover UK residents in receipt of Jersey pensions.

Jersey is expecting further advances in the exchange of tax information and hopes to see further benefits from entering into these agreements in the future.

Jersey has signed a comprehensive double taxation agreement (DTA) with Malta. This is the Island's first DTA based on the OECD Model Convention. It came into force on 19 July 2010. DTAs that existed prior to this date (such as those with Guernsey and the United Kingdom) contained a number of deficiencies compared with the OECD model. The most significant deficiency is the absence of a tie-breaker clause to determine in which state individuals are resident.

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## Netherlands

### Commission wants fiscal unity changes

The European Commission has officially requested that the Netherlands change its fiscal unity (group taxation) régime for corporate income tax. We expect that the Netherlands will comply, failing which the Commission would be expected to bring



an action at the European Court of Justice. The Commission believes that the Netherlands is in breach of the principle of freedom of establishment enshrined in the European Treaties inasmuch as a fiscal unity cannot be formed by two Netherlands companies under the direct ownership of a non-resident entity.

#### Fiscal unity rules

The Netherlands fiscal unity régime provides for a parent company and any of its subsidiaries in which it holds 95% or more of the legal and economic ownership of the shares to be treated as a single entity for the purposes of corporate income tax.

Currently, the law stipulates that both the parent and the subsidiary(ies) must be resident in the Netherlands for this purpose. Moreover, a fiscal unity may not

be formed by two or more Netherlands-resident subsidiaries, if their parent company is non-resident.

Once a fiscal unity has been created, the members of the fiscal unity are treated as one entity for the purposes of the corporate income tax. This means that just one corporate income tax return need be filed and internal pricing is entirely irrelevant within the fiscal unity. Furthermore, profits and losses are offset against one another and one consolidated Netherlands fiscal result is attained. The individual legal entities do still have the legal obligation to make their standalone financial statements for the purposes of company law.

#### Freedom of establishment

The principle of freedom of establishment is contained in Article 54 of the Treaty >>

on the Functioning of the European Union (TFEU). Essentially, the principle precludes the Member States from imposing legislation that is more disadvantageous for foreign legal entities than domestic legal entities in comparable situations, except in certain narrowly defined circumstances.

In this instance, the Commission believes that the criterion requiring the parent company to be resident in the Netherlands is discriminatory. It reasons that parent companies in the Netherlands are treated more favourably than foreign parent companies, since the latter may not request a fiscal unity be formed by their two or more resident subsidiaries whether Netherlands-resident companies may do so.

The European Commission has written to the Netherlands under the formal ‘reasoned opinion’ procedure, under which the Netherlands must within two months either respond by stating its intention to amend the offending legislation or clarify why it is of the opinion that its legislation is not in violation of the TFEU. Failure to do so within two months may cause the Commission to take proceedings before the European Court.

“We are of the opinion that the Netherlands legislation in its current form is indeed in violation of the Treaty.”

#### Our opinion

In 2008, the European Court of Justice held (in the *Papillon* case, C-418/07) that the French *intégration fiscale* system of group taxation, which is similar to that of the Netherlands, may not exclude companies held via a non-resident member from the group. In that



particular case, the parent company, which was resident in France, held all the shares in a foreign company, resident elsewhere in the European Union, which in turn held all the shares of a French-resident subsidiary. French law stipulated that the parent company and the sub-subsidiary could not form a French tax group because the shares in the sub-subsidiary were not held directly by French-resident shareholders. The European Court of Justice found this rule incompatible with and therefore in violation of the Treaty, since a solely French-resident group would be treated more favourably.

From a practical standpoint, foreign parent companies with two or more Netherlands-resident subsidiaries should be able to file for treatment as one single entity for the purposes of corporate income tax in the Netherlands. In a lot of cases, this can be advantageous from a Netherlands tax perspective, and can limit the administrative burden of filing multiple corporate income tax returns in the Netherlands.

We are of the opinion that the Netherlands legislation in its current form is indeed in violation of the Treaty. Further, we do not believe that any of the accepted justifications for permitting discriminatory treatment can apply in this case. Nevertheless, although the

Netherlands wishes to remain fiscally competitive, amending the legislation in order to comply with the Commission’s opinion may be too bitter a pill to swallow at a time when the national finances are already strained. There remains the possibility that the Minister of Finance will wait for a case to wind its way through the European Court, in order to buy time.

#### New government’s fiscal agenda

On behalf of the new right-wing government, the Secretary of State has sent the ‘fiscal agenda’ to Parliament. This programme translates the political principles of the government into proposals for the development of the tax system in the Netherlands. The main features of the agenda are highlighted below.

Taxes on labour will be reduced while taxes on consumption will increase. The rates of income tax may be reduced in return for higher VAT. With a higher VAT rate, it may also be possible to reduce the number of national taxes from 22 to 16. Minor taxes, such as packaging tax, could be abolished. For example, the government wants in its term of office to take a first step in this direction by a limited increase of the reduced VAT rate by two percentage points, from 6% to 8%.

It is intended to enlarge the tax base and

reduce tax exemptions, which provides for simplification and lower rates.

The possible erosion of the tax base for corporate income tax will be tackled by:

- introducing an interest-deduction limitation; and
- exempting profits and losses of foreign permanent establishments, the idea being to prevent the offset of foreign

branch losses against domestic profits.

As a result the corporate tax rate can then be reduced to 24%.

The possibilities of a payroll levy will be subject to examination.

Communication between tax authorities

and taxpayers will be simplified by use of digital tools such as a personal web page.

Measures are being taken to reduce tax fraud and fraud detected will be dealt with firmly.

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## Norway

### Simplified VAT scheme for imported electronic services

The Norwegian government has introduced a simplified VAT scheme for non-established vendors supplying electronic services to consumers in Norway, with effect from 1 July 2011.

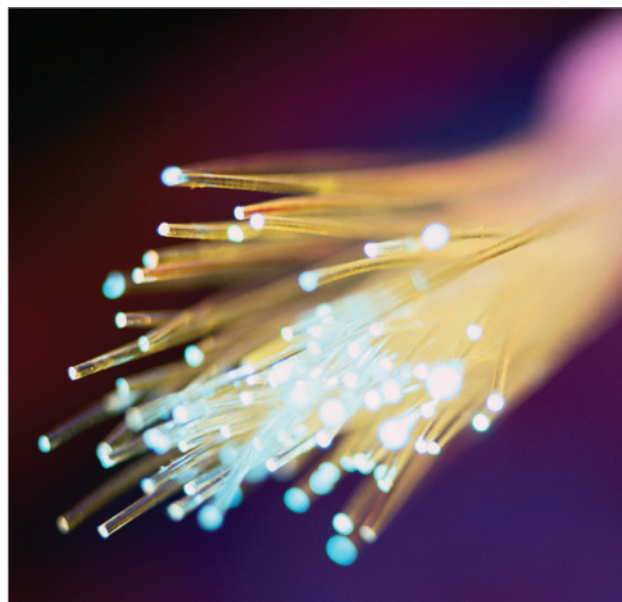
The intention is to create a level playing field for electronic services supplied from within Norway and supplied from abroad to Norwegian consumers.

Since 2001, supplies of electronic services by vendors established in Norway to Norwegian consumers have been subject to VAT in Norway. In December 2010, the Norwegian Parliament passed a bill imposing VAT also on purchases of electronic services from abroad by consumers in Norway at the standard rate of 25%. To accompany this change, which took effect on 1 July, the Ministry of Finance has introduced a simplified VAT scheme for non-established vendors supplying electronic services to consumers in Norway. The scheme provides for electronic and simplified registration and reporting procedures as from the same date.

The scheme will mainly affect vendors supplying electronic services from abroad. Such persons include those contractually responsible for the content of the services as well as certain types of intermediaries.

The main features of the simplified scheme are:

- the non-established vendor (including for this purpose also certain Norwegian intermediaries) supplying electronic services will be liable to account for VAT when supplying such services to Norwegian consumers. However, when electronic services are supplied domestically, both the supplier and the intermediary may be liable for VAT;
- vendors supplying electronic services will be required to register for VAT in Norway, but may opt to use a simplified VAT scheme, as an alternative to registration;



- vendors will have to communicate electronically with a single tax office in Norway, and be subject to electronic and simplified registration and reporting procedures and simplified documentation requirements;
- vendors opting for the simplified VAT scheme will be subject to most of the general provisions in the VAT Act, such as the general duty of disclosure. The vendors will also be subject to the VAT Act's penalty provisions, including civil penalties and criminal proceedings;
- vendors will not be able to deduct input VAT in the VAT return, but will be eligible for input VAT refunds; and
- quarterly turnover and VAT returns will have to be filed.

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# Ukraine

## New Tax Code

On 1 January 2011, major provisions of the new Tax Code of Ukraine ('TCU') came into force. The TCU was long-awaited and is the first codified law in the history of Ukrainian tax legislation. Previously, various different statutes contained the basic rules for various taxes. The TCU is more than a consolidating measure, however. The opportunity has also been taken to introduce material changes to the tax system, not all of which can be judged as positive.

### Corporate profit tax

#### Tax rates

Several changes have been made to the corporate profit tax (*podatok na prybutok pidpryjemstv*), with effect from 1 April 2011. The 25% rate has been reduced to 23%, and further progressive reductions are scheduled, as follows:

**Table 3**

Date	Rate of tax
1 April 2011 — 31 December 2011	23%
1 January 2012 — 31 December 2012	21%
1 January 2013 — 31 December 2013	19%
1 January 2014 —	16%

### Beneficial owner

The TCU introduces the concept of 'beneficial owner', which is new to Ukrainian tax law. Henceforth, only the beneficial owner may benefit from the reliefs afforded by Ukraine's double tax treaties or, in some instances, deduct certain expenses against tax.

### Computational rules

The main tendency of the TCU is to align the computation of profits for tax purposes more closely with national accounting standards. Thus, where concepts are not defined specifically in the TCU, their meaning will be taken from accounting standards.

Taxable profit is now assessed as income less cost of sales and other expenses, calculated using the accruals concept. This entails abolition of the so-called 'first event rule', under which advance payments made or received determined the time at which transactions were taken into account for tax purposes. Tax depreciation rules have also been more closely aligned with accounting standards, in place of the previous specific tax-depreciation rules.

The TCU removed some restrictions on tax-deductible expenditure (e.g. only 50% of the expenditure on car fuel or car leasing was allowable, and certain promotional expenses were

deductible only to the extent that they did not exceed 2% of the previous year's turnover), but replaced them with others.

Under the TCU:

- Expenditure on consulting, marketing and advertising services from non-residents are generally tax-deductible in the amount not exceeding 4% of the preceding year's turnover. This restriction does not apply to services purchased from Ukrainian permanent (commercial) representative offices of non-residents. This expenditure is wholly disallowed where the providers have so-called 'offshore status', i.e. are located in 'blacklist jurisdictions'.
- Expenditure on engineering services provided by non-residents are tax-deductible in the amount not exceeding 5% of the customs value of the equipment imported under the respective contract. This expenditure is wholly disallowed if:
  - the services are provided by non-residents having offshore status; or
  - payable to a recipient who does not qualify as the 'beneficial owner' of the payment.

### Restrictions on royalty payments

The TCU has introduced wholly new restrictions on the deductibility of royalty payments. Where paid to non-residents, royalties are:

- not deductible in the amount exceeding 4% of the previous year's turnover, except for:
  - royalties payable to permanent (commercial) representative offices of non-residents; and
  - certain literary, artistic, television and cinematographic royalties.
- wholly non-deductible if payable:
  - to non-residents having offshore status;
  - to persons not qualifying as the beneficial owner of the payment;



- in respect of intellectual property originating in Ukraine (i.e. where the underlying intellectual property has been exported from Ukraine); and
- to persons not taxable in their country of residence in respect of those royalties.

These restrictions are now the subject of active public discussion between the Ukrainian authorities and taxpayers and some of them may well be reduced in severity or abolished altogether.

Amongst other material changes, the TCU allows the carry-forward of tax losses of previous reporting periods with no restrictions. Previously, there existed some specific limitations.

The TCU also contains provisions establishing tax holidays for certain qualifying taxpayers. Under these provisions the 0% CPT rate is applicable to such taxpayers during the period from 1 April 2011 until 1 January 2016.

It is generally felt that the TCU contains various deficiencies and inconsistencies, and there a number of draft amending Acts already being considered by the Parliament (*Verkhovna Rada*). Some of these have already been enacted, such as the amendment removing the exemption from VAT of consulting, engineering, legal, accounting, audit and certain other services.

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## United Kingdom

### Consultation on CFC reform

In advance of the Parliamentary summer recess, the UK government has published a number of tax consultation documents, including one on a statutory definition of 'residence' for individuals and another on the further reform of the controlled foreign company (CFC) rules.

Published on 30 June 2011, the CFC document builds on proposals from the initial November 2010 consultation, and interim measures included in the current Finance Bill (expected to become the Finance Act 2011 shortly).

The proposals are designed to prevent tax avoidance without discouraging multinational companies from UK residence by:

- targeting profits artificially diverted from the UK, particularly in the areas of monetary assets and intellectual property; and
- exempting profits that arise from genuine economic activities undertaken offshore.

The mechanics of the new CFC régime and the requirement for companies to self-assess their liability would remain largely unchanged from the existing rules. As now, the régime would operate by

identifying companies resident outside the United Kingdom but under UK control that are subject to a 'lower level of tax', and then providing for a number of exemptions to remove companies that do not give rise to the artificial diversion of UK profits.

A 'lower level of tax' is currently a level that is less than 75% of the liability that would arise if the company were resident in the United Kingdom (so, broadly speaking, and all other things being equal, subject to a tax rate currently of less than 19.5%) and there are no changes proposed to this test. Capital gains would remain outside the scope of the régime (subject to existing anti-avoidance provisions).

The proposals include a 'general purpose exemption' to apply where CFCs can demonstrate that profits have not been artificially diverted from the United Kingdom. This would effectively replace the 'motive test' under the current rules, but without the default assumption that profits would otherwise have arisen within the United Kingdom. An 'excluded-countries exemption' will apply in respect of a list of companies in countries that have broadly similar tax

rates and bases to the United Kingdom, and a number of options for drawing up this list are explored.

There are also various proposals to extend the low-profits exemption (which currently, broadly, extends to profits of up to GBP 200 000). 'Territorial-business exemptions' would exclude genuine overseas trading operations with a relatively modest operating margin from the charge, and incidental finance income that arises from the working capital of such businesses would also be exempt.

A partial exemption for finance companies would normally result in a tax charge at a quarter of the main rate on those overseas profits: i.e. at 5.75% by the time the main rate reduces to 23% in 2014. The government is also considering whether a full exemption may be appropriate for such companies in certain circumstances.

Sector-specific rules are also proposed for insurers and banks (i.e. where monetary assets are an intrinsic part of the trade).

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## Statutory residence test proposed

In another consultation document, published on 17 June, the government has issued draft proposals for a statutory definition of when an individual is considered to be resident in the United Kingdom for tax purposes.

Under the current rules, there is no definition in tax legislation, and reliance has to be placed on case law (including some decisions made over a century ago) and guidance from HMRC (the tax authorities), which is subject to change and can be challenged in court.

The proposed new rules are intended to provide greater certainty. They distinguish between ‘leavers’ (individuals who were resident in at least one of the previous three tax years) and ‘arrivers’ (who were not resident in any of the three previous tax years). The rules are drafted so that it will be more difficult for leavers to cease being resident than it will be for arrivers to become resident.

“The proposed new rules are intended to provide greater certainty.”

As currently, if an individual is present in the United Kingdom at midnight at the end of a day, this will count as a day of presence for residence purposes.

There are three separate parts to the proposed new test. Part A sets out the circumstances in which an individual will be *conclusively* regarded as *not resident* in the United Kingdom. It sets a limit on the number of days in a tax year in which the individual can be physically present and yet not be resident:

- for an arriver, this is fewer than 45 days;
- for a leaver, the limit is fewer than 10 days; and
- for a leaver in full-time work abroad, the limit is fewer than 90 days.

Further rules apply to define ‘full-time work abroad’ for this purpose.

Part B sets out circumstances in which an individual will be *conclusively* regarded as *resident* in the United Kingdom:

- where he or she is present in the United Kingdom for 183 days or more in a tax year;
- where the individual's only home is (or all his or her homes are) in the United Kingdom; or
- where the individual is working full-time in the United Kingdom.



If, unusually, both Part A and Part B are satisfied, Part A will take precedence so that the individual is not resident, as for example, where a person's only home was in the United Kingdom, but he or she spent less than 10 days in the country in a particular tax year.

Part C applies where an individual's circumstances are more complex, and neither Part A nor Part B gives a conclusive answer. In such a case, Part C looks at a number of ‘connecting factors’ to determine the individual's residence status alongside the number of days of presence. These factors are:

- whether the individual's family is resident in the United Kingdom;
- whether the individual has accessible accommodation in the United Kingdom and makes use of it;
- whether the individual has a ‘substantive’ employment or self-employment in the United Kingdom;
- whether the individual was present for 90 days or more in either of the two previous tax years; and
- whether (in the case of leavers only) the individual spent more time in the United Kingdom than in any other single country in the tax year.

Existing anti-avoidance rules tax certain capital gains made by individuals while resident abroad for less than five full tax years, bringing the gains into charge on the individual's return to the United Kingdom. It is proposed to extend these rules to certain types of income derived during the years of non-residence. The extended rules would not apply to bank interest or dividends from listed companies, but could apply to dividends paid by private family-controlled companies which reflect profits earned during periods of UK residence.

A statutory definition of ‘ordinary residence’ is also proposed. Ordinary residence is a concept separate from residence, and in practice affects mostly some taxpayers in their first three years of residence.



Overall, the new tests should provide more clarity, but applying the connecting factors as they stand might raise some difficulties, which it is hoped the consultation process will resolve.

### Tax changes for non-domiciles

In his Budget statement in March, the Chancellor of the Exchequer proposed certain changes to the taxation of individuals resident or ordinarily resident, but not domiciled, in the United Kingdom ('non-domiciles'); see Issue 1 of *European Tax Brief*. A consultation document containing details was published on 17 June.

Changes identified in the document include an increase in the annual charge for use of the 'remittance basis' of taxation payable by non-domiciles who have been resident in the United

Kingdom for at least 12 of the previous 14 tax years from GBP 30 000 to GBP 50 000. The GBP 30 000 charge will remain unaltered, however, for those individuals who do not meet this test but have been resident in the United Kingdom for more than seven out of the previous nine tax years. Under the remittance basis, non-domiciles may elect to be taxed only on the amount of income or capital gains derived in, or remitted to, the United Kingdom. There are complex existing rules to determine when income or gains are to be regarded as remitted. However, there is also the intention to exempt income or gains remitted to the United Kingdom for the purposes of commercial investment in a qualifying business, and there are also proposals to simplify certain aspects of the non-domicile régime.

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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 14 July, and are for illustrative purposes only.

Currency	Equivalent in euros (EUR)	Equivalent in US dollars (USD)
Euro (EUR)	1.0000	1.4195
Pound sterling (GBP)	1.1357	1.6120

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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