

Global Dispatch

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Colombia

Colombian withholding tax on gross income recognized from export of hydrocarbons, other mining products and gold

Colombia's latest tax reform, passed in December 2010, (Law 1430, 2010) provided for income tax self-withholding on gross income recognized from the exportation of hydrocarbons and mining products. The new law provided that the applicable rate would not exceed 10%, but that the actual rate should be established through regulations. As described below, this withholding represents an advance payment of income tax liability.

In this regard, regulation (Decree) 1505, 2011 was issued on 9 May 2011 and introduced a 1% rate to be applied to the amount of income accrued or received, whichever occurs first. The tax base is calculated based on the exchange rate applicable to the day which the amount is accrued or received, regardless of whether the income is received in Colombia or abroad.

The application of this 1% income tax withholding also includes transfers of gold to "international trading companies," as defined, incorporated under Colombian legislation.

For purposes of the payment of this withholding, the Colombian exporter, the beneficiary of the income, is the self-withholding agent.

From a practical point of view, this tax withholding constitutes an advance on the final corporate income tax liability of the current fiscal year. Once the annual corporate income tax liability is calculated, the amount of this tax is applied as an advance payment, with the following results:

- If the annual income tax liability exceeds the 1% withholding tax, the income tax withholding will reduce the final amount payable and the taxpayer will make a final payment

- ▶ If the final income tax liability is lower than the 1% withholding tax, the excess can be requested as a refund, as provided in the Colombian tax legislation

It should be noted that the government is discretionally entitled to increase the 1% rate up to 10%, which is the maximum rate authorized by the law.

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Dominican Republic

Dominican Republic issues transfer pricing regulations

The Dominican Republic issued Revenue Ruling No.04-2011, dated 2 June 2011, that establishes the regulations applicable to individuals or business entities that have related party transactions.

Transfer pricing rules have been in effect in Dominican Republic since 1 January 2007 when Article 281 of the the Dominican Republic Tax Code (TC) was amended to empower tax authorities to adjust transfer prices that do not meet the arm's length standard. However, the reform did not include any documentation requirements or methodology to be followed in order to determine arm's length prices.

The key considerations of these new regulations are as follows:

- ▶ The regulations will apply to any transaction between associated enterprises involving goods, services, or intangible assets.
- ▶ The regulations will apply to:
 - 1) cross-border transactions;
 - 2) transactions conducted with tax havens; and
 - 3) transactions conducted with a related party that operates under the Free Trade Zone regime.
- ▶ For the interpretation of Revenue Ruling No.04-2011, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations are adopted.
- ▶ An annual transfer pricing informative return should be filed with the Dirección General de Impuestos Internos (DGII) within 60 days after the period to file the Income Tax return has expired.
- ▶ During the first year of application of the regulations, an extension of 30 additional days may be granted by the DGII to file such informative return.
- ▶ Transfer pricing documentation is required; that is, records need to be kept to support the arm's length nature of prices and information declared in the informative return.
- ▶ The regulations provide detailed information regarding the information to be included in the documentation.

- ▶ The new rules primarily provide the definition of related party, regulate the criteria that taxpayers must follow to perform a comparability analysis, and establish the transfer pricing methods to apply when assessing the mentioned arm's length principle.
- ▶ The regulations will be effective for accounting periods ending on or after 31 December 2011.

What should companies be doing now?

- ▶ Companies doing business in the Dominican Republic should review and inventory all their existing intercompany transactions and assess which transactions are likely to fall under the new regulations.
- ▶ Then they should assess which transactions meet the arm's length standard and determine which are within the scope of the rules.
- ▶ They should also assess what new intercompany transactions are anticipated in the next months where transfer pricing support will be required.
- ▶ Companies should have the required transfer pricing study to support their related party transactions.

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India

Mumbai Tribunal rules on transfer pricing issues

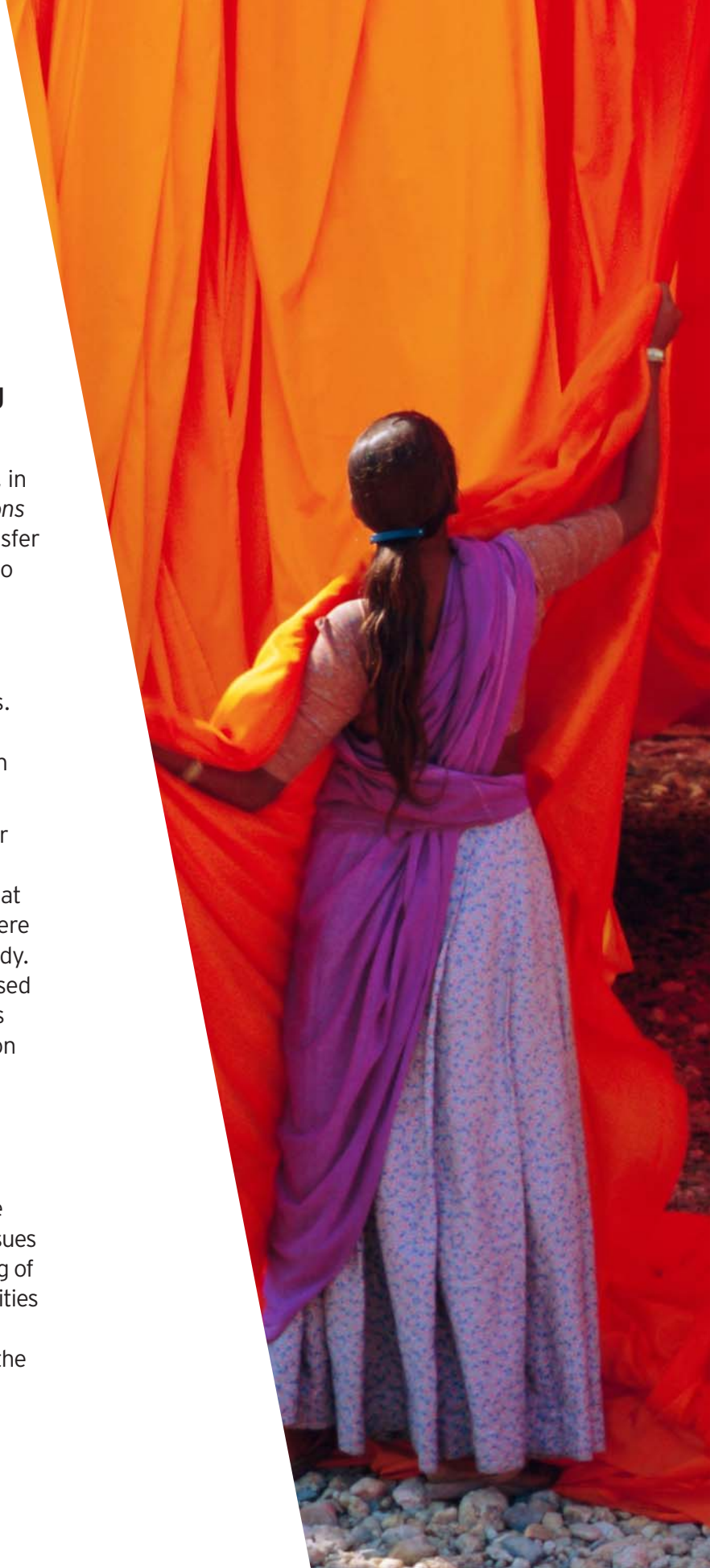
The Mumbai Income-tax Appellate Tribunal (Tribunal), in a ruling in the case of *M/s. Symantec Software Solutions Private Ltd* (Taxpayer) has adjudicated on certain transfer pricing issues with respect to transactions entered into by the Taxpayer with its associated enterprises (AEs).

Consistent with earlier rulings, the Tribunal observed that the Transactional Net Margin Method (TNMM) does not permit comparison of enterprise level profits. However, the Tribunal did not specifically rule on this point as the tax authority did not raise an objection on the combined approach adopted by the Taxpayer.

The Tribunal also held that the Transfer Pricing Officer (TPO) is empowered to consider all the data that are relevant for determining the arm's length price (ALP) at the time of such calculation even though such data were not available to the taxpayer at the time of the TP study. The Tribunal held that multiple year data cannot be used in all cases, but must be used in limited circumstances where such data has an influence on the determination of transfer price.

The ruling provides useful guidance on some aspects of the Indian transfer pricing rules such as the use of multiple year data and updating of comparable company margins during assessment proceedings. One controversial area in transfer pricing relates to timing issues in comparability both on timing of origin as well as timing of collection. It appears from the ruling that the tax authorities are not precluded from using data not available to the taxpayers at the time of filing the tax return, as long as the data relates to the relevant fiscal year.

The ruling highlights the importance of adequately documenting key issues such as justification for use of multiple year data, differences in functions and risks between the tested party and the comparables and



justification for use of quantitative filters for accepting/rejecting comparable company data.

Taxpayers should consider the impact of this ruling while preparing their transfer pricing documentation.

India - Vijay Iyer and Rajendra Nayak
(Bangalore)

Indian Tribunal rules “cost only” reimbursement unjustified, aggregation approach inappropriate

The Mumbai Income-tax Appellate Tribunal (Tribunal), in a ruling in the case of *M/s. Exxon Mobil Company India Private Ltd* (Taxpayer) has adjudicated on certain transfer pricing (TP) issues with respect to transactions entered into by the Taxpayer with its associated enterprises (AEs).

The Tribunal held that “cost only” reimbursement (without any mark up) is not justifiable as no part of the income derived by the AE from the activity of the Taxpayer is shared with the Taxpayer and the entire benefit of the activity is enjoyed by the AE. The Tribunal also agreed with the findings of the Transfer Pricing Officer (TPO) that the Taxpayer would not have rendered similar services to any third party without charging any mark up.

The Tribunal also held that the aggregation approach adopted by the taxpayer is not appropriate. The Tribunal held that use of data

from two years prior to the subject transactions is only an exception subject to the burden of proof on the Taxpayer to demonstrate that the prior year data has an influence on the determination of arm’s length price. The Tribunal stated a general point that it is not acceptable to assume multiple year data would provide for better comparability.

The Tribunal held, as a general principle, both loss making comparable companies and high profit companies cannot be eliminated from the analysis unless, there are specific reasons for eliminating the same. The basis of elimination should be other than the general reason that a company has incurred a loss or made abnormal profits. In the context of rejecting a loss making company, the Tribunal observed that as the taxpayer is a captive unit that does not bear market risk, a company that has incurred losses on account of level of competition in the market cannot be used as a comparable.

In recent years, the arm’s length transfer price for intra-group services has become one of the critical transfer pricing issues in India. This ruling emphasizes that under the arm’s length principle, based on the overall benefit derived from undertaking a particular activity, the parties to the intercompany transaction need to be adequately compensated and a “cost only” charge for intra-group arrangements may not sustain the test.

The ruling also highlights the importance of adequately documenting key issues such as justification for use of multiple year data, rationale for inclusion of loss making companies and/or exclusion of high profit companies and the need to ensure that selection of comparable data is consistent with the functional and risk profile of the tested party.

India - Vijay Iyer and Rajendra Nayak
(Bangalore)

Japan

Japan’s 2011 tax reform: current status

On 10 June 2011, a partial revision of the income tax law (Original bill), submitted to the Japanese Diet on 25 January 2011, was renamed as “Reform bill for partial revision of income tax law, etc. in response to the changing economic structure” with revisions made to certain items from the Original bill (Revised bill). The Revised bill has not been passed in the Diet yet and is still under discussion prior to enactment.

On 22 June 2011, certain items from the Original bill were enacted; however certain key items including a corporate tax rate reduction and changes in the net operating loss provisions are still under discussion.

As mentioned above, certain items in the Original bill (excluding a five-percentage point corporate income tax rate reduction, changes in the

net operating loss provisions, etc.) were submitted separately to the Diet and enacted on 22 June 2011.

Key items enacted on 22 June 2011 and Revised bill

The key items enacted on 22 June 2011 include:

- ▶ Extension of the special provision for R&D tax credit
- ▶ Contribution in-kind by foreign corporations

The key items in the Revised bill include:

- ▶ Reduction of corporate tax rate
- ▶ Changes in the net operating loss provisions

Note that further details regarding provisions enacted on 22 June 2011 should be provided through revisions to government ordinances which are to be released soon. The Revised

bill has not been enacted yet and a specific schedule for enacting has not been fixed at this stage.

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Netherlands

Developments in Dutch fiscal unity regime

The European Commission has recently formally requested the Netherlands to amend its tax rules, which currently do not allow two sister companies to form a fiscal unity where they are held by an EU parent. In the meantime, a Dutch district court decided that a fiscal unity should be possible between a Dutch parent and its lower-tier

Dutch subsidiaries, held through EU intermediary companies. These are important developments for (multinational) groups with profits and losses in the Netherlands that cannot be compensated under current Dutch fiscal unity rules.

Dutch *Papillon* fiscal unity

On 9 June 2011, the Haarlem District Court in the Netherlands reached a decision allowing a fiscal unity between a Dutch parent and its lower-tier Dutch subsidiaries where the lower tier Dutch subsidiaries are held through foreign intermediary companies. In the litigated case, the Dutch parent held its Dutch lower-tier subsidiaries through German intermediary companies.

Forming a fiscal unity for Dutch corporate income tax purposes is subject to a number of requirements. The main requirement is that the



parent of the fiscal unity should own (directly or indirectly) at least 95% of the legal and economic ownership of a subsidiary in order to form a fiscal unity with such subsidiary. In the event of indirect ownership, all companies in the chain of shareholdings should be resident in the Netherlands. A fiscal unity is, in principle, available for Dutch resident companies only; however, foreign companies may be included in a fiscal unity to the extent a permanent establishment is present in the Netherlands.

As a consequence, the formation of a fiscal unity between a Dutch parent and its Dutch lower-tier subsidiaries, held through a foreign intermediary company, as in the litigated case, is not possible. The taxpayer argued, by referring to a similar case rendered by the European Court of Justice (ECJ), the so-called *Papillon* case (C-418/07), that this constitutes an unjustified restriction of the freedom of establishment as laid down in EU law.

The District Court, in principle, agreed with the taxpayer on this point, although considered that this restriction may be justified by the need to prevent double loss compensation. While acknowledging that, under Dutch tax rules, a tax loss at the level of the Dutch lower-tier subsidiaries may potentially be utilized at the level of the Dutch parent, for example, when one of German intermediary companies is liquidated, the District Court

concluded that the restriction is disproportionate. Considering that Dutch tax rules contain necessary tools to mitigate the risk of double loss compensation, the District Court held that an unconditional disallowance of a fiscal unity, without leaving the taxpayer the possibility to demonstrate that double loss compensation is not present, is not in line with EU law.

It is anticipated that the Dutch State-Secretary of Finance will lodge an appeal against this decision.

Dutch “horizontal” fiscal unity

As noted earlier, on 8 June 2011 the European Commission (Commission) formally requested that the Netherlands amend its tax rules which do not allow two sister companies to form a fiscal unity where they are held by an EU parent. This constitutes restriction of the freedom of establishment, without valid justification, since both sister companies are resident in the Netherlands, according to the Commission. The Commission uses the abovementioned *Papillon* case as a basis and feels that a similar line of reasoning should be used. The Netherlands has two months to respond satisfactorily. Otherwise, the Commission may take the Netherlands to the ECJ.

The above developments are, however, of practical importance for multinational groups with profits and losses in the Netherlands that, under current Dutch fiscal unity

rules, cannot be compensated. These groups should review how these developments fit into their profile. In our view, there are indeed strong arguments that a fiscal unity should be possible in the instant two cases. In general, we believe that these developments can be considered as a way forward towards a more “territorial approach” of the Dutch fiscal unity rules, whereby all Dutch operations can be joined in a fiscal unity, notwithstanding the group corporate structure, at least within the EU. Please note that the analysis might differ significantly if the (intermediate) holding company were located outside the European Union.

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Thailand

Thailand enacts tax incentives for international procurement centers

The Thai government enacted incentive provisions for international procurement centers (IPC), which became effective 5 May 2011, in an effort to promote Thailand into one of the leading international distribution hubs in Asia. The incentives are offered for trading

activities that are carried on either entirely offshore or from onshore to offshore.

Key tax benefits

The corporate tax rate is reduced from 30% to 15% on the following qualified income for five consecutive accounting years:

- ▶ Income from offshore buy/sell activities with a corporation's overseas associated enterprises without importation of products into Thailand; and

- ▶ Income from sale of raw materials or parts to a corporation's overseas associated enterprises that have manufacturing facilities located outside of Thailand. Raw materials and parts may be purchased from either within or outside of Thailand.

This tax incentive program may create sufficient benefits for foreign multinational companies to move some of their large distribution operations to Thailand or consolidate

various distribution functions currently undertaken in different jurisdictions and house them in Thailand.

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