

# Global Dispatch

## Brazil

### Brazil provides tax incentives to stimulate private funding for infrastructure projects

On 27 June 2011 the Brazilian government converted Provisory Measure 517 (MP 517) into Law 12,431.

MP 517 and Law 12,431 are intended to stimulate private funding in strategic infrastructure projects in Brazil. The following are some of the more significant provisions of the new law.

#### 0% withholding tax on income received from bonds related to infrastructure projects

The income received by foreign investors with respect to bonds and securities issued as of 1 January 2011 by private companies and traded in organized markets is subject to a 0% withholding tax rate.

The 0% WHT benefit is now extended to payments by local investment funds held exclusively by nonresident investors that invest at least 98% of their resources in the bonds and securities mentioned above.

According to MP 517 and Law 12,431, the reduced rate only applies when certain requirements are met, such as: (1) the bonds are issued by a non-financial institution, have a pre-determined interest rate and a maturity term longer than four years; (2) no repurchase option by the issuer is available within the first two years after its issuance; (3) no resale commitment by the buyer; (4) periodic interest payments; (5) the foreign investor must be registered under Resolution 2,689/2000 and not resident in a low tax jurisdiction as defined by the Brazilian tax regulations.

#### Debentures issued by special purpose entities in infrastructure projects (SPE Debentures)

Law 12,431 confirmed that the interest income from debentures issued in the period January 2011 to December 2015 by a special purpose entity (SPE) incorporated with the purpose of implementing infrastructure projects

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approved by the Government, are (a) exempt of withholding tax if received by individuals resident in Brazil, or (b) subject to 15% withholding tax when received by local entities.

A penalty of 20% of the value of the issuance might be applied to the participants of the SPE in case the SPE fails to implement the expected infrastructure project.

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## **Brazilian government issues new tax regulations regarding derivative contracts**

In order to build a legal framework for the regulation of derivative contracts, the Federal Government issued a Provisional Measure (Medida Provisoria) allowing the National Monetary Council to set margin deposits, length and other conditions for transactions with derivatives. Provisional Measure 539, enacted on 27 July 2011, also stated that derivative contracts must be registered with a clearing house authorized by the Brazilian Central Bank (BACEN) or the Brazilian Securities and Exchange Commission (CVM). It also established that such derivative contracts would (as of

the issuance of the Provisional Measure) be subject to the Financial Transactions Tax - IOF at a maximum rate of 25%.

On that same date, the Federal Government also issued a Decree on this same subject. Federal Decree 7,536 amended the IOF regulations (Federal Decree 6,306) with regards to two topics. First, a correction was made to a paragraph within article 15-A, which deals with FX transactions. Paragraph 2 now states that should loan transactions be redeemed before the 720-day period (earlier version read 360-day period), IOF at 6% will have to be collected along with penalties.

Second, new regulations were established for IOF on transactions with derivatives. According to article 33-B (just added to the IOF regulations), derivative transactions must be subject to IOF at a 1% rate (not the cap of 25%) on the purchase, sale or liquidation of contracts that are exposed to FX variation and that, by the time of liquidation, result in a higher exposure to a "short" position. The taxable basis should be the notional value of the derivative contract; that is, the result of the total value of the contract times the difference between the value of the derivative contract and the value of the underlying asset. The taxpayer of the IOF will be the holder of the derivative and responsibility for the actual collection of the IOF will be the institution intermediating the transaction.

Exposures in different positions that one investor may have with different institutions (authorized to deal with derivatives) may be used to offset each other thus reducing the taxable basis. However, if the positions are held in only one entity (dealing with derivatives), then the investor may be entitled to a 0% rate if the exposure to a "short" position does not surpass USD10 million.

Although regulations were enacted on 27 July, they will only be enforced on 5 October 2011. This means that all derivative transactions subject to the before-mentioned IOF that occur from 27 July to 30 September 2011 will be subject to IOF collection on 5 October 2011.

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## **Canada**

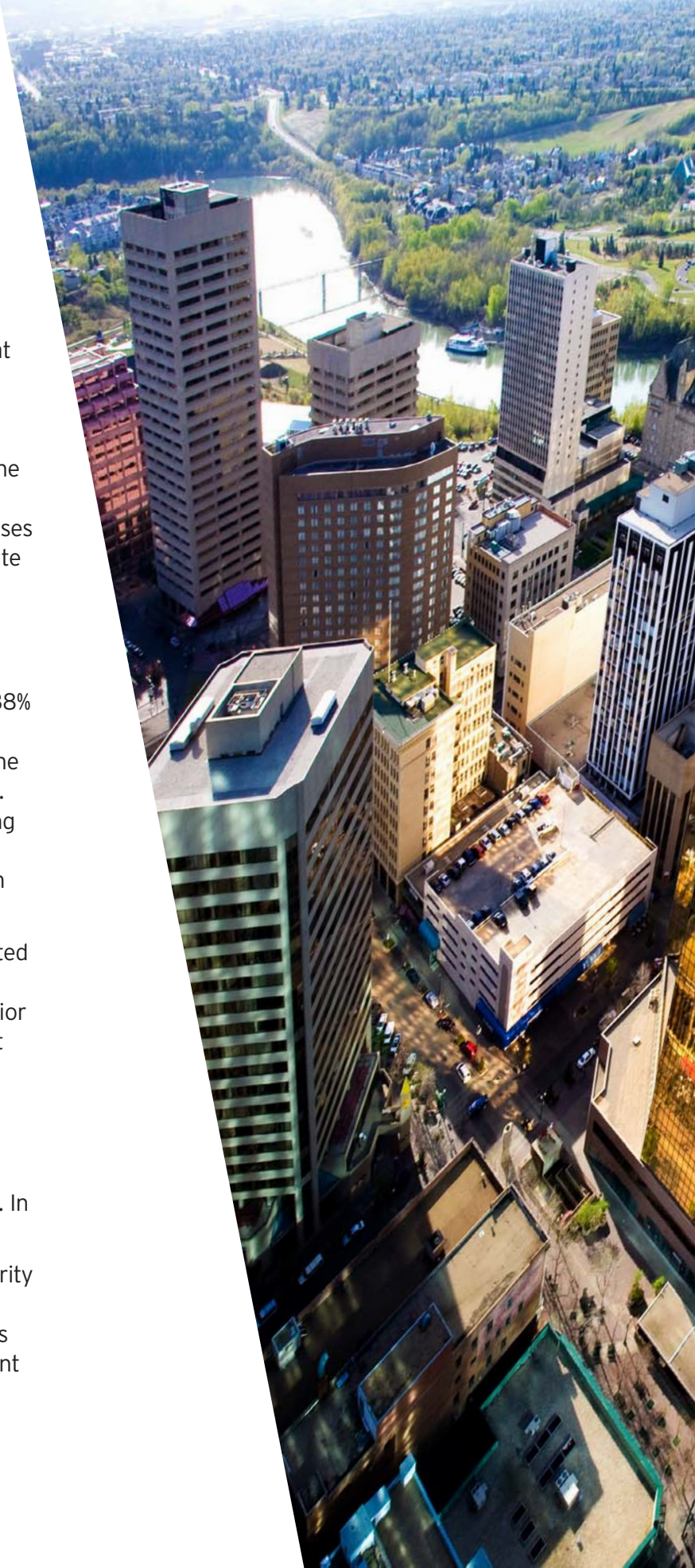
### **MAP program report reflects increased transfer pricing audit activity**

On 29 July 2011, the Canada Revenue Agency (CRA) released its *Mutual Agreement Procedure (MAP) Program Report* for the fiscal year ending 31 March 2011 (covering the period from 1 April 2010 to 31 March 2011). The MAP is the

process by which the competent authorities of two countries interact in an effort to eliminate taxation that is not in accordance with the provisions of a tax treaty between the two countries. The Canadian Competent Authority responsible for this process resides in the CRA's International and Large Business Directorate. The report provides an overview of the operations of the MAP program, including statistical analyses of MAP cases completed and in progress. The CRA releases a separate annual report on the Advance Pricing Arrangement (APA) Program.

The following are highlights from the MAP report:

- ▶ The percentage of Canadian-initiated cases rose to 88% of completed cases in 2010-11. This is the highest level ever observed and a significant increase over the 80% observed in 2009-10, and the 83% in 2008-09. In part, this may reflect an increase in transfer pricing audits coming through the pipeline following the increase in the CRA's international audit resources in the mid-2000s.
- ▶ The time required to complete these Canadian-initiated cases has increased significantly, to an average of 32.16 months, compared to 22.73 months in the prior fiscal year. This far exceeds the Canadian Competent Authority's targeted timeline of 24 months.
- ▶ Of the 95 cases negotiated with other jurisdictions, 13 (14%) did not obtain complete relief from double taxation. This is a somewhat higher percentage than usual, as rates below 10% have historically prevailed. In 2009-10, only three such cases were reported.
- ▶ The report indicates the Canadian Competent Authority resolved 649 non-negotiable MAP cases compared to 333 such cases in 2009-10. Non-negotiable cases are those that do not require the Canadian Competent Authority to negotiate with another jurisdiction, and usually pertain to excess withholding tax.
- ▶ Transfer pricing cases represented 78% of the 95 completed negotiable cases. Among completed transfer pricing MAP cases, the transactional net margin method (TNMM) was applied in 51% of cases (38 out of 74).



The results in the MAP report sound a cautionary note. The report states that the Canadian Competent Authority expects increased audit activity will result in more taxpayers seeking assistance through the MAP process. At the same time, the 2010-11 results reflect a program whose performance appears to be struggling to meet existing demand in an environment of government restraint and tight resources. The report does not provide any insights or indications on how the Canadian Competent Authority plans to cope with the expected increase in the number of MAP cases. Despite these impending challenges, the MAP generally remains an effective tool to resolve taxation not in accordance with a treaty.

International Tax Services - Tom Tsiopoulos, Sean Kruger and Ken Kyriacou (*Toronto*)

## France

### France announces tax measures for 2011 year-end finance bills

The French Prime Minister announced on 24 August 2011 at a press conference, budget and tax measures to reduce France's deficit.

Some of these proposed measures were examined by the Cabinet on 31 August and included in the draft of the second Amended Finance Bill for 2011 to be considered by Parliament starting on 6 September.

Other measures will be included in the draft Finance Bill for 2012 and the draft Social Security Financing Bill for 2012.

#### Tax measures affecting companies

- ▶ Alignment of loss utilization rules to existing rules in Germany, marking the first step towards the harmonization announced by French President Sarkozy and German Chancellor Merkel (2011 Amended Finance Bill of September - effective for fiscal years ending after the promulgation date of the Act)
  - Carry back of losses on the sole profit of the previous year (instead of the last three years), the excessive portion of losses not carried back being carried forward
  - Carry forward of losses limited to 60% of the current year profit in a given offsetting year (limitation applicable to the portion of profit in excess of 1 million Euros). The amount not used for a given year would still be permitted to be carried forward indefinitely
- ▶ Increase from 5% to 10% for the taxable portion of long term capital gains realized upon the disposal of shareholdings qualifying for the French participation-exemption regime (Finance Bill for 2012 - applicable to fiscal years ending after 31 December 2011)
- ▶ Increase from 6% to 8% of the social contribution (forfait social), notably applicable to sums paid under profit sharing plans, attendance fees, employer's funding of company savings plans and complementary retirement savings plans (Social Security Financing Bill for 2012)
- ▶ Legal harmonization of the basis of the social solidarity contribution on companies (C3S), in particular to put an end to the differences in business practices in the financial sector and limit the possibilities of optimization (Social Security Financing Bill for 2012)
- ▶ Consideration of overtime for the computation of contributions relief (the so called Fillon relief) "in order to preserve the social and tax advantages associated with overtime while limiting windfall effect and optimization opportunities for businesses" (Social Security Financing Bill for 2012)
- ▶ Revised scale for the tax on company cars (TVS) (Social Security Financing Bill for 2012)
- ▶ Removal of the 30% reduction on taxable income of companies in the overseas departments (Finance Bill for 2012 - applicable to the Corporate Income Tax due for the fiscal years ending as of 31 December 2011)

- ▶ Increase in the tax rate on insurance agreements (TSCA) applicable to health insurance contracts called “caring and responsible” (Art. 1001 of the French Tax Code) from 3.5% to 7% and increase from 7% to a 9% tax rate for other health insurance contracts (2011 Amended Finance Bill of September)
- ▶ Alignment of the taxable basis and rates of social contribution for businesses in the electricity and gas sector to those of the standard regime

## Implications

If the loss utilization rules are tightened, the proposal, as currently drafted, would not impact the amount of losses that can be carried forward (no change in ownership rules mentioned so far) and would not have any negative impact on the ETR, nor on financial communication or debt capacity.

However, proposals to limit the carry back and introduce a ceiling regarding the amount of carry forward losses in a given offsetting year, would penalize small and medium sized enterprises (SMEs), which is why the latter tax measure would only apply to Corporate Income Tax contributions exceeding 1 million Euros.

Paradoxically, the tax measures called “related” measures (tax on company cars, social contribution, and tax on insurance contracts) may be more expensive for businesses.

The content of these provisions, both in light of German tax rules (notably with respect to the deductibility of financial interest expenses) and the recommendations contained in the Carrez Report (Report No. 3631 of 6 July 2011), require, in our view, a close monitoring of the content of parliamentary debates that could, similar to discussions in the previous two years, give rise to the introduction of major parliamentary amendments.

French Tax Desk - Frédéric Vallat and Emilie Dugas (*New York*)

## India

### India increases focus on transfer pricing aspects of intangible property

Recent transfer pricing (TP) audit experiences have shown an increased and intense focus by the Indian tax authority on the intellectual property (IP) aspects of TP. The approach of the tax authority has been to make a detailed inquiry into the nature of the arrangements entered into by the taxpayer relating to transfer/use of the IP, request the taxpayer to demonstrate the benefits received from use of the IP, and seek justification that the payment is arm’s length in nature.

The nature and extent of inquiry is likely to put an onerous burden on most taxpayers as documentation of these categories of transactions often lags behind documentation for

tangible goods transactions. This is likely to result in making the already challenging Indian transfer pricing audit process even more difficult to manage. The absence of specific TP rules in India dealing with IP and the controversial nature of some of the issues are likely to result in complex and monetarily significant transfer pricing disputes and risks of double taxation.

From a review of the information/data requests, it appears the tax authority would expect a taxpayer to have the ability to demonstrate that the benefits it reasonably expects to secure from the use of the IP are satisfactory relative to other options realistically available and the relevant comparability factors. This test, known as the benefit test, is critical to determine whether a related party would pay for the use of the IP and, therefore, whether the licensor can justify a charge for the provision of the IP under arm’s length conditions.

Inherent in the information/data request is the need for a taxpayer to consider special factors relevant to comparability of IP transactions, which include expected benefits from the IP, limitations on the geographic area in which rights may be exercised, exclusive or nonexclusive character of any rights transferred, capital investment and start up expenses and the development work required to exploit the IP, the licensee’s right to participate in the licensor’s further developments of the property, etc.

In light of recent developments, taxpayers may need to consider developing or enhancing their existing documentation for these types of transactions, consider customizing their global TP platforms for IP transactions to meet local requirements, prepare for audits in advance by building a TP defense file based on the information/data requests made in recent audits and adopt a more proactive approach to TP dispute resolution and controversy management as early as possible in the audit life cycle.

#### **What does this mean for taxpayers?**

Taxpayers may experience more intense audit activity on related party IP transactions and more TP disputes. Further, as may be gleaned

from the information/data requests, compiling the necessary information is likely to be an onerous and time consuming task for taxpayers, which may be further compounded by the short time frame within which the tax authority would typically expect the taxpayer to respond.

Transfer Pricing - Vijay Iyer and Rajendra Nayak (*Bangalore*)

## **Italy**

### **Italy issues guidance on dividend withholding taxes**

On 8 July 2011, the Italian Revenue Agency (Revenue) issued Circular Letter No. 32/E (Guidance) providing clarifications on outbound dividend withholding taxes. The Guidance explains how, under the principles

expressed by the EU Court of Justice (ECJ) in judgment C-540/07, certain EU companies might achieve a refund of the Italian tax levied in excess of the tax applicable to domestic recipients. While addressing the mechanics for such a specific refund, Revenue provides important clarifications that may be of help in understanding the level of substance required to qualify for favorable withholding tax regimes in other scenarios.

EU companies that do not qualify for the exemption under the EU Parent Subsidiary Directive may still qualify for a beneficial 1.375% dividend withholding tax under certain conditions. Companies that reside in non-EU countries that are part of the European Economic Area (EEA) can also qualify.



This rule was introduced in 2008 after an EU infringement procedure in order to equalize the treatment of EU and EEA recipients with the one applied to Italian companies that, starting in 2004, benefitted from a participation exemption regime on dividends.

However, the reduced rate for EU and EEA recipients under the 2008 rule was applied to dividends paid out of profits generated from financial periods starting after 31 December 2007, thus still allowing for better treatment of Italian companies in respect to payments made starting in 2004 and out of profits generated in any year.

While some EU (and EEA) companies had already started refund procedures, the position held in their claims was further strengthened by the 2009 ECJ decision (C-540/07) on the above-mentioned infringement procedure, whereby the Court stated that equal treatment on dividend taxation should have been recognized due to the introduction of the participation exemption regime for domestic dividend payments in 2004.

The Guidance specifically recognizes the right to such a refund under certain prerequisites.

This development is of primary interest to groups with EU and EEA resident companies that have suffered from an Italian withholding tax higher

than 1.65%/1.375% on dividends received less than four years ago. Also, it may be of help to have a better general understanding of the level of substance that a foreign recipient needs to meet in order to qualify for beneficial regimes from the perspective of the Italian tax authorities.

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## Italy issues additional urgent measures for financial stabilization and development

As part of the 2012 Budget package, the Italian Government on 13 August issued Law Decree n. 138 concerning "additional urgent measures for financial stabilization and development" (Decree 138). Among the other measures, Decree 138 provides some significant changes to the corporate income tax surcharge for the energy industry (so called Robin Hood tax) and introduces a new regime for financial income.

The Decree came into effect on the day of its publication in the Italian Official Gazette, on 13 August 2011. The Parliament has 60 days (until 12 October 2011) to pass any amendment and to convert the decree into ordinary law.

Ernst & Young will closely monitor the conversion progress of Decree 138 and, in the following weeks or months, its approval process.

The Government had already issued Law Decree n. 98 on 6 July 2011 (Decree 98) introducing "urgent measures for financial stabilization." This decree was converted in Law n. 111 on 15 July 2011 (Law 111). On 4 and 5 August 2011, Revenue issued, respectively, Guidance n. 40 and n. 41 which provided some first clarifications on the new rules after the conversion into law. Additional clarifications are expected.

# Malaysia

## Malaysia's tax authority issues new transfer pricing form

In an effort to gather information on transfer pricing compliance and enforce transfer pricing rules, Malaysia's Inland Revenue Board

(IRB) has issued a new form that will be sent to selected corporate taxpayers. The IRB seems to target corporate taxpayers that have had significant related party cross-border transactions. The form requires the taxpayer to provide a complete global organizational structure as well as to confirm the existence of contemporaneous documentation.

The issuance of the form is an indication of the IRB's increasing attention to transfer pricing. The purpose of the form is to assess taxpayers' risk profile as well as their level of compliance with transfer pricing regulations.

It further emphasizes the need for taxpayers to reassess their current transfer pricing positions and to prepare and maintain contemporaneous transfer pricing documentation in Malaysia.

Asia Pacific Business Group - Jeff Hongo and Kaz Parsch (*New York*)

Transfer Pricing - Sockalingam Murugesan, Lee Hock Khoon and Julian Wong (*Kuala Lumpur*)

# Mexico

## Mexican Tax Court rules in favor of a taxpayer in a transfer pricing case

The Mexican Federal Tax Justice Court (TFJFA) recently ruled in favor of a taxpayer by annulling a legal resolution dealing with transfer pricing. The nullified ruling dealt with a fiscal credit that had been assessed by the Central Transfer Pricing Administration of the SAT on the basis that the taxpayer had paid greater-than-arm's-length transfer prices on finished products purchased from a foreign related party during 2004.

Although the tax authorities still have a chance to appeal to the Collegiate District Court, the case is

## New VAT rules for Mexican Maquiladoras

On 30 June 2011, the Ministry of Finance (Hacienda) amended the temporary regulations, (reglas de carácter general en materia de comercio exterior) to the Customs Law to include a rule that would require the payment (withholding) of VAT in the case of temporarily imported goods that are transferred to Mexican residents under a virtual export/import mechanism.

This change results in the payment of VAT twice on the sale of the goods by the foreign resident to a Mexican resident: first upon the virtual permanent importation of the goods by the Mexican resident and also as a consequence of the VAT withholding by the same Mexican resident.

The amended rule is very unfortunate. It punishes certain taxpayers with a double VAT cash flow cost, as well as an increased administrative burden to manage the cash and compliance with the VAT obligations.

More importantly, it sends the wrong message to foreign investors regarding the investment climate in Mexico, particularly in the maquiladora industry.

The rules regarding maquiladoras have suffered several changes during recent years, with the latest controversial change in the IMMEX Decree (making significant income tax amendments) barely seven months old.

Moreover, it is difficult to understand how a significant change, such as the one at hand, can be made through an adjustment of Temporary Regulations by the tax authorities, without any involvement of Congress or the Senate.

of great significance for the Mexican domestic tax system. The ruling is important not only because this is the first transfer pricing case that has been resolved in favor of a taxpayer, but also because the magistrates considered the work of experts, where the required knowledge went beyond the general (accounting) expertise initially sought after, to a more specialized body of knowledge (transfer pricing/economics).

The ruling confirms that:

- ▶ In a technically complex matter such as transfer pricing, substantive arguments can be put forward, and be effectively considered by a tax court

- ▶ The point of view of the tax authority in a tax review, although relevant, is not definitive
- ▶ Aside from the Mutual Agreement Process option available under a treaty, domestic means of defense, which are out of the control or influence of the tax authorities, are available to the taxpayer to effectively address transfer pricing issues

International Tax Services - Jorge Castellón and Violeta Valerio (*Mexico City*)

## Netherlands

### Netherlands to amend participation exemption for currency results depending on future ECJ case law

The Dutch participation exemption provides that foreign exchange gains and losses on a participation are not taxable or deductible, respectively. However, based on the *Deutsche Shell* case (C-293/06) it is arguable that foreign exchange losses derived from EU participations should be deductible from Dutch taxable profit.

The argument in favor of that position is that such losses are not visible and not recognized in the other Member State and that EU law requires that losses should always be deductible somewhere. At this moment, it is not clear if this position can be successfully upheld on the basis of the *Deutsche Shell* case, as the *Deutsche Shell* case relates solely to foreign branches and not to foreign participations.

If foreign exchange losses on participations in EU Member States are indeed found to be tax deductible, that would result in an asymmetric situation. Losses would be deductible, while foreign exchange gains would not be taxable.

In order to prevent cherry picking by taxpayers, Dutch legislation will be introduced providing for the following: if a taxpayer wants to take into account a foreign exchange loss



on an EU participation and it turns out that the taxpayer indeed was allowed to do so (i.e., if the *Deutsche Shell* case indeed can be applied to participations), the taxpayer also has to take into account foreign exchange results on all its (other) EU participations in the current and any future year.

### Scope of the proposed legislation

The proposed legislation will only apply if two conditions are met: (1) a taxpayer claims a foreign exchange loss on a participation *and* (2) the Netherlands accepts that foreign exchange losses on participations can decrease the Dutch taxable base. It is currently unclear whether foreign exchange losses on participations can be deducted from a Dutch entity's taxable profits. Eventually, the European Court of Justice probably will have to rule on this question, but this will likely take years.

Upon satisfying the above conditions, foreign exchange gains on all the EU participations of the taxpayer need to be added to the profit of the taxpayer (if and when realized). Also, the amount of gains that have to be taken into account are not limited to the amount of the losses that have been deducted. However, in that situation, the taxpayer presumably will not choose to deduct foreign exchange losses.

### Retroactive effect

The new provision will have retroactive effect from 9 April 2011, 5 PM (CET). This is the day that a press release was issued announcing that the Netherlands would introduce *Deutsche Shell* legislation.

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Netherlands Tax Desk - Reinout Kok (*London*)

International Tax Services - Ben Kiekebeld and Daniël Smit (*Rotterdam*)

## Spain

### Spanish Tax Court denies participation exemption benefits to Brazilian interest on net equity payments

The Spanish Tax Court (Tribunal Económico Administrativo Central) issued a resolution on 13 April 2011 declaring that income received by a Spanish entity from its Brazilian subsidiary in the form of Interest on Net Equity payments (juros sobre o capital propio (JsCP)) cannot benefit from the Spanish domestic participation exemption regime.

This is the first time that a Spanish court has issued a resolution on JsCP, a well known Brazilian hybrid instrument widely used by Spanish multinationals with Brazilian

investments, that qualifies as a dividend for Brazilian commercial and accounting law purposes, but which is generally allowed as an expense for tax purposes subject to certain requirements.

The decision can now be appealed to the Spanish Courts of Justice.

However, the decision represents a precedent that likely will be followed by the Spanish Tax Authorities when analyzing the application of the participation exemption regime to JsCP payments. Thus case-by-case consideration should be given to all JsCP structures already in place, as well as to any further planning contemplating the use of this specific instrument.

Spanish Tax Desk - Inigo Alonso Salcedo (*New York*)

International Tax Services - Laura Ezquerro and Alfonso Puyol (*Madrid*); Carlos Gabarro (*Barcelona*)

### Temporary increase of the tax burden on large Spanish enterprises

On 19 August 2011, the Spanish Council of Ministers adopted Royal Decree-Law 9/2011 (RD-Law 9/2011), which came into force on 20 August and contains certain temporary measures which affect Corporate Income Tax (CIT) and Value Added Tax.

The main goal of the measures on CIT consists of temporarily increasing the tax burden on profitable large enterprises, whereas the measures on VAT are intended to promote the sales of new houses.

### Measures relating to CIT

#### **Increase in the percentage applied to determine interim payments on account of CIT**

RD-Law 9/2011 increases, for certain large enterprises, the tax rate applied to determine the CIT interim payments to be filed from October 2011 to December 2013. This provision is not applicable to interim payments accrued before 20 August 2011.

Thus, as a general rule, instead of applying the previous tax rate (21%), the rate to be applied by companies, whose share turnover within the 12 months prior to the beginning of the fiscal year is between €20 million and €60 million, would amount to 24%, whereas the rate to be applied by companies whose turnover is higher than €60 million would amount to 27%.

It is to be noted that the CIT rate has not been modified, i.e., the tax rate still amounts to 30%. Hence, the final CIT burden of large enterprises has not been increased.

#### **Restrictions to offset carried forward tax losses generated in previous years**

Formerly, CIT taxpayers were able to offset carried forward tax losses (NOLs) against the positive taxable

base generated in the 15 subsequent years without limitation. Hence, the final taxable base could be nil if the amount of NOLs were at least equal to the positive taxable base.

In this regard, RD-Law 9/2011 establishes, for fiscal years 2011 to 2013, important restrictions to the offset of NOLs to companies with a turnover higher than €20 million; companies whose turnover within the 12 months prior to the beginning of the fiscal year is between €20 million and €60 million may only offset NOLs up to a maximum amount of 75% of the positive taxable base; such percentage would amount to 50% for companies whose turnover is higher than €60 million.

Therefore, large enterprises with a profitable taxable base in fiscal years 2011 to 2013 shall only be able to partially offset NOLs against the positive taxable base, and thus the final taxable base (after the offset) may not be nil.

#### **Extension of the period to offset NOLs**

In order to limit the effects of the abovementioned measure restricting use of NOLs, RD-Law 9/2011 establishes that pending NOLs should be offset at the beginning of fiscal year 2012 and NOLs generated as from fiscal year 2012 may be carried forward for 18 years instead of 15 years.

Please note that this extension is applicable to all the taxpayers (including small and medium size enterprises).

#### **Reduction of the annual amortization of financial goodwill**

RD-Law 9/2011 establishes that the negative book-to-tax adjustment to be made in fiscal years 2011 to 2013, as a result of the deductibility of financial goodwill by virtue of article 12.5 of CIT Law arisen in acquisitions of nonresident entities, shall amount to 1% (instead of the previous 5%) of the financial goodwill.

This measure is applicable to all taxpayers (not only to large enterprises) and does not cause a permanent reduction of the deductibility of financial goodwill, but a deferral of the deduction; i.e., the amounts not deducted in fiscal years 2011 to 2013 shall be deductible in subsequent fiscal years.

Spanish Tax Desk - Inigo Alonso Salcedo and Manuel Calvino Rivero (*New York*)

International Tax Services - Jose Enrique Garcia-Romeu Quinza, Antonio Pina Gil, Ana Liebana Martinez and Eduardo Sanfrutos Gambin (*Madrid*)

## Turkey

### **First unilateral APA signed in Turkey**

The Turkish Revenue Administration (TRA) announced the conclusion of the first unilateral advanced pricing agreement (APA) in Turkey. Although the bulletin, published on the official website of the TRA, does not provide

details about the case and solely mentions the conclusion of the first APA, this is a major step towards encouraging taxpayer compliance, by offering a flexible approach to avoid transfer pricing disputes.

Regulations on transfer pricing in Turkey were introduced in 2007 with strict documentation obligations. The legislation was amended in 2009 to enable corporate taxpayers to apply for an APA for their cross-border related party transactions. An APA is considered at the request of the taxpayer, and in principle, the agreed-upon method would be binding through the period determined; however, it cannot exceed three years.

As in many other countries with transfer pricing regulations, the Turkish APA program has been established as an alternative dispute resolution process for transfer pricing controversies. Since an APA allows the taxpayer and the TRA prospectively to negotiate the appropriate transfer pricing method for future cross-border intercompany transactions, the APA process is an innovative approach to transfer pricing in Turkey.

Unilateral, bilateral or multilateral APAs are possible in Turkey. According to the regulations, companies that have signed an APA do not need to prepare annual transfer pricing reports for transactions covered by the APA, but they do have to prepare annual APA reports. For other related party

transactions that are not covered by the APA, a transfer pricing report must be prepared.

Transfer Pricing - Alper Yilmaz and Akif Tunç (*Istanbul*)

## **Turkey, Malta sign new double taxation treaty**

On 14 July 2011, the governments of Malta and Turkey signed a new income tax treaty for the avoidance of double taxation. The treaty will enter into force once both countries complete the exchange of ratification procedures, and its provisions will apply beginning 1 January of the year following its entry into force. This is the first treaty concluded between the two countries.

The new treaty mainly adopts the current OECD model tax convention with some modifications. Significant provisions in the treaty would include:

- ▶ The determination of residency status in the countries in case of dual residency
- ▶ Inclusion of a services permanent establishment
- ▶ Provision of reduced withholding taxes on dividends, interest and royalties up to 10%
- ▶ Inclusion of an independent personal services article
- ▶ Exemption from capital gains tax on share disposition if the period between acquisition and disposal exceeds one year

- ▶ Elimination of double taxation with the use of the credit method
- ▶ A limitation of benefits article which restricts the application of the treaty if the competent authorities establish that the taxpayer's purpose is treaty shopping

Transfer Pricing - A. Feridun Gungor and Elif Aydin (*Istanbul*)

## **Vietnam**

### **Vietnam intensifies focus on transfer pricing; conducts transfer pricing survey and initiates criminal proceedings**

Late July 2011 witnessed a flurry of activities by Vietnam's General Department of Taxation (GDT) and Ho Chi Minh City tax authorities with respect to transfer pricing (TP).

In July 2011, the GDT published a Survey on transfer pricing (Survey) on its official website. The purpose of the Survey was to collect information, data, suggestions and comments on the implementation of the current Vietnam TP regulations (Circular 66) and seek recommendations on how to improve TP policy going forward. The respondents were taxpayers, local tax departments and local tax officers. Although the results of the Survey still have not been made public, the Survey shows the tremendous effort of the Vietnam tax authority in enforcing and

developing current TP regulations in the wake of TP audits of some companies in Vietnam.

Undoubtedly, the Vietnam tax authorities are both keeping a tight watch on the TP compliance practices of Vietnamese companies and strengthening the implementation of Circular 66. The queries in the Survey re-emphasize the focus of the tax authorities on the following as far as TP is concerned:

- ▶ Losses in years 2006 to 2010
- ▶ Compliance with the TP disclosure form and documentation from 2006 to 2010
- ▶ Nationality of related parties

On the other hand, the Survey provides an opportunity for taxpayers to highlight areas of concern and improvements such as the definition of related parties, sources of comparables and submission deadlines.

The idea of introducing advance pricing agreements (APAs) in Vietnam continues to generate interest as comments on their use are included in the Survey. This interest is consistent with the Prime Minister's Decision on Tax Reform for

2011 to 2020 to issue regulations on APA (among others) released a few months ago.

Requesting input on the definition of related parties (which is considered very narrow under the current rules vis-à-vis the OECD), other countries' TP guidelines, querying on the introduction of APAs and audit mechanisms from tax officers all seem to fortify the view that the Vietnam tax authorities are not only looking at TP as a means to enforce compliance among taxpayers and generate revenue for the government but also as an important area to grow and develop in this era of a globalized economy.

### **Criminal proceedings**

As a result of regular tax and TP examination and inspection in 2011, the Ho Chi Minh City Tax Department identified 10% of 170,000 companies in the territory as being under very high risk of using TP for tax evasion. It was reported that a list of foreign invested companies suspected of using TP to evade taxes was recently forwarded to a specialized unit of the Police Department for further tax evasion investigation. Under Vietnam criminal laws, if the evaded (i.e., underpaid) tax amounts to VND100

million (approximately US\$4,900) or more, the taxpayer may be subject to tax penalties under criminal proceedings.

### **Transfer pricing risk management**

Given the recent developments on TP enforcement and audit activities, it is important for companies in Vietnam to take a hard look at their TP compliance status, especially if they have persistent loss-making years and have high-volume related-party transactions. Again, current Vietnam TP regulations (Circular 66) require taxpayers to: (1) disclose related-party transactions annually, submitted in regulated form together with the annual Corporate Income Tax return; and (2) prepare and maintain contemporaneous TP documentation, which must be submitted to the tax authority within 30 days of a written request. Similar requirements existed from 2006 to 2010 under Circular 117. A timely review can mitigate TP audit and associated risks, including strict penalties.

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