

Changing Tax Laws Overseas

What you need to know



High Street Partners, Inc.
international expansion simplified

August 2009

CROSS-BORDER ACCOUNTING, PAYROLL, COMPLIANCE,
FINANCE, HR AND ADMINISTRATIVE SERVICES FOR VC
BACKED FIRMS, PUBLIC COMPANIES AND INSTITUTIONS
DOING BUSINESS INTERNATIONALLY

It's no surprise in these challenging economic times, that governments around the world are looking for creative ways to increase tax revenues. We know that, as in the U.S., foreign governments want to do so without the political embarrassment of overtly increasing tax rates. One answer for them is to "go after the other guys" and enforce existing anti-avoidance regulations more rigorously, particularly against U.S. and other overseas multinational companies (MNCs).

Your company is likely to be an appealing target of the new approach, especially in the area of **transfer pricing**. Transfer pricing involves the allocation of taxable income related to cross border transactions between affiliated companies, where the scope for profit

manipulation is seen as high. In nearly every country around the world, comprehensive tax regulations demand arm's length prices between affiliates and contemporaneous documentation to support the prices charged. Transfer pricing regulations globally are becoming increasingly onerous, with an ever greater risk of double taxation for MNCs.

With this in mind, below are summaries of a number of recent overseas tax developments, many related to transfer pricing. If you have operations in any of the countries listed below and require further information, or if you have concerns about any of the developments, believe you may have to prepare for proposed changes in legislation, or feel you may be at greater risk of a transfer pricing tax audit, you should contact appropriate advisors for guidance. It is important to note that this enhanced focus on anti-avoidance is relevant even to US MNC's operating a simple "cost-plus" sales office overseas with few employees, especially where the MNC may have meaningful revenues to customers in those same countries.

China – New Guidelines from State Administration of Taxation (SAT)

In China, the State Administration for Taxation (SAT) recently issued a circular "Notice on the Guidelines to Strengthen the Collection and Administration of Various Types of Taxes and Increasing Tax Revenue" (Guoshuifa [2009] No. 85), exhorting local tax bureaus to strengthen the collection and administration of the four main types of taxes in China - Business Taxes (a revenue or "turnover" tax), income taxes, property-related taxes and "international taxes".

Regarding international tax, local tax bureaus will be focusing on:

- Transfer pricing investigations and enforcing documentation requirements;
- Monitoring the tax filings of foreign taxpayers engaged in business and the provision of services in China;
- Monitoring tax payments and withholding compliance for foreign companies, which is especially relevant for

- expatriate employees working in China.
- Monitoring tax certificates supporting the remittance of service fees out of China.

Foreign MNCs that operate wholly foreign owned enterprise (WFOE) subsidiaries or representative offices (RO) in China should therefore expect more frequent and rigorous local tax audits.

In order to address the issue “head-on”, more and more MNC’s are using advance pricing agreements (“APAs”) to manage uncertainties about their transfer pricing arrangements in the light of increasing anti-avoidance enforcement by the Chinese tax authorities. Basically, via an APA, the MNC is seeking approval in advance from the appropriate tax authorities, so that there are no unpleasant transfer pricing “surprises” down the road. In one recent development, the Economic & Technological Development Zone Office of the Beijing Municipal State Tax Bureau (“BSTB”) recently signed its first unilateral APA and is responsible for transfer pricing and anti-avoidance enforcement in Beijing. Specific details include:

- The BSTB will be responsive to APA applications and will “carefully review them”, in particular focusing on comparability analysis and industry analysis in respect of “major assumptions”, “transfer pricing policy” and “methodologies”.
- Since along with Shanghai, Beijing is the PRC location for most foreign MNCs, the BSTB is expecting more APA applications, has increased its anti-avoidance resources, and is building a bilateral APA negotiation team.
- With five bilateral APAs currently in negotiation subsequent to the recent conclusion of its first unilateral APA, the BSTB has publicly stated that it believes there is now a “significant impetus to the APA process”.

Russia - Framework for new Russian transfer pricing rules has been agreed

In April 2009, the Russian Ministry of Finance and the Ministry of Economic Development adopted two documents (the “Framework Papers”) which provide that draft laws are to be submitted to the Russian Parliament some time in 2009 for new Russian transfer pricing rules and a consolidated taxpayer regime to come into effect as early as January 1, 2010. The key changes to the new Russian transfer pricing rules are summarized below:

- A reduction of the list of transactions that the Russian tax authorities may control prices for tax purposes, but an expansion of the list of related parties
- Introduction of the arm’s length concept
- Expansion of the list of information sources for determining market prices
- Introduction of new methods for determining market prices and changes to existing pricing methods to bring them more in line with internationally accepted transfer pricing principles
- Introduction of reporting and transfer pricing documentation requirements
- Introduction of penalties for non-compliance with reporting requirements and for failure to prepare transfer pricing documentation
- Burden of proof that prices of controlled transactions do not correspond to market will rest with the tax authorities
- Introduction of Advance Pricing Agreements (APAs)
- New transfer pricing rules to become effective from 2010 (with the exception of certain provisions regarding new methods and APAs)

The introduction of new Russian transfer pricing rules mean that companies doing business in Russia must perform a revision of their current transfer pricing policies. Adapting to the new requirements will take time and companies should therefore start preparing now.

UK - HMRC wins in Transfer Pricing Case

There have been a number of transfer pricing cases in the UK over the years, but these have been primarily concerned with the question of whether transfer pricing (TP) legislation applied rather than how to determine an arm's length price. The first case dealing directly with the

application of the arm's length principle was heard in late 2008 and the judgement has recently been published.

- The case concerned the TP arrangements between a major UK retailer (Dixons) and the group's captive insurer in the Isle of Man (DISL).
- DISL bore most or all of the risk on extended warranties or service contracts purchased by customers, apparently a very profitable business although the exact details are not available.
- The contracts were sold to customers when they purchased electrical goods in the stores of the main UK trading company, DSG Retail Ltd (DSG).
- The years in dispute were 1996-2004.

The key questions were:

- were the arrangements really at arm's length and
- if not, could DSG be charged to tax on imputed income?

In essence the judgement was:

- the transfer pricing rules did apply to the transactions between DSG and DISL.
- given all the particular circumstances (including an absence of relevant comparables and the need to understand the overall contribution by both parties to the arrangement and not just review the transfer pricing from the aspect of one of the parties) a profit split approach was the most suitable one.

The case was then adjourned pending a determination by the parties of a suitable level of reward for DISL.

Surprise has been expressed that the judgement held that a profit split method was the best approach, but this was specific to the facts of the case.

Summary of Other Recent Developments

In other developments likely driven by the challenging macroeconomic climate, many countries are seeking to ensure that their locations are still deemed “competitively desirable” as a destination location for MNCs operating, expanding or hiring overseas. A sample is below.

Netherlands - Ministry of Finance issues consultative document on corporate income tax reform

On June 15 the Dutch Ministry of Finance published a consultative document containing several proposed alternatives to change the Dutch Corporate Income Tax Act with effect from January 1, 2010 and aimed at improving the attractiveness of investing in and through the Netherlands. Comments are invited on the proposals before August 1, 2009.

Singapore – 2009 Budget proposals

The 2009 Budget announced changes including the following:

- a reduction in the corporate tax rate from 18% to 17% with effect from the year of assessment 2010 (income year 2009)
- temporary measures intended to help businesses with cash flow, including
 - a temporary tax amnesty for the repatriation of foreign-sourced income
 - minor enhancements to the loss carryback relief scheme
 - accelerated tax depreciation for plant and machinery and renovation expenditure.
 - property tax rebates

Taiwan

- A proposal to reduce the current corporate income tax rate from 25% to 20% is under review by the legislature.
- If approved it will come into effect in 2010.
- A number of anti-tax avoidance measures are also proposed:
 - thin-capitalization rules
 - introduction of Controlled Foreign Corporations rules
 - transfer pricing matters
 - substance over form rules.

High Street Partners, an SVB referral partner, is a global advisory services firm which offers cross-border accounting, finance and HR-related services to organizations doing business internationally. The firm provides a wide range of services related to the implementation and ongoing management of international subsidiaries and other entities, including registration, payroll, accounting and bookkeeping, tax compliance, advisory, and HR localization services. For more information, please visit www.hsp.com, or contact Scott Aldsworth at saldsworth@hsp.com.