GLOBAL REFERENCE GUIDE

corporate tax

with global advisor directory

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Corporate Tax 2011

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NORTH AMERICA

Transfer pricing and related party cross-border transactions

by Brian E. Andreoli and Theodor van Stephoudt | Squire, Sanders & Dempsey (US) LLP

TRANSFER PRICING HAS been a part of the tax system for well over 60 years. The level of enforcement, however, had been less than uniform. In 1995, the US issued regulations to provide a process for taxpayers to document their transfer pricing positions on a contemporaneous basis and thereby avoid the imposition of unrecoverable, substantial penalties on incorrect transfer pricing. In 2011 there are over 45 countries that have issued their own rules.

In 2010 testimony within the US Congress detailed the aggressive use of transfer pricing techniques by certain taxpayers to inappropriately understate income and thus lower US tax liabilities. Many of these structures' migrated intangibles that were developed in the US to lower-tax jurisdictions by the use of multiple holding companies. Recently, there were two prominent transfer pricing settlements with tax authorities; one for $3.4bn and another for $2bn. Former UK Prime Minister Gordon Brown had described and criticised the perceived abuses by some taxpayers using transfer pricing aggressively in constructing tax schemes. The OECD has multiple task forces to evaluate rules designed to bring uniformity of thought, methodology and enforcement so as to minimise the administration and compliance costs of transfer pricing.

At the same time, many taxpayers are reorganising their worldwide operations in response to changes in a competitive business environment by moving functions and risks. Many organisations send their employees to various jurisdictions either to oversee operations or to provide services to a related entity. In response, many tax authorities are demanding current recognition of future taxable profits that are being transferred to a related party in another tax jurisdiction. Although double tax treaties between countries should avoid double taxation of corporations in case of disagreements between tax jurisdictions, not all countries have double tax treaties and tax jurisdictions tend to interpret a double tax treaty to their own advantage.

The basic standard for transfer pricing has been the arm's length standard. Stated simply, related party transactions must recognise an allocation that would have occurred between unrelated parties. The various tax authorities have not been uniform in their application of the transfer pricing standard. In light of revenue shortfalls around the globe, certain countries have advocated positions that appear to disproportionately allocate income to their jurisdictions. Resulting disagreements lead to uncertainty with a risk of subsequent impositions of additional tax, interest

and penalties. Thus any cross-border transactions need to be evaluated in light of these developments.

Transfer pricing falls into three levels of importance: compliance; comparative return planning; and a business process analysis technique. In regard to compliance, the use of the master file approach is advocated. Under that approach, common terminology and common principles are consistently applied to document and implement the worldwide economic system of the related parties. Ultimately a business needs to comply with the increasing requirements to document its transfer pricing in order to avoid additional taxes, interest, and, ultimately, penalties. Where a tax treaty exists, the readjustment of transfer prices may be addressed by double taxation relief; however, there is no method of recovery of the penalties imposed.

In regard to comparative return planning, investors are constantly trying to evaluate the net return an organisation realises on both an income basis and a free cash flow basis. Returns can, and do, vary due to the legal structures as well as the nature of the underlying business model. In terms of evaluating potential investments, understanding those reasons is key to evaluating a business enterprise and assessing its ability to compete in this business environment. This can be particularly true when acquiring a division, or less than the entirety, of a business organisation. In this manner, transfer pricing evaluations are a tool for the cross-border investor.

In regard to the business process analysis, a properly performed analysis identifies the drivers of a business revenue stream. This is critical where the values of various inputs are changing rapidly due to the overall business environment, the life cycle of the business, the life cycle of individual product lines, and other aspects such as currency, competition, and commodity pricing.

In summary, transfer pricing on one level is a necessary and critical function in order to avoid the imposition of additional taxes, interest, and most importantly, penalties. At the next level, understanding the competitive landscape allows an entity to assess how to compete. Finally, transfer pricing is critical in assessing the acquisition of critical assets. In all of these cases the affirmative use of attorney client or work product privilege has been critical in preserving the confidentiality of the fact gathering aspects of each stage. ■

NORTH AMERICA

How transfer pricing disputes are resolved with tax authorities: lack of publicly available information

by Brian C. Becker | Precision Economic, LLC

PRACTITIONERS, REPORTERS, AND government officials offer significant amounts of information on transfer pricing. These sources typically provide news items, practitioner's opinions of general transfer pricing concepts, and documentations of new regulations in the field. While the overall availability of transfer pricing information has expanded in recent years, information regarding how a specific company and a tax authority analysed/resolved a specific transfer pricing issue remains limited.

The informational discrepancy described above is logical for several reasons. First, most transfer prices do not get challenged in a manner that would necessitate a public disclosure. That is, the details of contemporaneous documentation studies and/or APAs – the bulk of transfer pricing work for private sector practitioners – typically are not reported publicly. Second, while a challenge to transfer prices often includes a detailed analysis of a company's operations, the company and tax authorities have business and/or legal reasons to keep that proprietary information private.

With the above dynamics understood, some transfer pricing dispute information tends to become public in one of two ways. First, companies disclose material disputes to their investors. While such disclosures have become more common in recent years, often the description is so general that the details of the transfer prices at issue cannot be determined. For example, public disclosures have been made in recent years by Transocean and Amazon, among other companies. While the magnitude of the dispute is often stated in public filings, the competing economic and legal concepts are typically not made available.

Court decisions provide a second venue in which transfer pricing disputes are relayed to the public. Before the completion of trials, courts usually offer limited information on a dispute – for example, parties at issue, legal representation of both parties, identity of experts, court calendar, and so on. However, further information is typically made available following the court decision.

Court and trial information on transfer prices have both a 'good side' and a 'bad side'. On the good side, depending on venue and circumstance, much of the trial record can be made publicly available. For example, certain courts make expert reports and trial transcripts publicly available. Such documentation allows for an understanding of how issues are analysed and the points in the

analysis that were subjected to the highest levels of scrutiny.

Limitations on court documentation, however, provide a bad side to accessing information on transfer prices from trials. First, very few disputes get resolved in court. This is especially true in the US, where the *Veritas* matter represented the only major decision in the past five years, along with a major announced settlement with Glaxo. Canada has reported two significant court decisions – *Glaxo* and *General Electric* – during this time period. Australia has also reported the results of two cases – *Roche* and *SNF*. Even among these cases, there exists further bad news from a documentation perspective. The courts may provide varied/limited documentation of the trials, especially in 'sealed' cases like *Veritas*.

The limited public knowledge of transfer pricing disputes/resolutions creates an informational hole on the actual dispute resolution process. Articles try to close this hole by inferring details of the parties' analyses from single page press releases – for instance, the *Glaxo* settlement in the US – or a public decision from an otherwise sealed case – *Veritas*, for example. While such articles can be entertaining, insightful, and thought-provoking, ultimately the lack of factual foundation creates a high level of speculation. While the relatively few private or government practitioners involved in specific trial or audit disputes know the details on such matters, they are typically unable to disclose such proprietary information. As such, the 'tea leaves' of information provided by summaries of new decisions and/or large settlements will – probably, slowly – continue to add to public knowledge of how transfer pricing disputes are resolved. ■

EUROPE

Transfer pricing - recent developments and future expectations from a UK perspective

by Richard Fletcher | Baker & McKenzie

TRANSFER PRICING NOT only continues to be one of the most important and resource-consuming tax issues for multinational groups, but also one of the fastest moving issues. This is not least because there are a number of different bodies that can either directly or indirectly affect, or influence interpretation of, UK transfer pricing legislation. Broadly speaking, these bodies comprise the UK government itself and the two supra-national organisations of the EU Council and the OECD Committee on Fiscal Affairs.

The EU Council reviews and develops transfer pricing policy through the European Union Joint Transfer Pricing Forum (EUJTPF), made up of government, OECD, business, and advisory representative members. Their work can result in a range of final outputs, from pure guidelines up to directives – effectively law in European jurisdictions.

Amongst the most recent outputs have been guidelines on how both taxpayers and European taxing authorities should approach support and pricing of 'low value adding' intra-group services in a more efficient and consistent manner; for example, standard headquarter-type services, and identification of potential approaches to so-called non-EU 'triangular' cases, where transfer pricing involving a non-EU group company in the supply chain influences the pricing between two or more European entities. Both sets of guidelines, in common with earlier outputs, are pragmatic and mainly non-controversial from a UK perspective, which perhaps reflects the fact that the EUJTPF consists of both government and private sector/industry representatives, and is a very consensual body.

However, in a more revolutionary vein, the European Commission continues to show interest in replacing the arm's length standard of transfer pricing within Europe with a proposal for a single consolidated tax base – the Common Consolidated Corporate Tax Base (CCCTB). If introduced, the corporate tax profits of all European entities within a multinational group would be accumulated, and the resulting total profit would be split between the jurisdictions and tax paid based on that split, according to a combination of factors likely to include location of headcount, revenues generated, and asset base. Although the governments of eight jurisdictions submitted reasoned arguments against the proposal, this was insufficient to require the CCCTB proposal to be withdrawn or adjusted, so intergovernmental discussions are now ongoing in regard to po-

tential introduction.

The other main supra-national body, the OECD, has been very productive recently in generating some very useful analysis and guidance regarding the topics of business restructuring, and comparability. The former covers the often tricky technical issues that arise when a multinational group changes its transfer pricing policies to reflect a new business model, for example integrating a new acquisition so that the acquired operations use the same transfer pricing policies as the acquirer. The latter update and add to the existing commentary as to how taxpayers should best support their transfer pricing policies using comparable data and information on transactions between independent parties.

The OECD has now started a review of possibly one of the most analytically difficult and controversial areas in transfer pricing: intangible assets. This is a critical area, as an increasingly significant profit flow within multinational groups can be attributed to values arising not in 'hard' assets, but in assets such as intellectual property. The situation is made increasingly complex, however, because there are also arguably 'soft' intangibles that can generate profit for a group that needs to be allocated to group companies, such as workforce-in-place, customer relationships, and know-how. It will, however, likely be 2013 before a draft paper can be expected from the OECD. Finally, the UK government is focusing upon a more territorial approach to international taxation, for example taxing profit based upon whether it has a significant UK nexus. This involves quantifying the amount of profit to be attributable to the UK nexus, which will often involve transfer pricing-type concepts.

One of the most high profile areas at this time is the expected introduction in April 2013 of a patent box regime, rewarding ownership of certain patents held by a UK taxpayer by taxing related profits at a reduced rate of 10 percent. The other main area is in the controlled foreign companies legislation reform, in relation to taxing profits made subsidiaries of UK companies in lower tax locations that either hold intellectual property with a UK nexus or act as a central finance company, but have significant equity. In both these areas, the issue is "what is the 'right' level of profit to be allocated, whether to a patent portfolio, to a non-UK IP holding subsidiary, or to a finance-related offshore operation?" These are areas in which we are beginning to see fairly definitive views of UK government, which is important given the expectation of 2012 introduction of the new legislation.

In summary, there are a number of critical areas relating to transfer pricing that are currently being reviewed and developed, that will have a fundamental impact on UK-headed, and other international, groups. Groups clearly need to review their upcoming and future tax plans in the light of this process. ■

EUROPE

Portuguese-speaking African countries: re-launching the adventure of the Portuguese discoveries

by Jaime Carvalho Esteves, Catarina Nunes, and Francisco Guimarães Melo | PwC Portugal

A CHANGING WORLD economy, the financial crisis, and the needs and expectations of investors, have led to a remake of the 15th and 16th century Portuguese discoveries, with Africa as a strategic place to invest. Portuguese-speaking African countries (PALOP), namely Angola, Cape Verde, and Mozambique, are top of the list of investors' choices. Portugal is increasingly seen as a hub for investments in Africa, given its close affiliation with the PALOP and its advantageous fiscal framework.

Mechanisms of the Portuguese tax law

The tax regime for the internationalisation of Portuguese companies provides for a corporate income tax (CIT) credit between 10 and 20 percent on relevant investments above €250,000, made in the incorporation, registration or acquisition of foreign companies or branches. This benefit also provides for the elimination of economic double taxation of dividends distributed from the foreign subsidiary.

Additionally, under a unilateral tax exemption, dividends paid by a PALOP subsidiary to its Portuguese parent company are exempt from CIT provided, among other requirements, that the parent owns at least 25 percent for a minimum period of two years

Portuguese holding companies (SGPS) are an important investment vehicle since, among other tax advantages, capital gains realised on the sale of shares are exempt from CIT.

SGPS are even more interesting where the applicable convention for the avoidance of double taxation (convention) allocates to the State of residence the exclusive right to tax capital gains realised on the sale of shares, such as the Portugal/Mozambique convention. Current Cape Verdean and Angolan tax laws do not tax capital gains. However capital gains will be taxed under the expected new Cape Verdean tax legislation. Accordingly the exemption provided by the Portugal/Cape Verde convention will be of most relevance. Angola and Portugal are currently negotiating a convention.

Note that the Portugal/Mozambique convention includes a tax sparing clause, according to which, if Mozambican sourced income is exempt from taxation or subject to a reduced rate, Portugal will still grant a unilateral foreign tax credit for the tax that would be due in Mozambique, capped at the rate provided for in the convention. Furthermore, Portugal has signed several other relevant agree-

ments with Angola, Cape Verde, and Mozambique.

Entities licensed in the Madeira International Business Centre (MIBC), a duly authorised European Union (EU) state aid, benefit from a reduced CIT rate (5 percent until 2012 and 4 percent until 2020) on foreign-sourced income, although remain entitled to all other Portuguese (and EU) tax incentives.

Benefits to foreign investors

Portuguese companies, including SGPS and MIBC licensed companies, benefit from EU Directives, namely regarding dividends (EU Parent/Subsidiary Directive) and interest and royalties (Interest/Royalties Directive). This means that in the case of EU recipients, there is no withholding tax on the payment of dividends, and, from July 2013 onwards, on the payment of interest and royalties.

Non-resident shareholders of MIBC licensed companies, as well as other non-resident service providers, benefit from an exemption from withholding tax, which will last until 2020.

In addition, besides a network of more than 60 conventions, Portugal is currently negotiating several other conventions with emerging economies. A wide network of agreements for the promotion and protection of mutual investments is in force. Portugal has entered into agreements for the exchange of information relating to tax matters with some of the most emblematic offshore jurisdictions, and is also part of several social security conventions including the Ibero-American Multilateral Convention on social security. Portugal also has protocols on mutual administrative assistance with Cape Verde and Mozambique.

What is happening in Africa?

Investments in Angola, Cape Verde, and Mozambique may be subject to a significant tax burden as, in general, the local taxes are high. Angola has one of most consistent economic growth rates, offering investment opportunities in key sectors, such as agriculture, construction, industry, infrastructure, O&G, and telecommunications. Cape Verde is an emerging economy closely associated with the EU, besides being an excellent tourist destination. The recently created International Business Centre (IBC) of Cape Verde, provides for a reduced CIT on foreign sourced income (until 2025), similar to the Portuguese MIBC.

Angola, Cape Verde, and Mozambique, eager for foreign investment, offer interesting tax benefits and incentives to foreign investors, namely exemptions from CIT and withholding taxes, for extended periods of time. Portugal is increasingly and understandably being used by EU and non-EU investors as a hub for Africa. The converse is also true, since African investors are investing in the EU and other countries through Portugal, taking advantage of its favourable tax framework. ■

EUROPE

Withholding tax refunds in Romania

by Emilian Duca | BDO Romania

WITHHOLDING TAX IS the most controversial and complex area of the Romanian tax system. In practice, any transaction with non-residents is subject to particular scrutiny during tax audits. The complexity of these cases derives from the provisions of international double taxation treaties and corresponding domestic legislation which need to be corroborated in order to correctly apply the law. Furthermore, the aggressive approach of Romanian tax authorities, frequently accompanied by a limited knowledge of international tax concepts, may lead to over-taxation of cross-border transactions.

Cases when a refund may be requested

As we have mentioned, over-taxation of a non-resident's income justifies the beneficiary to request a tax refund. This process requires close cooperation between the non-resident entity and the domestic income payer – in most cases a local company. This cooperation is required due to the fact that the domestic entity bears the tax risks and is the primary 'target' in case of tax audits.

The withholding tax is calculated, declared, and paid by the Romanian income payer. As a result, compliance errors will be borne by the Romanian entity with the consequence of compromising the tax refund. It worth noting that the tax (fiscal) residence certificate is a critical item for any refund – a lack of this document excludes *a priori* the refund of withholding tax.

Each case is analysed individually, but practice has identified several situations where the refund may be requested: (i) the tax residence certificate was missing and the local entity has withheld the tax on income; (ii) the withholding tax has been applied for services, which are not taxable in Romania, according to the Romanian Tax Code or upon the provisions of applicable Double Tax Treaties; (iii) the withholding tax rate was higher than the rate provided by the applicable treaty; and (iv) the income shall be reimbursed or tax exempt according to the EU Directives in direct taxation area.

Procedure for applying for refunds

The first step is to identify the right treatment of the cross-border transactions and whether the actual procedure applied by the local partner is consistent with this treatment. Once the over-

taxation is recognised, the refund procedure becomes advantageous.

The procedure is not very complicated. The application for the refund should be submitted to the local entity (the payer of the income subject to withholding tax). This entity should forward this to the competent tax authority, that is, the tax authority where this entity is registered for tax purposes.

Based on the documentation provided by the local entity the refund should be approved (or rejected) within a legal timeframe of 45 days (calculated from the day of filing the application). In cases where the refund is approved the money will be paid into the account of the local entity and then re-paid to the non-resident.

How to deal with non-responsive tax authorities

The 45 day deadline is mandatory, however, Romanian tax authorities consider this as a recommended term and can request additional information which pushes back the deadline. Of course, it is not unheard of for the tax authority to reject the refund application. In this case the reason for rejection must be carefully analysed before a course of action is decided. Besides remaining patient in the case of delay, the non-resident may choose to open court litigation within 30 days, calculated from the day of the deadline.

Cost-benefit analysis

The tax refund procedure does not create additional expense in relation to the tax authority, except for the fees of the consultants/lawyers engaged in the case. However, court litigation may be expensive and a cost-benefit analysis must be made prior to taking this course of action. It is common sense that in cases where the fees chargeable are higher than the withholding tax payable, the refund procedure should not be followed. In any case, the possibility to apply for refund is there and may be applied any time in the prescription period of five years. ■

ASIA PACIFIC

Managing the transfer pricing risk in China: prepare or beware

by Joseph Fu and Sue Cuthbertson | JFU Consultants (Hong Kong) Limited

GUO SHUI FA [2009] No 2 (the Circular) of the State Administration of Taxation on Implementation Measures for Special Tax Adjustments (Trial Implementation) became effective on 1 January 2008. The purpose of the Circular is to implement the Enterprise Income Tax Laws of the People's Republic of China (PRC) regarding the administration of special adjustments, including transfer pricing adjustments and advance pricing arrangements.

The Circular defines nine types of relationships between enterprises and individuals which are considered to be 'associated enterprises', including relationships by way of shareholding, funding, control, and family relationships. It also defines associated transactions, including trading of tangible assets, and the use of intangibles. Resident and non-resident enterprises which have an establishment or presence in China, and are entering into associated transactions with associated parties, must annually file a nine-part statement with the tax authorities comprising statements of associated relationships, associated transactions, purchases and sales, labour services, intangible assets, fixed assets, financing funds, external investments, and overseas payments.

The Circular also imposes an obligation to prepare and retain for a period of 10 years, contemporaneous documentation for associated transactions for each fiscal year, which should incorporate the following: (i) organisational structure; (ii) production and operation; (iii) associated transactions; (iv) comparable analysis; and (vii) selection and employment of transfer pricing methods.

In simple terms it requires enterprises to have a well defined, supportable, and properly documented transfer pricing policy. However, the Circular does appear to have a 'get out of jail' card in relation to the maintenance of contemporaneous documentation for enterprises whose annual associated purchases and sales are less than RMB200m and other associated transactions totalling no more than RMB40m. Therein lies the pitfall for many enterprises.

Prepare or beware

Typically, enterprises in China and non-residents with establishments in China did not document their transfer pricing policies. Even members of international groups who had global policies in place did not necessarily document the policy as it applied to China, as there was no perceived ad-

vantage to be obtained in doing so. Accordingly, the implementation of the Circular caused a lot of consternation. It was perceived to be very costly to document the transfer pricing policy as it would require experts to go through the value chain of the business, identify functions and risks, document them, identify comparable risks, and determine the appropriate transfer pricing methodology. Many enterprises with associated transactions tried to complete the annual associated transactions report with little or no substantive support for the related party pricing mechanism. Many did this on the basis that their results were below the *de minimus* limit for the maintenance of contemporaneous documentation.

However, the Circular further elaborates that the tax authorities may investigate or audit any loss making enterprise or enterprises making a small or unstable profit or undertaking business transactions with an associated party in a tax haven. Given that many enterprises trade with associates in lower tax jurisdictions - for example, 16.5 percent in Hong Kong - and there are a number of enterprises in China making losses, they are subject to tax investigation or audit. Likewise, it is common for a tax haven to be integral in the tax structuring for international business. Accordingly, there are many enterprises exposed to tax audits, additional taxes, and potential penalties arising from the lack of a documented transfer pricing policy for China. As it is apparent that the tax authorities are stepping up their enforcement procedures in relation to transfer pricing practices, international businesses, if they are not already doing so, must look at their global transfer pricing policies and ensure that they are consistently applied and correctly documented and implemented in China. This is an integral part of the tax risk management function of the group.

In this regard the perceptions concerning the cost of preparing the contemporaneous document to support the transfer pricing policy for China are somewhat misplaced, as most global organisations do have a transfer pricing policy. It is really a matter of documenting what is happening in China in the context of the global policy. There may be situations where the Chinese business has not been considered in the formation of the global policy and a full transfer pricing study is hence required. This of course will be a much more costly exercise.

Finally, in terms of transfer pricing risk management, the circular also confirms that contemporaneous documentation can be dispensed with if an advance pricing arrangement (APA) is in place. The tax authorities in China are actively encouraging the use of APAs and have negotiated a number of unilateral and bilateral APAs. The APAs usually cover two to four fiscal years and therefore provide certainty in relation to associated relationships and transactions. ■

ASIA PACIFIC

Tweaking with treaty provisions: a lawyer's perspective on the direct taxes code bill, 2009

by Tarun Jain | Lakshmikumaran & Sridharan (L&S)

TAX TREATIES AND the rules of interaction of double tax conventions with domestic laws, have become extremely important in determining the tax liability of the tax payer. Treaties can be given overriding effect over domestic law or choose a middle-path between the two worlds, making the tax-payer eligible for treaty benefits.

The law under the Income Tax Act, 1961 in India

The Income Tax Act of 1961 made a departure from the prevailing situation under the Income Tax Act of 1922. The 1961 Act specifically provides that the provisions of an agreement for avoidance of double taxation shall prevail if beneficial to the tax payer in comparison with the domestic law provision. The Supreme Court of India came out emphatically in support of double tax avoidance agreements in *Union of India v Azadi Bachao Andolan* [2003] 263 ITR 706 (SC). The challenge to the treaties was repelled owing to the scheme relating to the charging provisions [Section 5] and the unbridled provision directing the treaties to apply where beneficial to the assessee [Section 90].

The proposal under the Direct Tax Code Bill, 2009

While the 2009 Direct Tax Code Bill continued to vest power in the Government of India to enter into agreements with other countries towards granting tax relief and avoidance of double taxation of income, it sought to replace the scheme under section 90 of the Income Tax Act 1961. Draft section 258(8) provided that "for the purposes of determining the relationship between a provision of a Treaty and this Code, (a) neither the treaty nor the Code shall have a preferential status by reason of its being a treaty or law; and (b) the provision which is later in time shall prevail". The obvious conclusion was that in respect of all treaties existing prior to the coming into effect of the Code the provisions of the Code would apply, regardless of the benefits under those treaties. Only subsequently negotiated and notified treaties would override the provisions of the Code.

Examining the validity of the proposal

The proposal was criticised in the national media as eroding the sanctity of international agree-

ments. A moot point remains: on what basis could the treaty-override provision – that is, the draft Section 258(8) – be challenged under India's constitutional set-up?

No prohibition on double taxation. Here, treaty override would imply double taxation of income in the hands of the same subject in two countries. However the Supreme Court has categorically declared that there is no prohibition on double taxation under the Constitution of India.

Treaty interpretation rules do not override domestic laws. The Vienna Convention on the Law of Treaties states that "a treaty shall interpret in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". But within the constitutional structure no international treaty can be implemented in India unless a domestic law so provides.

Competence of Parliament. Lack of competence provides major grounds to challenge the validity of a parliamentary enactment. However Entry 82 of List I, to Schedule VII of the constitution, vests the subject matter of 'taxes on income' with parliament, and the consensus of judicial ruling is in favour of the view that the subject matter of taxation includes the power to provide for assessment.

Violation of fundamental rights. The challenge to the powers of Section 258(8) may have arisen on its incompatibility with Part III of the constitution, that is, the violation of fundamental rights. Article 14 of the constitution can be invoked if the provision is discriminative or arbitrary. The Supreme Court has declared that a taxing provision can be struck down on the sole grounds of palpable arbitrariness, which is unlikely to be the issue in the case of denial of treaty benefit. Even Article 19(1)(g) of the constitution, which guarantees the right to a citizen to practise "any profession, or to carry on any occupation, trade or business", may not have provided enough ground in the wake of categorical pronouncements of the Supreme Court that there is no fundamental right to be immune from taxation.

Conclusion

Having examined the prospects of challenge to the validity of the proposed amendment it is heartening to note that the policy-framers have abandoned the proposal made in the 2009 Bill and have reverted back to the scenario under the Income Tax Act, 1961 in the proposed Section 291 of the Direct Taxes Code Bill, 2010, entailing provision relating to double taxation avoidance agreements. ■

MIDDLE EAST & AFRICA

Angola: a changing environment for FDI

by Jaime Carvalho Esteves and Ines Barbosa Cunha | PricewaterhouseCoopers (Angola), Ltd

FOLLOWING THE RECENT release of the new investment law in Angola, and considering its relevance for investors, this article will examine the major changes introduced in private investment regulation in Angola and its impact on foreign investors, especially in concern of the repatriation of profits.

In order to get protection of their investment, the first step to be taken by foreign investors is to submit an investment project with the National Agency for Private Investment (ANIP). The new investment law requires a minimum capital investment of US$1m and only projects approved under this regulation are recognised and protected by the Angolan authorities. In any case, the investor can only claim the status of 'private investor' if its own investment reaches the US$1m level. Having met this first condition, the investor should benefit from a significant set of rights and guarantees, such as the right to repatriate the profits and apply for tax benefits.

The tax benefits are neither automatically granted nor attributed for an unlimited period of time, they should rather be determined as part of a negotiation process between the Angolan authorities and the investors. The investment project should be submitted to ANIP, though the team in charge of the negotiation will include members of ANIP as well as members of the central bank of Angola (BNA), the tax authorities, and members of the entity which regulates the activity of the underlying investment. The final decision for approval of investments up to US$10m should be issued by the ANIP board of directors, considering the binding opinion of the Ministry of Finance regarding the attribution of tax benefits. Above the US$10m level, the decision belongs to the president, after consulting the Council of Ministers.

Several industries are considered of interest for the attribution of tax benefits, namely agriculture and livestock, fishing, infrastructure, telecommunications, energy, health, tourism, information technology, and construction of social housing. The support given by the Angolan authorities depends on how significant the impact of the investment is in terms of the country's development. In addition, some projects may be recognised by the president as having 'strategic relevance' for the country's development and, therefore, the process should be guided under a specific framework and in a closer negotiation with him. Investments with a 'strategic status' may claim special tax benefits when the investment reaches US$50m. They may also claim special

tax benefits if recognised by the president as having a high strategic relevance for the country's economy and meet one of the following conditions: (i) the investment creates at least 500 direct jobs for Angolans; (ii) the investment is into technological innovation and scientific research; or (iii) the investment leads to exports exceeding US$50m.

The repatriation of profits for 'officially approved foreign investments' is a right granted to the shareholders, nevertheless it is subject to some restrictions, such as: (i) a previous definition of the distribution plan and proportions, to be negotiated with the Angolan authorities; and (ii) to increase the foreign investor's commitment with the country and discourage the immediate outflow of capital at an early stage of the investment project, the distributions may only be allowed two or three years after its settlement, the time lapse being dependent on the region where the company/project is located, and the amount of capital invested. However investments considered to be strategically relevant for the Angolan economy will not be limited by this provision.

Tax benefits on the corporate income tax area may configure a total exemption or a reduction on the general rate of 35 percent. The ceiling for the reduction was fixed at 50 percent of the general corporate income tax rate meaning it can go no lower than 17.5 percent. The period to benefit from the exemption or the reduced tax rate may be up to five, eight, or 10 years, depending on the investment location. Less developed regions will entitle the investor to higher attention from the Angolan authorities.

Shareholders will also qualify for a tax holiday under the private investment regime, for periods not exceeding three, six or nine years, also depending on location of investment. The withholding tax on dividends is currently 10 percent and Angola has signed no tax treaty to avoid or reduce double taxation, although it is expected that treaties with Portugal and the Netherlands could soon be signed.

To summarise, the new investment law determines a strong negotiation process, with a more discretionary nature when compared with the previous law in force, which was based on objective criteria for the attribution of tax benefits. Under the new investment law the granting of tax benefits shall be limited to the merits of investment, assessed by the area of activity, demonstration of the economic and social impact, as well as the creation of jobs for Angolans, all of them analysed on a case-by-case basis. ■

MIDDLE EAST & AFRICA

South Africa: gateway into Africa

by David Warneke | BDO South Africa

IN ORDER TO promote South Africa as an attractive jurisdiction in which to locate holding companies for investment into Africa, the South African Income Tax Act (SA ITA) has recently introduced a new international headquarter company (IHC) regime that provides for substantial tax benefits. The IHC regime applies for all tax years commencing on or after 1 January 2011.

Qualification requirements

To qualify for the new regime the company concerned must meet the definition, as per the SA ITA, of a headquarter company (IHC). A SA resident company is an IHC if: (i) each of its shareholders (local and/or foreign) holds at least 20 percent of the company's equity; (ii) at least 80 percent of the cost of the company's assets is attributable either to investments by the company in foreign shares, loans/advances made, or intellectual property licensed, to foreign investee companies; and (iii) 80 percent of the company's total receipts/accruals are derived from foreign investees and are in the nature of passive income or management fees. It has recently been proposed that the second requirement be relaxed somewhat, in respect of the holding by the IHC of cash and cash equivalents. A further proposal is that in addition to meeting the above requirements, an IHC would have to be pre-approved by regulatory authorities in order to qualify as an IHC.

Tax treatment of an IHC per the regime

Inbound receipts/accruals of the IHC. The various receipts and accruals of the IHC are treated as follows per the SA ITA: (i) local dividends received by or accrued to the IHC are not subject to tax; (ii) interest, royalties, foreign dividends and management fees are subject to tax at the South African corporate tax rate of 28 percent; and (iii) disposal of shares held by the IHC in foreign companies is tax free provided that the IHC has held such shares for at least 18 months and such shares are disposed of to a non-resident. Absent the fulfilment of these requirements, the IHC is liable for capital gains tax as imposed by the SA ITA on such share disposals at the effective rate of 14 percent. If the shares were held with a speculative intention, the gains would be taxed at the corporate rate for revenue gains which is 28 percent.

Outbound payments by the IHC. The various payments made by the IHC are treated as follows:

(i) the SA ITA currently imposes secondary tax on companies (STC) on dividends at the rate of 10 percent on company dividends declared out of profits. However an IHC is not subject to STC on dividends declared by it. Further, once the new dividends withholding tax regime replaces the STC regime with effect from 1 April 2012, IHC shareholders will not be subject to this withholdings tax; (ii) the dividends declared by the IHC are also exempt from Income Tax in the hands of the shareholders of the IHC; (iii) interest and fees paid by the IHC to shareholders are not subject to a withholdings tax; and (iv) payments of royalties that are in respect of intellectual property that has been used in South Africa to foreign shareholders of the IHC are subject to a 12 percent withholding tax. This withholding tax may, however, be reduced in terms of double tax agreements.

Controlled foreign company regime. The South African controlled foreign company (CFC) rules, which operate to attribute the income and/or capital gains of foreign investees back to the SA investor, will apply neither to the IHC itself nor to its foreign shareholders.

Transfer pricing. Transfer pricing rules (including thin capitalisation) do not apply to interest income and expenditure which is part of a back to back arrangement, i.e., where the IHC procures foreign funding which is then on lent to the foreign investees. Transfer pricing rules do, however, apply in respect of non-funding transactions with foreign investees of the IHC, for example, management fees, intellectual property utilisation and so on.

Foreign exchange control. Foreign exchange control regulations which, in a South African context, often impair the free flow of funds across borders do not apply to the IHC as far as loan funding to and from its investees is concerned. Foreign exchange controls do apply, however, to non-funding arrangements, for example, management fees etc.

Tax treaty access. The IHC is considered a South African tax resident for treaty purposes and is thus able to utilise South Africa's extensive double tax treaty network. Notably, South Africa has double tax treaties with some 83 jurisdictions, 18 of which are African countries.

Conclusion

The IHC provisions have been widely welcomed. South Africa is Africa's largest economy and given its good infrastructure it would seem to represent a logical choice as a holding company jurisdiction. Although the above concessions are not tantamount to affording South Africa tax haven status insofar as IHC's are concerned, they will hopefully go a long way towards attracting foreign investment. ■

Cape Verde - a business friendly regime in Africa

by Leendert Verschoor and Liza Helena Vaz | PwC Cape Verde

CAPE VERDE, BEING a former colony, maintains strong links with Portugal and has close ties with the European Union (EU). Due to various measures approved by the Cape Verde government in recent years, the country is an attractive destination for foreign investment.

Cape Verde and the EU

The relationship between the EU and Cape Verde was reinforced following the introduction of a special partnership, which turned the EU into Cape Verde's main trading partner. Also, in 1998, Cape Verde and Portugal agreed to peg the national currency, the Cape Verdean Escudo (CVE), to the Portuguese currency (the Escudo, at the time), and, later on, to the Euro, keeping the exchange rate fixed at €1 – 110.265 CVE. This situation brought advantages to the commercial relationships between EU and non-EU countries, increasing investors' confidence due to the stability of the currency.

Cape Verde and Portugal

The similarity between Cape Verde and Portuguese tax legislation, as well as special provisions in the Portuguese tax law, allow for structuring of foreign investment in Cape Verde through Portugal, which is an EU and OECD member with more than 60 double taxation treaties (DTT). To date Cape Verde has signed only one DTT, with Portugal. Under the DTT, payments of services from Cape Verde to Portugal are not subject to withholding tax in Cape Verde (the Cape Verdean tax authorities usually levy a 20 percent withholding tax). The Cape Verdean tax on other income from Cape Verdean sources is limited under the DTT. Additionally, Portuguese companies are allowed to claim a tax credit for the tax paid in Cape Verde on, among others, dividends, interest, and royalties.

Portuguese tax law also provides for attractive tax benefits for investments made in Cape Verde. For example, dividends paid by a Cape Verdean subsidiary (currently not subject to withholding tax in Cape Verde) to a Portuguese parent are exempt from Corporate Income Tax (CIT), if the parent company owns at least 25 percent for a minimum period of two years, and the subsidiary's profits were taxed at a rate of 10 percent CIT. Also a CIT credit is available, up to 20 percent of

the eligible expenses, in case of relevant investments in Cape Verde (benefits to the internationalisation of Portuguese companies).

The Portuguese special tax regime of the Madeira International Business Centre, duly authorised by the EU, benefits from all EU Regulations and Directives and from most of the DTT´s signed by Portugal. It is very attractive for foreign investors, and a hub to Cape Verde, considering the tax benefits available, namely reduced CIT rates (5 percent) and, in general, an exemption from withholding taxes on dividend, interest, services and other income paid to non-residents.

Tax benefits and the International Business Centre of Cape Verde

Cape Verdean tax legislation has an interesting feature that relates to capital gains realised on the sale of shares of Cape Verde companies, which currently are not subject to taxation. This will change once the new Cape Verdean tax law enters into force. Capital gains will be taxed irrespective of the ownership period. However, in that case the exemption can be achieved under the DTT between Cape Verde and Portugal.

There are several tax benefits and incentives available in Cape Verde, providing for exemption from CIT, property taxes, withholding taxes, and custom duties, among others. There are currently many opportunities in construction, tourism, renewable energies, industry, and provision of services. The recently created International Business Centre (IBC) of Cape Verde is intended to attract foreign direct investment, with the purpose of diversifying and modernising the archipelago's economy. The IBC special tax regime will apply until 31 December 2025, and provides for a reduced CIT rate of 2.5 percent, and, afterwards, 3.75 percent. The reduced CIT rate will only apply to income arising from the activities carried out with non-resident entities – those without a permanent establishment in Cape Verde – and with other IBC licensed entities.

The IBC special tax regime also provides for an exemption from withholding tax on dividends and interest payments made to non-resident shareholders. Additionally, entities licensed to operate in IBC will benefit in general from the VAT exemptions provided for in the Cape Verdean VAT Law, and are entitled to a VAT refund within 30 days. Cape Verde's tax regime, in particular the new IBC, makes it an attractive destination for foreign investment. A close relationship with the EU and Portugal makes Cape Verde a very business friendly regime, and definitely a place for investment. ■

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