No. 1/2008

VECO TAX News

Periodical review of the latest international tax news published by Verga Group
Via Lavizzari 4, CH–6900 Lugano • tel. +41 91 911 71 11 • fax +41 91 923 94 19
Website: www.vergagroup.com • Email: info@vergagroup.com

IN THIS EDITION:

EUROPEAN UNION
VAT- New rules regarding the place of supply of services
1

ITALY
New tax regime for dividends paid to EU companies
2

CZECH REPUBLIC
Reductions in corporate and personal income tax rates
2

LUXEMBOURG
New tax regime for intellectual property income
3

SWITZERLAND
Flat tax for the Canton of Obwalden
3

NEW ZEALAND
Reform of limited partnerships
4

CHINA
Provisions implementing the tax reform
4

EUROPEAN UNION

VAT- New rules regarding the place of supply of services

As part of a broader scheme aimed at harmonising VAT laws and preventing fraud or abuse, Directive 2008/8/EC (amending Directive 2006/112/EC) sets out, among others, new rules concerning the place of taxation of supplies of services.

As from 1 January 2010, supplies of services to persons subject to VAT will, as a rule, be taxed in the place where the recipient is established, with more widespread application of the reverse charge mechanism.

The supply of services to a taxable person acting as such will be subject to VAT in the member state where the latter has established his business (taxation at "destination"). However, if those services are provided to a permanent establishment of the taxable person located in a place other than the place in which he has established his business, the place of supply of those services is the place where that permanent establishment is located. In the absence of such place of establishment, the place of supply of services is the place where the taxable person who receives such services has his permanent address or usually resides.
On the other hand, for the purposes of VAT, the place of supply of services to private individuals is the member state where the supplier has established his business (taxation "at source").
If those services are provided from a permanent establishment of the supplier located in a place other than the place in which he has established his business, the place of supply of those services is the place where that establishment is located.
In the absence thereof, the place of supply of services is the place where the supplier has his permanent address or usually resides.

By way of exception to these general rules, alternative criteria apply to some specific cases. In particular:

- supplies of services rendered to a non-taxable person (private customer) by an intermediary are taxable in the place where the underlying transaction is supplied;
- supplies of services connected with immovable property - including the services of experts and estate agents, the provision of accommodation in the hotel sector or in sectors with a similar function, the granting of rights to use immovable property and services for the preparation or coordination of construction work, such as the services of architects and of firms providing on-site supervision, are taxed in the place where the immovable property is located;

- supplies of transport, cultural, artistic, sporting, scientific, educational, entertainment and similar services, ancillary transport services and valuations of and work on immovable property, restaurant and catering services (other than those physically carried out during the section of a passenger transport operation effected within the Community) are taxed in the place where the services are physically carried out;
- supplies of short-term hiring of means of transport are taxed in the place where the means of transport are actually placed at the disposal of the customer;
- supplies of electronically supplied services to non-taxable persons who reside in a member state by a taxable person who has established his business outside the EU or has a fixed establishment there from which the service is supplied are taxed in the member state where the customer resides.

Moreover, as from 1 January 2010, Regulation (EC) No. 143/2008 amending Regulation (EC) No. 1798/2003 with regard to the introduction of administrative cooperation and the exchange of information concerning the rules relating to the place of supply of services, the special schemes and the refund procedure for VAT, will come into force.

This means that, to ensure the proper application of VAT on services which are subject to the reverse charge mechanism, the data collected by the member state of the supplier must be communicated to the member state where the recipient is established.

ITALY

New tax regime for dividends paid to EU companies

In response to the reasoned opinion issued by the European Commission (C(2006) 2544 of 28 June 2006), article 1, sub-sections 67-69, of the 2008 Budget Law changed the tax treatment applicable to outbound dividends paid by Italian companies to non-resident companies and entities, subject to taxation in other EU member states and countries belonging to the EEA included in the "white list" to be drafted pursuant to the new article 168-bis of the Income Tax Consolidation Act (inclusion in the list is based on exchange of information criteria). Under the new law, the previous 27 per cent rate has been replaced by a 1.375 per cent rate.

The new provisions introduced by law No. 244/2007 (article 27 sub-section 3-ter of Presidential Decree No. 600/73) bring Italy's domestic legislation in line with the provisions of the EC Treaty. The same issue was the subject of ECJ rulings C-170/05 (Denkavit) and C-379/05 (Amurta).

The aim is to introduce the same tax treatment for outbound dividends as that applicable to domestic dividends paid to Italian companies, which are only taxable for 5 per cent (at the 27.5 per cent corporate income tax rate (IRES), resulting in a tax rate of 1.375 per cent). This equalisation is further justified in view of the elimination of article 122, sub-section 1, letter a) of the Consolidated Income Tax Act, which allowed Italian residents to benefit from 100 per cent exemption of profits under the tax consolidation regime.

The amendments introduced with the budget are applicable to profits realised starting from the tax year beginning after that underway on 1 January 2008 (profits realised prior to that date will be taxed at the previous 27 per cent rate or at a lower rate applicable in accordance with the provisions of a tax treaty).

No changes have been made to the 100 per cent exemption for dividends distributed to qualifying "parent" companies resident in another EU member state, on which no tax is withheld at the time of distribution (article 27-bis of Presidential Decree No. 600/1973, implementing Directive 90/435/EEC, the "Parent-Subsidiary" Directive).

Pending publication of the aforesaid white list, the law in question applies to EU member states and countries that belong to the EEA and are included in the list of countries that operate an exchange of information system with Italy pursuant to tax treaties with the Italian Republic in accordance with the Ministerial Decree of 4 September 1996 (essentially only Norway).

CZECH REPUBLIC

Reductions in corporate and personal income tax rates

The corporate tax rate in the Czech Republic has been reduced to 21 per cent as from 1 January 2008, replacing the previous rate of 24 per cent, in force until the end of 2007. Further reductions are planned, to 20 per cent in 2009 and 19 per cent in 2010.
Income of individuals will be taxed at a flat rate of 15 per cent. This replaces the previous rates of between 12 and 32 per cent in

force until 2007. In the face of these lower rates, the government has increased the tax rate applicable to capital gains on the sale of shareholdings in unlisted companies. Total exemption, originally available after a holding period of six months, will now only be available for shares that have been owned for five years.
As from 1 January 2008, the standard rate of VAT is 19 per cent, with the reduced rate standing at 9 per cent. This brings the Czech Republic in line with the other new EU member states, which have introduced highly competitive income tax rates. Lower withholding tax rates are also to be introduced for royalty payments to non-residents. More specifically, the withholding tax on royalties and fees for services provided in the Czech Republic, including payments for commercial, technical and hire services, will be reduced from 25 per cent to 15 per cent.

The provisions of the Parent-Subsidiary Directive concerning outbound dividends have been extended to include companies being wound up. Dividends paid by such companies to non-residents will not attract withholding tax.

The Czech Republic has also introduced an advance ruling system. This will allow taxpayers to obtain a preliminary binding ruling from the tax authorities concerning specific tax-related issues. The tax authorities will issue rulings with regard – among others – to methods for allocating costs that refer to both exempt and taxable income, deduction of costs relating to property for mixed use and evaluation of accounting and tax treatment of expenses in connection with immovable assets and the possibility of capitalising these or charging them in full to the year.

LUXEMBOURG

New tax regime for intellectual property income

A special tax regime for income and capital gains derived from the use and sale of intellectual property (trademarks, patents, software, etc.) came into force on 1 January 2008.

Under the new system (article 50-bis, LIR), as from 1 January 2008 only 80 per cent of the income derived from the aforesaid intellectual property, purchased by third parties or group companies, will be exempt from tax (providing for an effective tax burden of around 6 per cent of profits).
The exemption regards royalties for the use of licenses by third parties or group companies, and notional income deriving from own use of the intellectual property.

Capital gains realised on the disposal of intellectual property will also benefit from partial exemption, under certain conditions.

To avoid repetitive use of the tax incentives, the new regime is not available for intellectual property and the relative rights acquired from a “related company". Related companies are defined as:

- subsidiaries, in which the taxpayer holds at least 10 per cent of the capital;
- parent companies, which own at least 10 per cent of the capital of the subsidiary;
- sister companies, in which a third company holds at least 10 per cent of the capital.

However, the law does not refer to the circumstances in which capital is held indirectly, i.e. capital owned by individuals rather than corporations.

This new regime is a significant incentive, since it will likely be attractive to enterprises that use and create intellectual property and R&D centres. Unlike similar incentives available in other countries (France, Belgium, the Netherlands and Ireland) they are not subject to specific R&D activities being carried on in Luxembourg.

SWITZERLAND

Flat tax for the Canton of Obwalden

In a referendum on 16 December last year, the electorate in the Swiss Canton of Obwalden voted to adopt a new flat income tax rate to be levied at cantonal level. The new rate came into effect on 1 January 2008 (the direct federal tax rate remains unchanged).

In addition to adopting the single rate of 1.8 per cent, the new cantonal regime also exempts the first CHF 10 thousand of income from taxation.
Taking into account the effects of the so-called “multiplier” and federal taxes, the overall tax rate on personal income should not exceed 13 per cent.

The canton has also reduced its corporate tax rate, from 6.6 per cent to 6 per cent.
Company profits are therefore taxed at an effective rate of approximately 12 per cent (considering federal tax and income tax deductions).

This makes Obwalden the canton with the most favourable tax

regime in Switzerland. It replaces the previous proposal for a regressive tax system, i.e. lower rates with increases in taxable income, aimed at encouraging wealthy taxpayers to move to Obwalden. This proposal was judged to be unconstitutional as it went against the principle of taxation on the basis of the ability to pay.

The flat rate of personal income tax has aroused interest in other cantons, also with a view to adoption alongside the "lump sum" system of taxation based on expenditure (there have also been proposals at federal level for a single tax rate throughout Switzerland).

The Tax Reform II, approved at federal level, abolishes, at least in part, the double taxation of corporate profits and introduces partial exemption of dividends from qualified shareholdings (dividends only taxed to the extent of 60 per cent or 50 per cent if the shares are held as private or business property, respectively).

Lastly, as regards dividend income of trading enterprises, the required threshold for participation exemption (Beteiligungsabzug) has been lowered from 20 per cent to 10 per cent and from CHF 2 million to CHF 1 million, respectively.

NEW ZEALAND

Reform of limited partnerships

The government of New Zealand has approved a draft bill reforming its limited partnerships (similar to limited partnerships in other jurisdictions, without corporate personality).

The purpose of the reform is to create an efficient corporate vehicle with a view to making New Zealand more competitive on international markets.

New Zealand's new LP regime will be very similar to the English LP and LLP. Its key features will be:

- limited partners who are only liable to the extent of their contribution to the partnership;
- general partners who are liable for all of the debts and liabilities of the partnership;
- flow-through tax status (the income of the LP flows through directly to the partners and is taxed on the basis of their partnership share).

CHINA

Provisions implementing the tax reform

The new Company Income Tax Law establishing a unified corporate income tax regime for foreign-invested enterprises (FIEs) and Chinese enterprises was approved on 16 March 2007. Both types of enterprises are now taxed at a rate of 25 per cent (see Veco Tax News No. 1/2007).

The implementing provisions, which integrate the scope of the tax reform and clarify some important practical aspects, became effective as from 1 January 2008.

The new law confirms the abolition of tax incentives for manufacturing FIEs, i.e. the two-year 100 per cent tax holiday followed by a 50 per cent reduction for another three years. There is a grandfathering arrangement for companies already benefiting from this system and for those that, although not benefiting, were established prior to the approval of the new rules.

The new flat tax rate will also be introduced gradually over a five-year period for the Special Economic Zones (SEZs) (18 per cent in 2008, 20 per cent in 2009, 22 per cent in 2010, 24 per cent in 2011, 25 per cent in 2012). China will continue to offer tax incentives to companies established in western areas of the country.

Innovative and high-tech companies will continue to be taxed at a particularly favourable rate (15 per cent instead of 25 per cent).

The implementing provisions introduce limits for deducting entertainment expenses and strict transfer pricing rules.

Lastly, withholding tax on dividends paid to foreign shareholders has been reduced from 20 per cent to 10 per cent, in line with that on interest and royalty payments and other China-source income.

Dividends paid to foreign companies by their Chinese subsidiaries continue to be exempt and the incentives for reinvestments of profits continue to apply.

The authors assume no responsibility whatsoever for any damage in connection with actions, whether undertaken or not, relating to the opinions or information set forth herein.