

# The International Tax Letter

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International news and analysis to help you in your international tax strategy.



## Focus on: European Union

### European Commission fights against tax fraud and proposes a better cooperation between tax authorities



The European Commission approved two proposals of Directive concerning administrative cooperation in the field of taxation (COM(2009)28) and mutual assistance for the recovery of claims relating to taxes, duties and other measures (COM(2009)29).

Once approved by the Council and implemented by the Member States, the two Directives should improve and enhance the cooperation between Member States in the collection of taxes. This will result in a drastic reduction of tax frauds by the taxpayers.

The said proposals provide for common rules of procedures, common forms, formats and channels for exchanging information between the competent authorities of the Member States. They also allow tax administration officials in one Member State to be on the territory of another Member State and to actively participate and with the same powers of inspection in administrative enquiries carried out there.

One of the main elements of the new Draft Directive regards bank secrecy. The European Commission, in fact, proposes a specific rule which prevents a Member State from refusing to provide information about a certain taxpayer of the requesting Member State solely because this information is protected by a bank or other financial institution.

The abolition of the bank secrecy among tax administration will allow Member States to effectively assess the tax situation of one of its resident taxpayers. Furthermore, the European dimension of the proposals is underlined by the provision according to which Member States are obliged to provide the same level of cooperation to their EU partners as they have agreed to with any third country.

The Draft Directives also aim at improving the mutual assistance in the recovery of taxes between Member States. The Commission proposes to reinforce the cooperation in the collection of all taxes and duties levied by the Member States and their administrative subdivisions, as well as compulsory social security contributions.

A spontaneous and compulsory exchange of information system should be introduced in the matter of tax refunds to non-resident taxpayers and the powers of tax administrations abroad will be enhanced.

## BRAZIL

### Transfer pricing on exports - adjustment mechanism

Effective from 30 December 2008, Directive 310 issued by the Ministry of Finance and Normative Instruction 898 issued by the Chief of the Federal Revenue Service have provided for a mechanism to adjust prices derived from export transactions for transfer pricing purposes.

Transfer pricing rules on exports include a general safe harbour for income derived from export sales. Exports are subject to transfer pricing adjustments only when the average price of the exported goods, services or rights during the current tax period is lower than 90% of the price charged domestically for the sale of the same types of goods, services or rights in the same period and under similar payment conditions.

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However, exports prices charged below the general safe harbour margin, will a priori, be deemed to be at arm's length if the following requirements are met:

- The net income before taxes derived from export transactions of the relevant company is equal to at least 5% of its overall export revenue (considering the average of the same period and the 2 previous year); or
- The enterprise's export-related net turnover in a tax period is 5% or less of its total net turnover in the same period.

In order to mitigate the impact of the appreciation of the Brazilian Real on the calculation of the 90% general safe harbour and on the first 5% threshold (i.e. the net income threshold), Directive 310 and Normative Instruction 898 establish that the revenue from exports may be adjusted by multiplying the revenue by a factor of 1.20 for the 2008 calendar year.

Normative Instruction 898 further clarifies that for purposes of calculating the average of the 3-year period under the first 5% threshold, the export revenue earned in 2006 and 2007 can be adjusted by a factor of 1.29 and 1.28 respectively. Alternatively, the taxpayer is also allowed to calculate the minimum net income of 5% only for the 2008 calendar year by using the 1.20 factor.

Finally, the 1.20 factor can also be used when the taxpayer applies the cost-plus method to verify the adequacy of the prices charged on export transactions (this will be the case when the taxpayer does not meet any of the available safe harbours mentioned before).

## GUERNSEY

### Proposed amendments to tax laws

On 9 January 2009, the Treasury and Resources Department announced some proposed amendments to the tax laws.

The tax cap, which is currently set at GBP 250,000, should be reduced to GBP 100,000 and GBP 200,000 in case it is elected for the tax cap to apply to worldwide income. The proposals are made against the backdrop of concerns that Guernsey was losing its competitive edge against other jurisdictions offering a lower tax cap.

A flat tax charge should be introduced. Taxpayers who are resident, but not solely or principally resident, in Guernsey are liable to tax on their Guernsey-source income, as well as on their overseas income remitted to Guernsey. The minimum level of tax liability is proposed initially to be GBP 25,000. This would be payable in cases where Guernsey-source income does not exceed GBP 125,000. Taxpayers who elect to pay the charge must make a declaration as to their Guernsey-source income, and must also satisfy certain other requirements. Taxpayers who do not qualify to pay the charge would be subject to tax on their worldwide income. There would be an exception for taxpayers who are in Guernsey solely to undertake employment. They would continue to be subject to the current regime.

In order to ease the administrative burden, proposals have been made to allow companies to elect to distribute at least 65% of their trading profits each year. In such a case, the requirement to report deemed distributions would be waived. Such companies would simply need to deduct and account for Guernsey tax on actual distributions made. The legislation would also contain anti-avoidance measures.

Furthermore, it is proposed that the dwelling profits tax be suspended, and the position kept under review. This is due to the administrative burden involved in the collection of the tax, given the insignificant revenues raised thereby. The tax-free threshold applicable to termination payments should be increased from GBP 10,000 to GBP 30,000, effective from 1 January 2009.

Proportional relief should be abolished. There are also proposals to introduce a simpler system that would offer full allowances to non-resident pensioners receiving a Guernsey pension.

For merchant seamen, a 100% deduction is proposed in respect of relevant "foreign earnings". However, where such a deduction is available, there would be no entitlement to any other allowances, reliefs or deductions. The taxpayer would then decide, based on his personal circumstances, whether or not to claim the deduction.

## UNITED STATES

### Tax highlights for US citizens and residents going abroad

The US Internal Revenue Service (IRS) has released the 2008 revision of Publication 593 (Tax Highlights for US Citizens and Residents Going Abroad). The publication is dated December 2008 and is available on the IRS website.

It generally explains the provisions of US federal income tax law that apply to US citizens and resident aliens who live or work abroad and who expect to receive income from foreign sources.

The publication discusses:

- The applicable US tax return filing requirements;
  - The treatment of income earned abroad, including the Section 911 earned income exclusion and housing exclusion or deduction;
  - Tax withholding and estimated taxes;
  - Claiming a credit or deduction for foreign income taxes;
  - Claiming tax treaty benefits; and
- Information on how to obtain tax help from the IRS.

## INTERNATIONAL MODELS

### Chinese partnership as an instrument of tax planning

On 23 December 2008, the State Administration of Taxation issued a notice no. 159 with regard to the tax treatment of partners of a cooperative enterprise (i.e. partnership), which retrospectively applies from 1 January 2008. Partners of a cooperative enterprise are liable to income tax. If a partner of a cooperative enterprise is an individual, the partner is subject to the individual income tax. If the partner is a legal person or other organization, the partner is subject to enterprise income tax.

A cooperative enterprise's profits and other income before tax (including the reserves of the current year of the cooperative enterprise) should be distributed to partners. Partners are required to calculate their taxable amount by taking in account the following rules:

- Profits and other income must be distributed to partners according to the ratio as specified in the cooperative agreement. The agreement must include *all* partners in the distribution.
- In case of lack of an agreement or a clear agreement, all profits and other income must be distributed to the partners based on the result of consultations.
- If the consultation does not provide a solution, the profits and other income must be distributed according to each partner's proportion of capital contributions.
- If the proportion of capital contributions of partners cannot be determined, the profits and other income must be divided equally among the total number of partners.  
Partners that are legal persons or other organizations may not offset losses of the cooperative enterprise against their profits for the purposes of enterprise income tax.

