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International Tax

North America and the Caribbean

Canada

Mini-Budget Announces Tax Cuts But Election Called

Conscious that his government's days were numbered, Canada's Minister of Finance, Ralph Goodale, announced a mini-budget promising major tax cuts on November 14.

The measures the Liberal Government proposed to introduce included a reaffirmation of the abolition of the corporate surtax (currently at an effective rate of 1.12 percent on income) from January 1, 2008, a half-point cut in the general federal corporate tax rate from 21 percent to 20.5 percent from January 1, 2009 and a further three half-point cut to 19 percent on January 1, 2010. Individual taxpayers were also to benefit from an immediate backdated cut in the lowest federal income tax rate (from 16 percent to 15 percent) and from a major increase in the top-rate (29 percent) threshold from the current CAD 115 739 (EUR 83 075) to CAD

200 000 (EUR 143 550) from January 1, 2010.

However, the future of these proposals is now in the hands of voters, as shortly afterwards, the Government lost a vote of confidence supported by the three major Opposition parties (the Conservatives, the New Democrats and the Bloc Québécois). As a result, a general election has been called for January 23. Opinion polls suggest the result will be close.

Dividend Tax Treatment Eased In Response To Income-Trust Debate

Shortly before losing the confidence vote, the Canadian government also announced (on November 23rd) changes to the treatment of dividends received by individuals and trusts. The changes are intended to lower the average rate of income tax on such dividends.

This measure was by way of response to the government's own consultation paper on income trusts

issued on September 8th (reported in the last issue of the International Tax Newsletter.) The paper highlighted the increasing resort had by individuals to owning equity stakes in corporations via an income trust, so benefiting from a lower rate of income tax than they would have faced on the dividend from a directly owned shareholding.

In order to level the playing field between different sources of dividend income, and so reduce the tax advantage of income trusts, the Government proposed to increase the gross-up rate of eligible dividend income received by individuals and trustees to 45 percent and give them a tax credit of 19 percent on the resulting tax. Eligible dividends would, broadly, have been dividends from public companies and others not qualifying for the small-business rate of corporate tax. The treatment of Canadian dividends receivable by non-residents of Canada would not be affected.

However, this measure too is now subject to the result of the January 23rd general election. There is no certainty that a new government would enact the same proposal.

Supreme Court Delivers Judgments On Avoidance Cases

The Supreme Court of Canada has delivered two important decisions on the application of Canada's general anti-avoidance rule (GAAR). In both cases, it upheld the judgment of the Federal Court of Appeal, namely that the GAAR did apply in one of the cases (*Kaulius* – also known as OSFC) and did not apply in the other (*Canada Trustco*).

In *Canada Trustco*, there was a complex series of transactions, in which the taxpayer bought trailers valued at USD 120 million from a US leasing corporation. The trailers were then circuitously leased back to the lessor under a sublease, under arrangements that effectively repaid the purchase price to the taxpayer. The taxpayer claimed capital cost allowances (tax depreciation) amounting to approximately CAD 31 million on the trailers. Its claim to the allowances was denied by the tax authorities, ultimately by invoking the GAAR, but the taxpayer was successful, principally on the grounds that the transaction, although admittedly an avoidance transaction, was not so dissimilar from an ordinary sale and leaseback transaction as to constitute abusive tax avoidance. It was only to abusive tax avoidance that the GAAR could be applied.

In *Kaulius*, a company that had lent money on the security of mortgages went into liquidation. In order to maximise the value of the company's assets, the liquidator entered into a series of transactions that allowed the taxpayers to deduct losses that had accrued on a portfolio of the insolvent company's mortgages. In that case, the Supreme Court affirmed that there had been abusive tax avoidance.

In short, the Court set three conditions for the GAAR to apply:

- There must be a tax benefit from a transaction or series of transactions,
- The transaction(s) must be a tax-avoidance transaction, and
- There must be abusive tax avoidance.

It is for the taxpayer to rebut the first two propositions and for the tax authorities to establish the third. Avoidance is abusive if it cannot be reasonably concluded that the tax benefit in question was consistent with the object, spirit or purpose of the statutory provisions relied on by the taxpayer in claiming the benefit.

The conclusion is that the GAAR is alive and well and is a factor that must be respected when engaging in aggressive tax planning. Where a situation fits squarely within the framework set out by the Court, assessment of penalties by the Canada Revenue Agency for loss-trading arrangements, among others, cannot be ruled out.

Netherlands Antilles

Change in Aruba Tax-exempt Company Régime

As from January 1, 2006, the Aruban Government is introducing a revised tax régime for the Aruba Exempt Company (*Arubanse Vrijgestelde Vennootschap* – AVV). Except in certain circumstances, the main effect of the revised régime is that the Aruba Exempt Company (AVV) ceases to be a tax-exempt entity and becomes a taxable entity.

As from January 1, 2006, an AVV will automatically be considered taxable at the rate of 35 percent on its profits, unless either of the following situations applies:

1. The Aruba Exempt Company is solely involved in the following activities (these activities are not subject to profits tax in Aruba):

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Activities:	Strict Conditions:
Holding	The (foreign) subsidiary companies should be subject to a profit tax of at least 17.5 percent. An exception has been made to this rule, whereby dividends received from non-qualifying foreign companies will not cause exemption to be lost, as long as the dividend income from these companies does not exceed 5 percent of the total amount of dividends received from holding activities.
Financing	The Aruba Exempt Company (AVV) may not qualify as a bank or other credit institution.
Investment	Excluding real estate.
Licensing Of Patents	

2. The AVV elects for transparency status. This status converts the AVV into a transparent entity for tax purposes in Aruba. As a consequence, it will not be subject to profits tax in Aruba but tax (if any) will be due at the shareholder level.

When electing for transparency status an AVV will have to comply with the following annual requirements:

- The AVV is to disclose the identity of its shareholder(s) to the local tax authorities;
- The AVV has to file its financial statements with the tax authorities in Aruba within six months of the financial year-end; and
- The AVV will be publicly listed as transparent.

In order to avoid a potential liability to Aruban profits tax from next year, a review of AVV status is strongly recommended. In the absence of any action, any AVV not solely engaged in the tax-exempt activities mentioned above will automatically be considered taxable

at the rate of 35 percent of its profit, starting from January 1, 2006.

Aruba Introduces Dividend Withholding Tax

A further change in the Aruban tax system sees the introduction of a withholding tax on outbound dividends as from January 1, 2006.

There will be both a 5 percent and a 10 percent rate, depending on the circumstances. As far as Aruban exempt companies are concerned, those that remain tax-exempt or have opted for transparency will not be obliged to withhold tax; AVVs now subject to 35 percent profits tax will have to withhold tax.

United States

IRS Issues Final Regulations and Temporary Regulations (T.D. 9235) to List of Per Se Corporations

The IRS has issued final and temporary regulations (T.D. 9235) in order to add six new business enti-

ties to its list of “per se corporations.” These types of entities are thus not eligible to elect a status other than that of a corporation for US federal tax purposes. Domestic and foreign business entities are generally free to choose their status as either transparent or taxable entities for US tax purposes, unless they are “per se corporations.” The list of foreign per se corporations has now been amended to include the following:

- Societas Europaea (SE), European Union,
- Aktsiaselts, Estonia,
- Akciju Sabiedriba, Latvia,
- Akcine Bendroves, Lithuania,
- Delniska Druzba, Slovenia,
- Aktiengesellschaft, Liechtenstein.

These rules apply to entities formed on or after October 7, 2004 (SE) or October 8, 2004 (all other entities).

The SE in particular may deserve extra attention in the future. Even though heavily promoted by European (tax) policy makers, the SE has yet to emerge as a popular form of doing business within the EU.

President's Tax Reform Panel Reports

The Advisory Panel on Federal Tax Reform appointed by President Bush in January 2005 to examine revenue-neutral ways of reforming the US federal tax system delivered its final report on November 1, 2005.

Rejecting more radical proposals such as the introduction of a federal VAT, a flat tax on corporate and personal income, or a progressive con-

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Progress on the Gulf Opportunity Zone Act of 2005

The United States Senate and House of Representatives passed H.R. 4440, the Gulf Opportunity Zone Act of 2005 (Gulf Act), on December 16, 2005, one of the most elaborate programs of credits and incentives since the Depression. While the details of the Act are too numerous for the space permitted in this newsletter, a fuller description of this Act is being posted to <http://www.bdo.com/about/publications/tax/index.asp>. The Gulf Act establishes special tax incentive zones for those businesses in areas affected by hurricanes Katrina, Rita, and Wilma. Presidential approval is expected by the New Year. The Act created three different Gulf Opportunity Zones (GO Zones), covering portions of LA, MS, AL, TX and FL, each providing an elaborate array of benefits arising from:

- Bonds
- Low Income Housing Credits,
- Accelerated Depreciation Deductions,
- Rehabilitation Tax Credits,
- NOL Carryback for Certain Losses,
- New Markets Tax Credits,
- Employee Retention Credits, and
- Suspension of Charitable Limits.

Congress is currently reviewing the terms of a separate plan to provide federal money directly to communities and businesses affected by the hurricanes. This additional aid package, expected to total between \$25 billion and \$30 billion, is expected to include modified Community Development Block Grants and other grant programs that will allow state and local development officials to provide direct infusions of cash and capital to spur redevelopment within the hurricane zones. These programs will likely be administered through state economic development authorities as occurred after the 9/11 attacks in New York. Eligibility for these awards will likely be based on a combination of business recovery costs, commitment to continuing operations in one of the Zones as well as job retention and creation. BDO Seidman's Credits & Incentives practitioners have been very active in advising clients and negotiating better terms and conditions from among this rich set of incentive programs. For further details, please consult the above tax alert at www.bdo.com.

sumption tax, the Panel has recommended the adoption of one of two options.

The first option, called the Simplified Income Tax Plan, would replace the current worldwide basis of taxation of corporations by a territorial approach, exempting foreign-source business income. It would reduce the top marginal rate of corporate income tax from 35 percent to 31.5 percent and abolish the alternative minimum tax (AMT). Individuals would remain liable to worldwide tax liability based on citizenship rather than residence. However, the top marginal rate of income tax for individuals would fall from 35 percent to 33 percent, the number of tax bands would be reduced from six to four, exemption would extend to all health-insurance benefits, and the tax benefits of home ownership and charitable donations would be enhanced. Taxpayers would no longer be entitled to deduct state and local taxes from their federal taxable income, however.

Under the second option, the Growth and Investment Tax Plan, there would be a partial move towards a consumption-based tax, in that corporations would be entitled to immediate deduction (expensing) of investments. The top corporate income tax rate would fall to 30 percent but the worldwide basis of taxation would be retained. For individuals, the top rate would also be reduced to 30 percent and there would only be three tax bands. A flat rate of tax would apply to dividends, interest and capital gains. As with the Simplified Income Tax Plan, the AMT would be abolished and the measures on health insurance, home ownership and charitable donations would be the same.

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The Panel's recommendations are being considered by the Secretary of the Treasury, who will then make recommendations to the President.

Treasury Aims To Reverse Boise Cascade Case

The US Treasury has issued proposed regulations to reverse the decision of the 9th Circuit court in the *Boise Cascade* case, which involved stock (share) options awarded to a departing employee.

As part of a severance package, the employee was paid cash in redemption of shares distributed to him as a participant in the corporation's employee stock ownership plan

(ESOP). Under US law, a company that pays a dividend to an ESOP or to a participant in an ESOP can in certain circumstances claim a deduction for that dividend. The taxpayer company did so in the *Boise Cascade* case, but the Internal Revenue Service denied the deduction on the grounds that the payment to the employee was a redemption of share capital, not a dividend. Additionally, it ruled that the payment was not a dividend because it was paid to one individual only and not to all the participants in the ESOP.

The court, however, held that the ESOP, not the individual participants, was the sole owner of the

shares, and since the payment to the employee had not meaningfully reduced the ESOP's ownership of ESOP shares, it could not be classed as a redemption and therefore qualified to be treated as a deductible dividend.

The decision of the 9th Circuit court is under appeal, but the Treasury has opted to pre-empt the final judgment by issuing regulations that would classify payments such as those made in the case as linked to a redemption and consequently ineligible as dividends. ■

Europe and North Africa

European Union

Marks & Spencer: Foreign Losses Must Be Recognised In A Group Consolidation Régime Only Where Relief Possibilities Exhausted In Original Jurisdiction

The European Court of Justice gave its final judgment in the *Marks & Spencer* case on December 13. Although it represents a victory for the taxpayer, it is limited in extent and leaves several questions unanswered.

The outcome of the case is important to all multinational groups with subsidiaries or parent companies in EU Member States that allow some form of group consolidation.

Marks & Spencer had argued that the UK's group relief system was in breach of European Community law

because it did not allow relief against UK tax for losses suffered by its subsidiaries in Belgium, France and Germany. Since most other group consolidation regimes across the EU have a similar prohibition (exceptions are Austria and Denmark), a clear victory for the taxpayers would have had wide-ranging consequences.

It will be remembered that the Advocate-General in his opinion (reported in the April 2005 issue of this Newsletter) had said that the UK's system was indeed incompatible with the EC Treaty, but that rules to prevent double counting of losses would be justified.

The Court's final judgment has reversed the emphasis of that opinion. On the one hand, it is clear that losses arising in a foreign subsidiary in its final year and which cannot be

utilised in that foreign jurisdiction should be eligible for surrender as group relief (in the UK) or for group consolidation more generally. All corporate groups should therefore now examine the fact pattern where they have closed down foreign operations in the past with a view to submitting a claim for the loss where they have not already done so. The Court, it should be noted, placed no time limit on the effect of its ruling.

On the other hand, the Court also made it clear that Member States can legitimately reject claims to utilise foreign subsidiaries' losses where those losses have been utilised in the year in which they have arisen in the foreign jurisdiction. What is not entirely clear, however, is the situation between these two extremes. The general principle underlying the Court's judgment is that economic relief should be given

for losses somewhere but not more than once, and that in order to protect the position of Member States, there should be a presumption that losses that can be carried forward will be relieved in the foreign jurisdiction at some point.

Until the precise effect of this principle is clarified, which we expect will require a further ruling from the European Court of Justice, taxpayers should consider continuing to submit claims for cross-border loss relief in situations where there is any uncertainty about the future use of those losses in the foreign jurisdiction.

In the UK, Marks & Spencer must now return to the courts to determine the extent to which its claim for relief of the last four years' losses of its foreign subsidiaries will be granted in the light of the European Court's judgment. The Group Litigation Order (joined cases) based on the Marks & Spencer claim, but with varying fact patterns and posing further questions in this area, is due to be heard by the European Court in due course.

Attention will now also shift to the Cadbury Schweppes case, which the Court has begun hearing. Here, a clear victory for the taxpayers would probably render EU Member States' CFC (controlled foreign company) rules largely ineffective.

Czech Republic

Minimum Holding Period For Participation Exemption Reduced

Currently, to benefit from the 100 percent participation exemption for dividends from shareholdings in other companies, a Czech company

must have an interest of at least 20 percent in the distributing company and have held those shares for an uninterrupted period of at least two years before the distribution. With effect for distributions declared on or after January 1, 2006, the minimum holding is reduced to 10 percent and the minimum holding period to 12 months.

Germany

Grand Coalition's Tax Programme

The new 'Grand Coalition' government of Angela Merkel has included several important tax measures as part of its programme. Inevitably, the measures are an amalgam of the proposals offered by both parties (the Chancellor's CDU/CSU and their partners, the Social Democrats (SDP) before and during the election campaign. The Finance Minister of the new government is the Social Democrat, Peer Steinbrück.

The measures that will be put before Parliament, where they are certain to be agreed by both houses, include the following:

- No change in the rate of corporation tax before 2008 (the former governing coalition of SDP and Greens had proposed a reduction from 25 percent to 19 percent and the CDU/CSU a reduction to 22 percent), when a comprehensive reform of business taxation, covering both companies and partnerships, will take effect. There will be a reduction in the rate of tax on businesses at that time but also a broadening of the tax base;
- An increase in the standard rate of VAT from 16 percent to 19 percent from January 1, 2007 (this

had been one of the CDU/CSU's proposals);

- An increase in the top marginal rate of income tax payable by individuals from 42 percent to 45 percent. This increase will not apply to business income (from a sole proprietorship or partnership) and will only affect persons with an income of more than EUR 500 000 (USD 595 000) in the case of jointly assessed married couples) or EUR 250 000 in the case of single persons. This will probably take effect in 2007;
- Abolition of the home-owner cash grant and certain other tax reliefs, including the exemption for the first slice of redundancy payments; and
- A charge of 20 percent from January 1, 2007 for capital gains from the alienation of securities and immovable property – there will no longer be an exemption for securities held for more than 12 months or property held for more than ten years

Greece

Changes To Offshore Company Tax Reliefs

In 2002, under pressure from the European Commission, Greece abolished the tax and custom duty exemptions available to offshore branches of foreign entities under Law 89/1967. For branches existing in 2002 the exemptions continue until December 31, 2005.

The Government has recently announced new legislation intended to replace Law 89/1967. Under these proposals foreign companies that provide administrative support serv-

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ices to other group companies established outside Greece may establish branches in Greece taxable on a cost-plus basis. The taxable profit rate will be determined by the Ministry for the Economy for each case and may not be less than 5 percent. The minimum amount of annual operating expenses for such entities will be set at EUR 100 000 (USD 119 000).

The same provision will apply to Greek companies that provide services to group entities established abroad. These provisions do not affect shipping entities, which continue to enjoy certain tax exemptions.

Hungary

Hungary To Introduce Reduced Rate Of Corporate Tax And Cut Vat

Under legislation approved recently by the Hungarian parliament, a reduced rate of corporate tax of 10 percent for the first HUF 5 million (approx. EUR 19 550, USD 23 150) of taxable profits will be introduced with effect from January 1, 2006. Any remaining profits will be subject to the standard rate of 16 percent. However, a condition being placed on the reduced rate is that the company concerned must pay social security contributions in respect of employees on a base that is at least 150 percent of the minimum wage (the amount of earnings on which employers pay their share of social security contributions is to a certain degree elective in Hungary).

Other changes include a 20 percent reduction in the standard rate of VAT, which falls from 25 percent (the maximum permitted in the

EU) to 20 percent, with effect from January 1, 2006. Prior to complete abolition of the local business tax in 2007, income derived by a Hungarian company from a foreign permanent establishment is to become exempt from the tax, also from January 1, 2007.

However, a new immovable property tax, at a rate of 0.5 percent on the value of property to the extent that it exceeds HUF 100 million (EUR 391 000; USD 462 950), is to be introduced.

Higher-earning individuals will benefit from a 2 percent reduction in the top rate of income tax, which falls to 36 percent.

It is also worth noting, that as from January 1, 2006, as reported in the last issue of this Newsletter, Hungary is abolishing withholding tax on outbound dividends to foreign corporate entities. This will have the result that neither dividends, interest or royalties receivable by such entities will be subject to tax at source in Hungary.

Ireland

Ireland Abolishes Capital Duty

As part of his Budget speech on December 7th, Ireland's Minister of Finance, Brian Cowen, announced that capital duty on the issue of new shares and other related transactions, would be abolished with immediate effect. The rate of capital duty has been 0.5 percent.

Among other measures was the withdrawal of the exemption from income tax for the qualifying income of artists, writers etc on all but the first EUR 250 000 of annual

income from January 1, 2007 and the introduction of a cap on the size of an individual's pension fund qualifying for tax reliefs. There is to be no change in the rates of corporation tax or income tax, but income-tax band thresholds have been raised.

The remittance basis of income taxation, which applies to individuals resident but not domiciled in Ireland on their income from sources outside Ireland and the UK, is being discontinued in respect of income from employments exercised in Ireland from January 1, 2006.

The measures announced in the speech have to be published in the form of a Finance Bill and then enacted by the Irish Parliament early in 2006, and they may be subject to amendment.

Italy

Participation Exemption Cut Back

Italy has reduced the benefits of its participation exemption for capital gains from the alienation of qualifying shareholdings. The reductions are included in Decree Law No 203 issued by the Government on September 30, 2005 and finally approved by Parliament on December 2, 2005.

Before the Decree Law took effect on October 4, 2005, there was a complete (100 percent) exemption for capital gains from shareholdings qualifying for the participation exemption. The exemption was reduced with immediate effect to 95 percent and has now been further reduced to 91 percent from December 3, 2005. It will be further reduced to 84 percent from January 1, 2007. The minimum holding

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period required to qualify for the exemption has also been increased from 12 months to 18 months.

The Decree Law also introduces restrictions on the availability of capital losses on holdings not qualifying for the exemption, but there is no change in the capital loss régime for qualifying holdings. Losses on these remain non-deductible.

Luxembourg

Net Wealth Tax To Be Abolished But Interest Withholding Tax To Be Introduced

Under a bill currently being debated by the Luxembourg Parliament, the net wealth tax on individuals is to be abolished with effect from January 1, 2006. Also from that date, however, a withholding tax of 10 percent on the payment of interest by a Luxembourg paying agent to individuals resident in Luxembourg is to be introduced. Certain forms of interest (such as interest on current accounts) will be exempt, as will the first EUR 1500 (USD 1785) of interest on savings accounts.

The Netherlands

Withholding Tax On Dividends To Antilles Companies Reduced To Zero In Some Cases

On December 1, 2005, an agreement was reached between the Netherlands and the Netherlands Antilles on a reduction of withholding tax on dividends.

Under the current arrangement (the Tax Regulation for the Kingdom – *De Belastingregeling voor het Koninkrijk*), the

Netherlands levies a reduced withholding tax of 8.3 percent on dividends from a Netherlands company to an affiliated Antilles company, provided that the Antilles company has an interest of at least 25 percent in the Netherlands company. In all other cases, a 15 percent rate applies.

The new agreement provides for a 0 percent withholding tax for Antilles companies listed on the stock exchange, banks, insurance companies and pension funds. For all other Antilles companies, the rate will be 5 percent. In both cases, the minimum shareholding to be held by the recipient Antilles company is reduced from 25 percent to 10 percent.

The zero rate of withholding will also apply where the Antilles company receiving the dividends invests them in 'durable economic activities' in the Antilles. For that purpose, a special Recovery Bank will be established. For the zero rate to apply, the entire dividend must be invested via the Recovery Bank for a period of no less than 24 months. After the 24 months have expired, a quarter of the dividend may be paid out by the Antilles company to its shareholders. The remaining 75 percent must continue to be invested via the Bank for another 24 months.

The draft of the new agreement is not yet available, but it is expected that it will enter into force in the first half of 2006.

Portugal

Portugal Standardises Dividend Withholding Tax

A uniform rate of 20 percent for withholding tax on dividends not

qualifying for the benefit of the EC Parent Subsidiary Directive is to be introduced from January 1, 2006.

Russia

New Tax Benefits For Special Economic Zones

The Federal Government has announced the creation of six Special Economic Zones (SEZs), which are to offer a range of tax benefits, starting from January 1, 2006. These benefits include:

- The maximum rate of social security contributions is reduced to 14 percent;
- SEZ businesses may apply accelerated depreciation rates of up to twice the normal rates of depreciation;
- Current-year taxable profit may be entirely set off by losses carried forward (normally, such losses can reduce profits by no more than 50 percent of the taxable base)
- R&D expenditure (including abortive R&D) may be fully recognised (i.e. written off for profits tax purposes) in the reporting (tax) period in which it is incurred;
- Assets booked in the taxpayer's accounts remain exempt from property tax for the first five years; and
- Land acquired by an SEZ business remains exempt from land tax for the first five years following acquisition.

In addition, foreign goods may be imported into the territory of an SEZ free of customs duties and VAT. Furthermore, the sale of Russian goods imported in the territory of an

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SEZ is zero-rated for VAT, but remains liable to excise duties.

An SEZ business is any commercial legal entity or in certain cases a private entrepreneur registered with local authorities within the territory of an SEZ and which has concluded a special contract with the SEZ authorities.

There are two categories of SEZ under Russian law – namely an industrial-manufacturing SEZ and a technical-development SEZ.

A business operating in an industrial-manufacturing SEZ is required to make capital investments of at least EUR 1 million (USD 1.19 million) in the first year of its activities and EUR 10 million overall and should be engaged in the manufacturing or processing of goods for onward sale.

A business operating in a technical-development SEZ should be engaged in R&D with a view to bringing a finished product (including software, data processing and transfer systems) into industrial use.

Certain activities, such as extraction or processing of natural resources, manufacturing or processing of excisable goods (except for cars and motorcycles), as well as the manufacture of metals, are outside the scope of qualifying activities within an SEZ.

There will initially be four technical-development SEZs and two industrial-manufacturing SEZs within the territory of the Russian Federation.

The technical-development SEZs will be created in Zelenograd, Dubna (in the Moscow region), St Petersburg and Tomsk. The two

industrial-manufacturing SEZs will be located in the Lipetsk region (in South-Western Russia, about 400 km south of Moscow) and in the Tatarstan Republic.

Even outside the SEZs, several regions offer investors making capital investments tax benefits such as reductions in profits tax, property tax and land tax, as well as subsidies in the form of partial refunds of profits tax. Among the regions that provide tax benefits for investors are St Petersburg, Novosibirsk, Tula, Smolensk, Pskov and Bryansk, and the Altay, Kalmyk, Khakassian and Mordovian republics.

Spain

Status Of Malta And Cyprus As Tax Havens

Despite their accession to the European Union on May 1, 2004, Malta and Cyprus remain on the Spanish tax authorities' blacklist as tax havens, and there seems to be no current prospect of any change.

The blacklist is contained in Royal Decree 1080/1991, as amended by Royal Decree 116/2003. Essentially, a jurisdiction can only be removed from the blacklist if there is a double tax treaty with an exchange of information article or an exchange of tax information agreement in force between Spain and the jurisdiction concerned. To date, no jurisdictions have been removed from the list in its 14 years of existence.

The EU membership of Malta and Cyprus obliges them, amongst other things, to comply with EC Directive 77/799/EEC on the exchange of information in relation to direct taxes. Despite this fact, no changes

have been made to the blacklist with respect to those two countries.

In accordance with the decisions of the European Court of Justice, Member States are obliged to exchange tax information under Community law and they cannot deny the application of a tax benefit to a taxpayer on the grounds that they lack sufficient information to verify that the requirements for the benefit to apply are met.

It therefore appears that Spain could be in breach of Community law if it does not amend the Royal Decree or associated legislation in order to provide for the exclusion of Malta and Cyprus from the status of tax havens.

Corporate Tax Cuts In The Pipeline

The Spanish Government has made it known that it intends to cut the general corporate tax rate from 35 percent to 30 percent, and the reduced rate for SMEs from 30 percent to 25 percent over the next three to five years.

Spain Reduces Thresholds For Tax-Free EU Dividends

With retroactive effect from January 1, 2005, Spain has reduced the minimum shareholding required under the EC Parent Subsidiary Directive for dividends to affiliated companies established elsewhere in the EU to be exempt from Spanish withholding tax.

The measure, part of the implementation law for the recently enacted amendment of the Directive, reduces the minimum shareholding the recipient EU company must have from 25 percent to 20 percent. In line with the amended

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Directive, the threshold will fall further to 15 percent on January 1, 2007 and to 10 percent as from January 1, 2009.

In addition, an amendment has been introduced according to which dividend distributions made to permanent establishments of a parent company would benefit from the same tax treatment as if they were distributed directly to the parent company, unless the permanent establishment is established in a tax haven.

United Kingdom

Zero Corporation Tax Rate To Be Abolished

An abolition of the zero rate of corporation tax for the first GBP 10 000 (EUR 14 800; USD 17 700) of taxable profits is one of the measures announced by the Chancellor of the Exchequer, Gordon Brown, in his Pre-Budget Report, delivered on December 5.

Among the measures announced by Mr Brown, giving his first Pre-Budget Report since the Labour Government's re-election in May 2005 for a third term of office, are:

- Abolition of the zero rate of corporation tax and the minimum 19 percent rate for distributions to non-corporate shareholders. From the financial year 2006, the minimum rate of tax on all company profits will be 19 percent. There is to be no change to the full 30 percent rate of corporation tax
- Introduction of a tax-privileged vehicle for property investment – the Real Estate Investment Trust (REIT) will enjoy tax exemption

on qualifying rental income and capital gains. REITs will have to distribute at least 95 percent of their net taxable profits on rental income to investors, who will pay tax at their marginal rates on the distributions

- Introduction of new rules having effect from December 5, 2005 to prevent the use by companies of bought-in or artificially created losses
- Removal of the opportunity for self-invested and self-directed pension funds to invest in residential property and certain other assets, such as fine wines
- Extension of the disclosure régime for tax avoidance schemes to all schemes aimed at saving income tax, corporation tax or capital gains tax
- Further anti-avoidance measures aimed at the transfer of assets abroad, inheritance tax planning involving trusts, and the sale of leasing companies
- A doubling (to GBP 1.375 million – EUR 2.035 million; USD 2.420 million) in the turnover ceilings for the VAT cash accounting and annual accounting schemes, subject to EU approval

These (and other measures) will form part of the actual 2006 Budget, which the Chancellor will deliver in March or April 2006. They must then be included in a Finance Bill, which will not become law until July 2006, so may well be subject to amendment.

European Court rules on Marks & Spencer case

See under European Union. ■

Latin America

Brazil

New Tax Measures Benefit Exporters

The Brazilian Federal Government has introduced a series of incentives and benefits available to exporters.

Chief among these are the Special Tax Régime for Exports of Information Technology Services – REPES – and the Special Régime for Acquisition of Capital Goods for Export Companies – RECAP. Others measures relate to the design of new products or manufacturing processes, as well as new functions or features for products or processes implying an improvement and actual gain of quality or productivity, resulting in more market competitiveness.

REPES

Companies with software development activities and/or that provide information technology services and that export at least 80 percent of their annual gross revenue from the sale of goods and services, will obtain a deferral of their liability to the Employees' Profit Participation Programme – (*Programa de integração social* – PIS) and COFINS (*contribuição para financiamento da seguridade social* – social security contributions) payable at 7.6 percent; and from IPI (excise duty) on the sale or import of goods intended for development in Brazil of software and IT services.

RECAP

This regime is applicable to any company that pays PIS and COFINS at rates of 1.65 percent and 7.6 percent, respectively, and exports at

least 80 percent of its total gross revenue from goods and services, and undertakes to maintain that level of exporting for two years after joining RECAP.

The benefit offered by RECAP is exemption for three years from PIS and COFINS on sale or importation of new machinery, devices, instruments and equipment intended as additions to fixed assets. The types of asset that will qualify will be specified in regulations.

Incentives for technological innovation

New measures have been introduced to stimulate technological innovation in Brazilian companies. These include:

- A full deduction for expenditure incurred on research and development
- A reduction of 50 percent in IPI payable on equipment, machinery, devices and instruments, as well as on spare parts and associated tools intended for technological research and development
- Accelerated amortisation, by means of deduction as a cost or operating expense of expenditure related to acquisition of intangible assets, exclusively linked to technological research and development
- Introduction of a zero rate of withholding tax on remittances overseas intended for the registration or maintenance of trademarks or patents

These incentives will come into effect in January 2006.

Uruguay

Personal Income Tax To Be Introduced

A fundamental reform of the tax system in Uruguay has been proposed by the government. It would involve the introduction of a personal income tax and the replacement of corporate income tax by a new economic activities tax, among a range of other measures.

A new economic activities tax (*Impuesto a la Renta de las Actividades Empresariales* – IRAE) is intended to replace both the existing corporate income tax and the ordinary agricultural income tax. IRAE would be payable at a rate of 25 percent on the Uruguayan-source income of resident entities. Non-resident companies and other legal entities would be liable to IRAE at a rate of 10 percent on their income derived in Uruguay. In accordance with the territorial principle prevalent in Latin America, foreign-source income would be exempt from IRAE. Transfer pricing rules based on the OECD Guidelines would also be introduced.

A new personal income tax (*Impuesto sobre la Renta de las Personas Físicas* – IRPF) would have a dual charging system. Income from dependent and independent personal services would be liable at progressive rates of between 10 percent and 25 percent. Investment and other passive income (including interest, royalties and lease rentals) would be subject to a flat rate of 10 percent, but dividends would be exempt. The tax would be payable by both residents and non-residents on their Uruguayan-source income.

Continues on next page

Other changes include the abolition of several taxes, such as the tax on bank assets, a reduction in the net worth tax on certain privately owned businesses and limited-liability partnerships, a reduction in the standard VAT rate from 23 percent

to 21 percent and in the reduced rate from 14 percent to 10 percent.

It is expected that the Bill containing these proposals will be introduced in Parliament in March 2006, and the intention is to bring the measures into effect in 2007. ■

Asia Pacific

Australia

Non-Residents' Capital Gains Liability To Be Narrowed

The Australian Government has announced that it intends to bring forward legislation narrowing the class of assets on a disposal of which a non-resident is liable to Australian capital gains tax (CGT).

Currently, liability to the tax extends to the disposal by a non-resident of any specified asset having "the necessary connection with Australia." In future, only Australian real property and the business assets of a permanent establishment through which a non-resident was carrying on a business in Australia could give rise to a CGT liability. In order to prevent avoidance of CGT on Australian real property by the interposition of a controlled entity, however, the disposal by a non-resident of shares in any entity, wherever that entity was resident, whose value was wholly or principally derived from the possession of Australian real property would also render the non-resident shareholder liable to Australian CGT.

Sri Lanka

Corporate Tax Rate To Be Reduced For Small Companies

As part of the Budget 2006 proposals, announced on December 8, 2005, the Sri Lankan Government is intending to reduce the corporate tax rate for 'small' companies, but increase the rates for other companies. A 'small' company for this purpose is any company with a taxable profit of no more than SLR 5 million (EUR 40 100; USD 49 000). The proposed changes are as follows:

Taxable profits (SLR) or type of company or business	Proposed new rate	Existing rate
No more than 5 million	15 percent	20 percent
New listed companies:		
– for the first 5 years	33.33 percent	
– thereafter	35 percent	30 percent
Gaming and auto lotteries	40 percent	
All other companies	35 percent	32.5 percent

Transfer pricing regulations are to be strengthened and thin capitalisation rules are to be introduced with respect to interest payments within a group of companies. Deductibility of interest is to be denied to the extent that the debt-equity ratio exceeds 2:1 in the case of manufacturing companies and 3:1 for all other companies.

The Philippines

Non-Residents Cannot Rely On Treaty Rulings Given To Other Taxpayers

The Philippines Court of Tax Appeals has confirmed that a non-resident taxpayer cannot rely on a ruling given to other taxpayers when claiming the benefit of a preferential tax rate granted by a Philippines double tax treaty. Only an application to the tax authorities by the taxpayer concerned and the subsequent issue by them of a ruling granting the preferential rate to that taxpayer can be called in aid.

The information in this newsletter is for general guidance only and is not a substitute for professional advice. The BDO Member Firms accept no responsibility for any actions taken or not taken on the basis of the information in this newsletter.

BDO International is a world wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country.

Coming Attractions

Webinars

January 13:

AcSense Webinar: 2005 Annual Year-End Technical Update

Time: 12:00 EST

Speakers:

Ben Neuhausen

National Director of Accounting

Jeff Lenz

National SEC Practice

Jay Howell

Associate Director of Assurance Practice

Topics:

The webinar discussion will focus on developments within the accounting, SEC and internal control reporting arenas designed to keep you abreast of relevant technical accounting and reporting developments in connection with this year-end closing season.

Enrollment:

Go to bdo.webex.com, click the "Events" tab and click the "Enroll" button associated with this event; or email jframe@bdo.com for more information and a link to the enrollment page.

January 24:

R&D: Enhancing Global R&D Benefits & FAS 109

Time: 1:30 EST

Speakers:

Chris Bard

National Leader of R&D Practice

Jonathan Forman

Eastern Regional Leader R&D Practice

Randy Friedman

Western Regional Leader R&D Practice

Dan Fuller

Central Regional Leader R&D Practice

Feifei Wang

National R&D Systems & Technology Leader

Topics:

The webinar discussion will focus on global R&D planning opportunities, enhancing R&D credits, and FAS 109 & R&D credits.

Enrollment:

Go to bdo.webex.com, click the "Events" tab and click the "Enroll" button associated with this event or email jframe@bdo.com for more information and a link to the enrollment page.

Seminars

Thursday, January 12

Hot Topics in FAS 109 and 123R

A Free Seminar Hosted by
BDO Seidman, LLP
Nashville Marriott
at Vanderbilt University
2555 West End Ave.

8:15 a.m.

Continental Breakfast/Registration

9:00 a.m.

Seminar

Speakers:

Andy Gibson

National Compensation and Benefits Tax Partner

2 CPE Available

TO REGISTER:

Email Barbara Boucher at bboucher@bdo.com

Tuesday, January 17, 2006

Hot Topics in FAS 109

The Penn Club of New York
30 West 44th Street,
New York, NY 10036
(212)764-3550

8:00 a.m. to 8:30 a.m.

Registration & Breakfast

8:30 a.m. to 11:30 a.m.

Presentation

Speakers:

Scott Guertin

Partner and Regional Leader, Income Tax Accounting Services

Catherine Fox

Senior Manager, Income Tax Accounting Services

Topics:

- FAS 109 Interpretation on Uncertain Tax Positions
- Business Combinations
- Valuation Allowances
- SFAS 123R

3 CPE credits will be earned.

Who Should Attend:

Executives and professionals involved with your firm's Taxes, Accounting, & Finances.

Enrollment:

Register at

<http://www.bdo.com/fas109/ny.asp>

or Email aarndt@bdo.com

Other

Attention: Washington, DC-Baltimore-Virginia Area Tax Professionals:

The BDO Seidman Metro DC Office is interested in hearing from area international tax professionals currently practicing in middle market public and private companies in the Baltimore-Washington-Northern Virginia region interested in joining a regional networking forum to address current corporate tax challenges, opportunities and best practices. Meeting locations would rotate between Tower Club VA, University Club DC and Strathmore/BSO Club in Maryland. Limited access, continental breakfast or lunch would be provided along with CPE. Please e-mail your interest to: tcord@bdo.com.