CHANGES ON THE TAX FRONT

CHANGES TO TAX LEGISLATION THIS YEAR BRINGS GOOD NEWS FOR TREASURY OPERATIONS. **JAN KOOI** OF OMNICOM PROVIDES AN UPDATE OF INTERNATIONAL TAX LAWS.

This year has been less frugal than 2000 regarding major tax overhauls in the various countries I cover in this yearly recurring article. Nevertheless, there have been some interesting developments in domestic legislation in 2001, some of which have already come in to effect or are about to soon.

GOOD NEWS ON WITHOLDING TAX. Treasurers will have welcomed the abolition in the UK of domestic withholding tax on interest paid between UK companies that are not a member of the same tax group. Furthermore, as far as treasury operations are concerned, the new Dutch/Belgium tax treaty brings more good news. Under the old treaty, withholding tax on interest was already – as an important exception to other treaties concluded by Belgium – reduced to zero per cent, provided it was not paid to a 25% holding parent company. The new treaty provides – subject to some anti abuse provisions – for a relief of withholding tax on interest on any corporate loan, even when paid to a 25% parent company. This means that certain structures for financing on Belgium may possibly be simplified.

Another important development for the UK is the new US/UK tax treaty. It finally provides for better guidance and solutions regarding the position of expatriates – more in particular on the issue of pensions and life insurance contracts. The anti-abuse provisions, relating to certain (hybrid) financing transactions, may at first seem new and far-reaching, but they reiterate in the treaty domestic UK provisions which have been around for some time.

FURTHER AFIELD. On the continent, there have been proposed changes to the Dutch fiscal unity regime, which will come into effect for tax years starting on or after 1 January 2003. Under the current regime, a 99% direct or indirect ownership is required, which is considered an impediment for the use of stock options. The new regime will reduce the ownership percentage to 95%. Some further changes concern the group of companies which is eligible, as well as the fact that the fiscal unity can be elected in the future during the year, with retroactive effect of, at the most, three months (compared with the current possibility of 12 months.)

Some provisions are furthermore included to stop perceived abusive transactions, known as the BV1/BV2 structure, which used to be of particular interest to US companies

In Germany, the tax reform (see *The Treasurer,* March 2001) is continuing and it is expected that the rules for tax consolidation, which were substantially relaxed for corporate income tax purposes as per 1 January 2001, will also be applied for trade tax and possibly VAT purposes from 1 January 2002.

Many of the changes in domestic legislation in the EU countries, have been instigated by international pressure. Especially those that are directed at potential abusive structures. This is due to the work of the OECD and the European Committee.

As far as the OECD is concerned the *Report on Tax Havens* has prompted various countries to modify their tax legislation as well as other regulations, especially those related to financial transactions. The EU committee has produced the European Code of Conduct to Eliminate Harmful Tax Competition in 1997, followed by the black-list of the Primerolo report in 1999. The effects of these reports are now being felt.

The EU/European Committee has realised that it is impossible at this stage to try to attempt full harmonisation and that probably more is to be gained by enforcing freedom of establishment, which would almost automatically bring about the necessary changes in tax regimes.

An important role in the changes must, however, be attributed to the European Court of Justice in Luxembourg (ECJ), which has promulgated some ground-breaking rulings over the past few months. For those less familiar with the two reports mentioned above, note that the OECD is mainly concerned whether a certain tax regime (and legislation related thereto in the financial transactions area) is only available to a restricted group of taxpayers (known as 'ring fencing') and whether there is sufficient exchange of information.

The EU Committee, however, has a broader scope and is principally concerned about the freedom of establishment. Therefore, under the OECD guidelines, an EU member state could well have a zero tax rate, provided it is available both to residents and non-residents. From an EU perspective, however, this would be considered harmful tax competition.

Most readers will be familiar with the effect that the ICI ruling of the ECJ has had on UK domestic tax law, in essence leading to the introduction of the extended group relief, as per 1 April 2000.

HOECHST CASE. More recently, the defeat of the Inland Revenue (IR) in the *Hoechst case* has prompted the IR to create a damage assessment group. The ECJ judged that the levy of witholding tax on refunded Advance Corporation Tax (ACT) and underlying dividends was discriminatory. The consequences of this ruling are, however, not limited to a possible obligation of the UK IR to refund substantial amounts of withholding tax to non-residents who received refunds of ACT.

The *ICI*, *Hoechst* and other decisions, some of which are mentioned below, will have a broad influence for many other EU tax regimes. Interesting in the ECJ ruling was the way in which the court flatly waved away the IR's argument that a ruling in favour of the taxpayer would lead to a substantial loss of revenue for the UK, so limiting the UK's sovereign rights.

The *Hoechst case* will not lead to a change in UK law, since the ACT has in the meantime been abolished, but the trend of the decisions will be felt in other countries. In a recent case (4 October 2001) concerning Greece (*Athenaiki*), the ECJ ruled that any tax levied at the moment of a dividend distribution – whether as an actual withholding tax or as an (alternative) corporate income tax – is incompatible with the EU parent/subsidiary directive. This decision is not only in line with the *Hoechst* decision, in that it disallows the levy of any type of withholding tax in qualifying situations, it also substantially expands the meaning of withholding tax on distributions as such by including the Greek version of the French *précompte* or Italian equalisation tax.

The decision is in line with the *Epson case* of 8 June 2000, in which the ECJ ruled that the Portuguese alternative inheritance tax of 5%, levied on distributions by Portuguese companies, other than the Special Flooding Company (SGPS), is not in line with the above mentioned EU directive. These rulings may lead to changes in the French *précompte* and perhaps even the *avoir fiscal*. At the same time, in the past few months, the Italian courts have – taking in to consideration the ECJ rulings – decided that the application of withholding tax on a refund by the Italian government of part of the corporate income tax or of the equalisation tax (the first is only possible under the treaties with France and the UK) is not allowed by the EU directive.

THE EU FLEXES ITS MUSCLES. In other areas, the EU and ECJ has shown its teeth. The Primerolo report listed 66 possibly harmful tax measures. In an attempt to be taken off the list, some countries have either changed their laws already or are contemplating doing so. For instance, Denmark has in the past year amended its holding regime, especially with regards to the exemption of withholding tax on dividends and the treatment of dividends received from low-taxed foreign subsidiaries (with passive income).

On the other hand, Denmark is contemplating abolishing the current three-year holding period to benefit from exemption of capital gains. The UK is also revisiting the treatment of capital gains to bolster its position as holding company residence. Belgium has agreed to gradually abolish the co-ordination centre regime and is no longer issuing rulings on that front. Germany is re-drafting its controlled foreign company (CFC) legislation by proposing that these rules will already apply when a German resident owns 1% in such entity, rather than the current 10%.

Germany is also considering whether it should abolish the current favourable tax regime for centralised services and co-ordination companies. Austria has proposed the introduction of CFC legislation comparable to the current German regime. Austria will have to eliminate a number of other domestic provisions, which will lead to different tax results, depending on whether the ultimate beneficiary/shareholder is an Austrian resident (especially important regarding investment funds). The Netherlands has changed the ruling policy in an attempt to make it clear that it is not co-operating with tax avoidance.

A NON-CORPORATE ANGLE. As far as non-corporate income tax issues are concerned, just a few cases from the ECJ are of particular importance. In the *Eurowings case*, Germany was reprimanded because it obliged German lessees to add back 50% of cross-border lease payments for trade tax purposes, while such add-back was not required for domestic lease payments. Pending a change in legislation, the Länder has agreed not to enforce the add-back. Recently the German administration published its proposal (severely criticised by the German leasing industry), which would lead to an across-the-board 25% add-back, regardless of the residence of the lessor. Certain authors point out that the Eurowings case may also mean that the current German thin capitalisation rules, which do not apply where interest is paid to a German taxpayer, will also be considered discriminatory. If that is the conclusion of the ECJ (some cases are currently pending), this could also apply to, say, the French thin capitalisation rules, which do not apply when the lender is a French parent company.

In the *Sandoz case*, the Austrian tax administration was reminded that the levy of a 0.8% stamp duty on written loan documentation conflicted with EU rules. A similar decision is expected with respect to the Portuguese stamp duty in loans, which, for example, does not apply when the Portuguese party is an SGPS.

Looking at the trend in the ECJ jurisprudence, it appears that not only discrimination in pure tax laws but also more severe accounting or administrative regulations can mean that an EU member state is considered to violate the freedom of establishment principle. This position has been repeated in a number of recent cases and was also clearly stated in the Fortuna decision of the late 1990s. An extensive interpretation could mean that the UK requirement for consolidation for accounting purposes could be discriminatory, since most other EU member states allow companies to refer to published consolidated accounts of a foreign (ultimate) parent – for example, in the US.

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'WE WILL BE EXPERIENCING SOME INTERESTING DEVELOPMENTS AS A CONSEQUENCE OF THE INTRODUCTION OF GENERAL ANTI AVOIDANCE RULES. THE COMING YEAR WILL NOT BE A DULL ONE'

REST OF THE WORLD. As will be clear from the above, many changes in the EU have found their origins in the efforts of the EU Committee and of the OECD. The OECD has also influenced changes in other countries around the world, most of them earmarked as tax havens in the OECD reports. As an example, Mauritius has modified its anti-money laundering legislation and is gradually changing its off-shore regime. There are, however, also some other far-reaching changes worth mentioning and which may have a serious impact on foreign operations. Australia has introduced, with effect from 1 July 2001 new thin capitalisation rules. They are complex, especially as regards the computation of the eligible equity (or assets, since the law expresses the allowable debt as a function of the net assets). Important elements of the changes are that the thin capitalisation ratio's are no longer limited to foreign-related party debt but to all debts.

The rules are also no longer limited to so-called foreign-invested companies, but also apply to 100% Australian-owned companies which make foreign investments. Moving north from Australia a recent statement by the Malaysian tax authorities is of great interest. It has admitted that for more than 10 years withholding taxes have incorrectly been imposed on certain payments for services, including management fees, paid to treaty countries. – it might be worth investigating whether a refund can still be obtained.

Noteworthy is that Brazil has recently announced that it considers payments for services of any kind no longer to be covered by the business income article (7 OECD Model convention) but by the 'other income' article, which always means Brazil as well as the treaty partner can tax.

Moving back to the Pacific, you should be aware of the important changes in Japan. As per 2001, the rules for corporate restructurings, especially the interposing of holdings, have been substantially relaxed. Starting 1 April 2002 Japan will introduce tax consolidation in the case of 100% ownership. A negative aspect of this change is that, at the time of the creation of the tax consolidation, the assets of the companies entering the consolidation have to be stepped-up to current fair market values.

Finally, it is to be expected that, in a similar trend as the current developments that have emerged from the work of the OECD, the European Committee and the ECJ, we will be experiencing some interesting developments as a consequence of the introduction, either by law or by case law, of General Anti Avoidance Rules. It is certain that the coming year will not be a dull one, at least as far as taxation is concerned.

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PROFILE	**PAUL COWDELL** PRINCIPAL LECTURER IN BANKING, SHEFFIELD HALLAM UNIVERSITY
Age	57
Education & Qualifications	Batley Grammer School, West Yorkshire 1966 ACIB 1983 The Financial Studies Diploma of the ACIB 1987 Elected Fellow of the Chartered Institute of Bankers (FCIB) 1994 MCT
Career	1968 Doc credits/collections etc, Midland Bank. 1971 Secondment to staff training function. Also taught at Institute of Bankers professional courses part time at Leeds College of Commerce. 1977 Accountant, Midland Bank. 1979 Senior Lecturer in Banking, Sheffield City Polytechnic

"During the late 1980s it became apparent to me that I needed to develop my skills and understanding to keep abreast of the dramatic innovations in the financial markets (derivatives) and to acquire an understanding of the rapidly developing role of the Corporate Treasurer in major companies. I believed then (and still believe) that the MCT course is a unique mixture of theory and practice, which enables successful students to understand the financial theory concepts and apply them in practical situations. By taking these examinations I was able to develop relevant units on the BA (Hons.) Financial Services (International Treasury Management at level 3) and on the MA in Banking and Finance Programme (Derivatives and Treasury Management). I could not have done this without the experience gained from MCT study.

With the knowledge and experience I gained from my MCT studies, I have written (or co-authored) a number of published texts including, *Finance of International Trade (Institute of Financial Services)*; Investment Management (Institute of Financial Services); and *Problems & Practices of Corporate Treasurers* (FT/ Pitman 1998).

I have also presented conference papers at the Operational Research Society on Derivatives and on FAS 133.

I find the ACT, CPD & *The Treasurer* an excellent means of keeping abreast of developments. The ACT kindly provide a guest speaker for my undergraduate unit (this year Michael Russell of Christian Salveson) and my students are going to be involved in an ACT Christmas quiz."☐