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Global tax newsletter

Hello and welcome to this latest edition of the Global tax newsletter.

Over the past few months, we have seen significant activity by the OECD with respect to the Base Erosion Profit Shifting (BEPS) work, which if implemented will have major implications for cross border transactions. A number of working paper drafts have been submitted for comment including:

- mismatches through the use of hybrid entities
- transfer pricing country by country
- treaty tax planning
- BEPS and the digital economy.

In addition there have been a number of important decisions in many jurisdictions addressing Controlled Foreign Corporations (CFCs), transfer pricing, direct income taxation, and foreign tax credits, just to name a few. This edition also features significant Mexican developments in a feature article and an interesting article on a recent US IRS ruling on how 'Digital Currency' should be treated for US tax purposes.

Finally, we also feature a description of a new 'Model Treaty' that comes to us from Germany.

We hope you enjoy this edition and we welcome updates on any international tax developments in your jurisdiction, be it legislation, a ruling, or a judicial decision, as a submission to the next edition.

Francesca Lagerberg
Global leader – tax services
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Go to page…

Mexico featured article

On 26 December 2013, President Peña Nieto issued a Presidential decree granting several tax benefits to the maquiladora industry as a result of discussions between the executive branch and the maquiladora industry association (INDEX). As a result of this, the Mexican Tax Authority (SAT) followed by issuing a miscellaneous tax ruling on 1 January 2014 to clarify how certain items mentioned in the Presidential decree should be treated. In general, these rules are intended for the maquiladora industry to maintain its competitiveness.

> Mexico grants a decree with several tax benefits to the maquiladora industry.

The highlights of the Presidential decree are:

Permanent establishment status

The decree includes a two-year grace period for those companies operating as maquiladoras before 2010 to comply with the new requirement that at least 30% of the machinery and equipment used in the maquiladora process is owned by a foreign company. This ruling exists because companies operating as maquiladoras prior to 2010 were not required to have 30% or more of the machinery used in the operation to be owned by a foreign company. Under the new reform, there will be no benefits for maquiladoras under the 30% threshold, they must all now satisfy this new requirement or risk losing their statutory exemption of permanent establishment in Mexico. If this requirement is not met by the end of the two year transition period, the foreign company contracting with the maquiladora will be at risk of losing its exemption from permanent establishment status.

Value Added Tax (VAT) credit

The decree contains an immediate VAT credit for qualified maquiladoras that purchases goods in a Mexican territory that belongs to foreign residents. Under general rules, VAT withholding credit would be done in the month following the withholding and payment of the tax requiring an actual cash payment. For 2014, this credit will be applicable as long as the goods have the proper documentation and they are being transferred as part of a supply chain of products destined for export, not the Mexican market. For 2015, the credit will be applicable as long as the purchasing company that withholds the VAT is certified by the SAT as part of a new process that will be in place for temporary imports.

Previous Presidential decrees

The decree eliminates the special income tax reduction granted by a previous Presidential decree of 30 October 2013. This was expected since the laws referenced in the 2003 decree were abolished under the 2013 reform. As a result, beginning in 2014 maquiladoras will have to pay the regular corporate income tax rate of 30% rather than the effective rate of 17.5% that had previously applied.

Tax benefits for maquiladoras

A maquiladora may either use a 'Safe Harbor' protection or an Advance Pricing Agreement (APA) to comply with local transfer pricing regulations and avoid permanent establishment status in Mexico, as long as the foreign entity it is doing business with is in a country with which Mexico has signed a double taxation treaty and the foreign entity is fully compliant with any treaty requirements applicable to its Mexican activities. Taxpayers must inform the SAT by March of the following year of the amount of tax incentive that was applied.

The new SAT miscellaneous tax ruling states:

General rules

For a maquiladora to qualify for permanent establishment exemption, 100% of their production must come from maquiladora-related activities. Maquiladora related activities will be deemed to include income from providing services to a foreign company supported with a service agreement. Enforcement of this ruling will be deferred until 1 July 2014. Until then, all income earned between 1 January and 30 June 2014 will fall under maquiladora related revenue no matter whether it is maquiladora-related or not. This transition period is intended for companies to restructure their operations as needed to comply with this ruling in the near future.

Certification system

All maquiladoras will be classified and certified using a three-tier rating system (A, AA, and AAA) as indicated by the 'Sixth Resolution of Modifications to the General Rules on Foreign Trade' the SAT also published on 1 January 2014.

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To qualify for permanent establishment exemption, 100% of their production must come from maquiladora-related activities.

United States featured article

Virtual currency is a digital representation of value that functions as a medium of exchange and can be purchased for, or exchanged into US dollars, euros, and other real or virtual currencies. The currency may be short lived based on recent developments, however various taxing jurisdictions have been issuing guidance on the tax consequences of virtual currency transactions. Irrespective of what happens to the Bit Coin, the internet is here to stay.

The US Internal Revenue Service (IRS) recently issued a notice in the form of frequently asked questions. Some of the more interesting questions and answers contained in the notice were:

How is virtual currency treated for federal tax purposes?
For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.

Is virtual currency treated as currency for purposes of determining whether a transaction results in foreign currency gain or loss under US federal tax laws?
No. Under currently applicable law, virtual currency is not treated as currency that could generate foreign currency gain or loss for US federal tax purposes.

Must a taxpayer who receives virtual currency as payment for goods or services include in computing gross income the fair market value of the virtual currency?
Yes. A taxpayer who receives virtual currency as payment for goods or services must, in computing gross income, include the fair market value of the virtual currency, measured in US dollars, as of the date that the virtual currency was received.

What is the basis of virtual currency received as payment for goods or services?
The basis of virtual currency that a taxpayer receives as payment for goods or services, in the above question, is the fair market value of the virtual currency in US dollars as of the date of receipt.

How is the fair market value of virtual currency determined?
For US tax purposes, transactions using virtual currency must be reported in US dollars. Therefore, taxpayers will be required to determine the fair market value of virtual currency in US dollars as of the date of payment or receipt. If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into US dollars (or into another real currency which in turn can be converted into US dollars) at the exchange rate, in a reasonable manner that is consistently applied.

Does a taxpayer have gain or loss upon an exchange of virtual currency for other property?

Yes. If the fair market value of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency, the taxpayer has taxable gain. The taxpayer has a loss if the fair market value of the property received is less than the adjusted basis of the virtual currency.

What type of gain or loss does a taxpayer realise on the sale or exchange of virtual currency?

The character of the gain or loss generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer. A taxpayer generally realises capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. For example, stocks, bonds, and other investment property are generally capital assets. A taxpayer generally realises ordinary gain or loss on the sale or exchange of virtual currency that is not a capital asset in the hands of the taxpayer. Inventory and other property held mainly for sale to customers in a trade or business are examples of property that is not a capital asset.

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Virtual currency is a digital representation of value that functions as a medium of other real or virtual currencies.

EMEA news

Austria

Austria has implemented a prohibition on the deductibility of royalties and interest within a group of companies.

In cases where royalties or interest are paid from an Austrian company to another company, which is subject to a corporate income tax rate of less than 10% and is part of the same group of companies, these payments are not deductible for Austrian tax purposes. This new rule has been released in order to follow OECD's guidelines and recommendations for the avoidance of Base Erosion and Profit Shifting (BEPS). The rule shall prohibit the utilisation of differences between the tax treatment of expenses on the one hand and the corresponding income on the other hand. It is applicable to every payment of royalties or interest which was effected after 24 February 2014, irrespective of the date of the underlying agreement. A company is considered as part of the same group of companies if a direct or indirect shareholding structure exists or if both companies are under the leadership of the same company. These changes will lead to a new judgement of existing financing structures of groups of companies.

Moreover interest payments for debt, which is financing the acquisition of shares in another group company, are not deductible for tax purposes in Austria. Despite this limitation in regard to intra-group transactions, interest payments for the acquisition of shares are still tax deductible in a third party scenario. In such scenarios the definition of interest payments has been limited; ie service charge for providing a bank facility will not be tax deductible. This rule is also applicable to payments effected after 24 February 2014.

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Belgium

If a Belgian company receives interest from a foreign-source investment and it includes the interest received in gross income and subjects it to tax, it is entitled to off-set a limited foreign tax credit against its Belgian income tax liability if it can prove that tax has been withheld at source. This applies to all foreign-source investment income except dividends. The foreign tax credit is added to the company's profit as a disallowed expense and is subsequently set off against its company tax liability. The foreign tax credit is, however, subject to limitations. There are no carry forwards of carry backs.

In a recent case a Belgian company had given a loan to its Australian subsidiary. The subsidiary withheld tax on the interest payment at the rate of 10% in accordance with the Australia-Belgium income tax treaty.

Under the treaty, Belgium has to grant a foreign tax credit for that interest income, as provided by Belgian law, provided that the tax credit is not less than the rate of the tax withheld in Australia.

The taxpayer claimed the credit but could not use it effectively because it did not have taxable profits. However, the foreign tax credit was still added to the company's taxable profits and the tax authorities would not allow the credit to be carried forward.

The taxpayer claimed discriminatory tax treatment because while the profit-making company can credit the foreign tax and effectively avoid double taxation, the loss-making company can neither credit nor carry forward the Foreign Tax Credit (FTC), and thereby loses it.

The court accepted the taxpayer's argument that the foreign tax credit must be added to a company's taxable profits and this discriminates against loss-making companies. Thus taxpayers are required to add the FTC to their taxable profits only to the extent that they can off-set the tax credit against the income tax due, other taxpayers are then allowed to claim back excess company income tax paid on amounts for which the foreign tax credit was not credited.

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Bulgaria

New legislation entered into force from 1 January 2014 concerning companies in preferential tax regimes in the form of restrictions.

The companies falling in the scope of the new law may not directly or indirectly:

- be licensed or hold shares in a company that has a license for exercising banking, financial, insurance or payment services, or performs independent financial audits or evaluations, or acts as a collective investment vehicle, investment intermediary on the financial markets, or pension fund
- be licensed or hold shares in a company that has a license for a professional sports club, TV, radio, publishing, or mobile operator activities, or activities related to renewable energy
- be licensed under the excise duties and tax warehouses act, the energy act or the gambling act
- receive a permit for trading with dual-use goods, exploration of natural resources or concession for supply or discharging of water, waste collection and cleaning
- participate in privatisations, public-private partnerships, public procurement procedures and in priority investment projects as per the act on the investment promotions
- acquire municipal or state property.

There are exceptions to the restrictions and penalties for non-compliance.

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Czech Republic

Recent legislative measures suggest that the tax base of taxpayers which are 'reporting entities', should be more closely aligned with their accounting profit and loss. This, in turn, suggests that unrealised FX differences, should be reflected in the tax bases of such taxpayers. In a case, the Supreme Administrative Court had held that unrealised FX gains were not taxable. The taxpayer was a joint-stock company resident in the Czech Republic. The taxpayer had initially included unrealised foreign exchange gains in its taxable income. Subsequently, the taxpayer filed an appeal against its assessment arguing that the unrealised foreign exchange gains were not taxable. The appeal was rejected by the tax authorities.

The Supreme Administrative Court upheld its earlier jurisprudence that unrealised foreign exchange gains were not taxable. The court held that unrealised foreign exchange gains did not meet the characteristics of 'income'. Only a real (and not merely fictitious) benefit may be subject to corporate income tax. With respect to foreign exchange gains (and losses), the court held that such real income (or loss) could only arise upon realisation of the gain (or loss).

The tax authorities confirmed that foreign exchange differences should be reflected in the tax bases of taxpayers. Taxpayers which, in line with the above-mentioned case law, did not include foreign exchange gains in their tax bases must ensure that:

- the treatment of foreign exchange losses is 'symmetrical' to that of foreign exchange gains, ie such losses are not included in the tax bases
- there are procedures in place to track the realisation and taxation of foreign exchange gains
- the actual (and not accounting) profit and loss will be claimed upon realisation.

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Denmark

Cash pooling is an important financial planning tool used by multinationals to move cash from cash surplus locations to cash deficient jurisdictions. This is an important treasury planning function and is often done through special purpose vehicles to minimise taxation on the cross border movement of financial flows within an international group. The Administrative Court of Denmark published its first decision on cash pooling as follows.

The Danish company (DK Co) was a subsidiary of an international group. DK Co entered into a zero-balancing cash pool arrangement with a Swiss sister company (CH Co), which acted as a cash pool administrator. According to the cash pool arrangement, all surplus liquidity of DK Co was transferred to the account of CH Co on a daily basis. DK Co could withdraw transferred liquidity and borrow additional liquidity from CH Co. DK Co's deposit paid a daily overnight rate minus a spread, whereas loans from CH Co paid a daily overnight rate plus a spread. This is a very common treasury structure within an international group.

DK Co had a surplus of cash. It deposited amounts and only during two months DK Co needed to borrow funds from CH Co. The need for these short-term loans was due to insufficient liquidity as DK Co had deposited too many funds under short-term agreements with a more favourable rate than the negative spread on ordinary deposits. All deposits and loans under the cash pool arrangement were unsecured and CH Co's assets mainly represented unsecured inter-group loans. CH Co did not have an independent credit rating but the group had a rating.

The issue was whether the applicable rates under the cash pool arrangement were at arm's length. The Danish tax authorities increased DK Co's taxable income and argued that the rate on the net balance of the deposits should be increased. The Administrative Tax Court upheld the decision of the Danish tax authorities.

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In a recent case dealing with a Finland-US wealth transfer tax case the Supreme Administrative Court of Finland upheld the decision by the administrative court. The taxpayer was a Finnish citizen residing in Finland who received inheritance from a decedent who at the time of his death was a US citizen and resided in the US. All of the assets of the deceased were situated outside Finland. The Finnish tax authorities imposed an inheritance tax on the beneficiary according to the domestic law and included in the tax base all the assets of the deceased.

Under Finnish domestic law taxable inheritances include all immovable and movable property located in Finland or abroad if the deceased or the beneficiary was a resident of Finland at the time of death. The US-Finland treaty provides that in the case of a decedent (other than a resident of Finland) who at the time of his death was a citizen of or domiciled in the US, Finland shall not take into account property situated outside Finland when imposing the inheritance tax and determining the amount or rate of tax.

The issue was whether the treaty article would override the domestic law provision and consequently limit Finland's right to tax the inheritance. The court overruled the decision of the tax authorities. The court emphasised that as the deceased was at the time of his death a US citizen residing in the US, Finland cannot, due to the treaty, take into account the deceased's assets outside Finland, when imposing an inheritance tax on the beneficiary.

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France

The Minister of Economy and Finance recently provided guidance on tax credits for research and development (R&D) expenses. The following companies may benefit from an immediate refund of the tax credit for R&D expenses:

- new companies, under certain conditions
- start-up innovative companies
- companies that are subject to a conciliation plan, safeguard plan, recovery plan or are in the process of liquidation
- small and medium enterprises (SMEs).

In another development, there was an interesting court decision concerning cross border residency and employment. The court has decided a case regarding the tax treatment of income earned by a well-known French model. In 2001 and 2002, the model and actress, was a UK resident. She acted and modelled in France, and the remuneration of this activity was paid to a Dutch company in which she was an employee. Indeed, she gave the Dutch company the rights to exploit her image and name. Consequently, the services performed in France were paid to the Dutch company and not to the model directly.

French tax law allows the French tax authorities to ignore the interposition of the foreign company where:

- the taxpayer controls directly or indirectly the company to which the remuneration is paid
- the company that receives the remuneration does not have another activity than the services performed, that is, another industrial or commercial activity
- the company that receives the revenues is located in a country with preferential tax treatment.

On this basis the French tax authorities reassessed the model for the services performed in France that were paid to the Dutch company, considering that the Dutch company had no industrial or commercial activity. The issue was whether French domestic legislation violated the principle of freedom of movement.

The court declared that the domestic French article restricts the freedom of movement for employees. If the model had been the employee of an equivalent French company, she would not have been subject to the reassessment. She would only have been subject to income tax for the remuneration paid by the company, and not on the basis of the remuneration paid by the client to the managing company, which is a larger amount.

The court concluded that there was no artificial arrangement intended to circumvent national law because of the substance of the Dutch company. The court observed that the Dutch company's activity was to facilitate the work of artists working for them, notably by managing their activities and looking for new performances, managing and protecting their legal rights, and counselling them in their career development. The court noted that the model was not the sole employee of the Dutch company, many artists and athletes were also employees.

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Germany

Germany released the English version of the German model income and capital tax treaty. So, like the US, OECD and may other jurisdictions it now has its own model which will be used by German treaty negotiators. The existing taxes to which the agreement shall apply are in particular: in the Federal Republic of Germany:

- income tax
- corporate income tax
- trade tax
- capital tax.

In addition, to include the OECD style definitions, the model treaty has articles for:

- residency
- permanent establishments
- immovable property
- business profits
- associated enterprises
- dividends, interest, royalties, capital gains
- employment income
- pensions, annuities
- elimination of double taxation
- non-discrimination, mutual agreement procedures, exchange of information, and competent authority.

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Ireland

Capital gains tax is charged on gains realised on the disposal of assets. It is charged on the aggregate of gains and losses for each year of assessment. Taxpayers who are resident or ordinarily resident, as well as domiciled in Ireland are subject to capital gains tax on a worldwide basis. Taxpayers who are not domiciled in Ireland are taxable on gains on assets located in Ireland, but otherwise only upon the remittance of gains. Non-resident taxpayers are taxable only on the disposal of specified Irish assets, including:

- land in Ireland
- minerals in Ireland
- exploration/exploitation rights on the Irish continental shelf
- private companies deriving value from three investments above
- assets located in Ireland associated with an Irish permanent establishment
- goodwill of a trade carried out in Ireland.

The Irish revenue issued guidance on changes to the capital gains tax, which included an anti-avoidance measure introduced with respect to taxation of chargeable gains accruing to an Irish resident but non-domiciled person from disposals made abroad. Generally, capital gains derived by such individuals from assets located abroad are taxable on a remittance basis. Under the measure, where amounts from such capital gains are transferred abroad to a spouse/civil partner of the transferor and are brought into Ireland by the spouse/civil partner on or after 24 October 2013, the gains are deemed to be received in Ireland by the transferor.

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Israel

The Israeli legislature has enacted significant tax changes to the taxation of trusts. The main change is the cancellation of the 'foreign settlor trust' regime. Previously trusts that were settled by foreign residents were generally tax exempt in Israel, even after the settlor's death. Distributions to Israeli resident beneficiaries were exempt from tax.

Under the new law, these trusts will be tax exempt in Israel only to the extent that all their beneficiaries are foreign residents. If a trust that was settled by foreign residents has Israeli beneficiaries, the trust will be subject to tax in Israel either on distributions at the rate of 30% (if the settlor is still alive and is a relative of all the beneficiaries) or on its worldwide income (if the settlor has died or he is not a relative of all beneficiaries).

The amendment arose because of the suspicion that the foreign settlor trusts were being abused by Israeli resident beneficiaries to avoid paying Israeli taxes. The tax authorities concluded that all foreign settlor trusts with Israeli beneficiaries were tainted and that the Israeli beneficiaries were likely influencing the trusts.

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Italy

The Italian Supreme Court has ruled on residency for tax purposes for a Maltese company that offered online gaming services to customers in Italy. The gaming platform was exclusively managed in Malta, where the server was also located. The only activity carried out in Italy was online assistance to clients.

The Italian tax authorities claimed that the Maltese company should be considered resident in Italy for tax purposes, based on the fact that the company's main business purpose was in Italy.

Under domestic legislation a foreign company is resident in Italy if its registered office, place of effective management or main business purpose is there for the greater part of the fiscal year.

The lower court recognised that the company had its registered office and place of effective management in Malta, where the company managed the gaming platform. However, it held that the Maltese company should be considered resident in Italy based on the main business purpose criteria because it operated in the Italian market, also by virtue of a specific licence issued by the Italian state.

The Maltese company disagreed and appealed.

The Supreme Court clarified that the main business purpose is the purpose indicated in the articles of incorporation. It held that the license constituted only a formal requirement to conduct online gaming activities in Italy and the main business purpose of the Maltese company was the gaming platform management, which was conducted in Malta. Therefore, the Maltese company should not be considered resident in Italy for tax purposes.

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Luxembourg

Luxembourg has historically attracted high net worth individuals. Recently, discussions have been taking place concerning the introduction of a wealth management vehicle in the form of a private foundation. A discussion bill was introduced to introduce a 'Family Foundation' inspired by foundation regimes introduced in other countries such as the US.

The Luxembourg profit tax system consists of national corporate income tax at a rate of 21% and municipal business tax at a rate of 6.75%. In addition there is a 7% solidarity surcharge, calculated on the IRC. The total combined tax rate for 2014 (inclusive of surcharge) is 29.22%.

The 'Family Foundation' is an entity subject to income tax at the standard corporate income tax rate, but benefits from an exemption for dividends, interest and capital gains on securities. It is also exempt from the Luxembourg annual net wealth tax. Payments made to non-resident beneficiaries are not subject to withholding taxes and should not be taxable in Luxembourg.

Payments in kind to a beneficiary or founder are tax neutral. When the founder dies, the transfer of the assets from the 'Family Foundation' to the beneficiaries will be subject to a specific registration duty, which will only apply if the deceased founder was a Luxembourg resident or when Luxembourg real estate is transferred.

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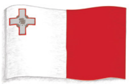

The Maltese Government has launched an 'Individual Investor Programme' providing for the grant of Maltese citizenship by a certificate of naturalisation to foreign individuals and their families who contribute to the economic development of Malta. Affluent persons of impeccable standing and repute may apply for Maltese naturalisation by investment and subject to certain conditions being met, they would be entitled to Maltese citizenship on the basis of:

- a €650,000 application fee, €10,000 of which will be a non-refundable deposit payable upon application (70% of this amount will be invested in a national development and social fund)
- a €150,000 investment in identified Maltese stocks, bonds, special purpose vehicles or other investment vehicles (must be retained for a minimum period of five years)
- residential immoveable property (must be retained for a minimum period of five years):
  - the acquisition of property in Malta having a minimum value of €350,000; or
  - the taking on lease of property in Malta for a minimum annual rent of €16,000.
- proof of one year's residence in Malta.

The applicant's spouses and children below 18 years of age are required to contribute €25,000 each, while unmarried children between the ages of 18 and 25 and dependant parents above 55 years will also be granted citizenship on the basis of a contribution of €50,000 each.

Eligibility

Besides the aforesaid investments applicants and dependants must:

- have a clean criminal record
- not be indicted or have appeared before the International Criminal Court
- not be or have been wanted by INTERPOL
- not be a 'potential threat' to national security, public policy or public health
- not have pending charges or have been found guilty of terrorism, terrorist funding, crimes against humanity, war crimes, crimes against the European convention of human rights or other similar crimes
- not have been charged or found guilty of paedophilia, defilement of minors, rape, violent indecent assault, inducing persons under age to prostitution, and abduction, or other offences that disturb the good order of the family
- provide a medical certificate confirming that applicants and dependents are not suffering 'from any contagious disease and that they are otherwise in good health'.

Due diligence and the application process

The Maltese Government is committed to the highest standard of due diligence to ensure only affluent and reputable applicants are allowed to proceed for the grant of Maltese citizenship.

Upon submission of the application a background check is carried out over 90 days (three months), and is then reviewed by Identity Malta (the responsible national body) for further background checks over a 30 day period before it issues its recommendation to the Minister. A personal interview with an applicant is not a mandatory requirement, but may be recommended or considered by Identity Malta, on a case-by-case basis.

Within five days of approval, the applicant will be required to pay the required fees, and five days later take the oath of allegiance.

Applicants who provide false information, have a criminal record, are subject to a criminal investigation, are a potential national security risk, involved in an activity that could cause disrepute to Malta, or were denied a visa to a country with whom Malta has visa-free travel, will not be approved for citizenship unless Identity Malta is satisfied that the applicant is still worthy of being considered for approval due to special circumstances demonstrated by the applicant.

Benefits

Malta has been a member of the EU since 2004 and part of the Schengen Area since 2007. Citizenship under this scheme grants the benefits of full citizenship and access to all investment opportunities in Malta and throughout the EU open to Maltese and EU citizens.

Taxation of New Citizens

Residents of Malta who are not domiciled in Malta are taxable on a remittance basis. The grant of Maltese citizenship to a non-domiciliary of Malta does not of itself, cause the beneficiary to acquire a new domicile of choice in Malta. Accordingly, non-doms who are not domiciled in Malta are not taxable on foreign source income not received in Malta and also not taxable on any capital gains arising outside Malta, whether remitted to Malta or otherwise.

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Netherlands

A lower Dutch court has decided a case concerning a Swiss captive insurance company. The Swiss captive was a brass plate and had no employees and on this basis argued that the transactions were not at arms-length and that the premiums were excessive. The Swiss profits were reallocated back to and taxable in the Dutch company. The court imposed penalties amounting to 50% of the additional Dutch corporate income tax. The key factors which influenced the court's decision included:

- the director worked two days per week for the captive
- the captive had no employees
- the captive had three directors, two of whom lived abroad
- commercial profit included premiums retrocessions from third-party insurance companies, and its investment results.

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Poland

Last year, the Ministry of Finance introduced the concept of Controlled Foreign Corporations (CFC) anti deferral tax consequences to its tax regime which have now been adopted by the council of ministers. The main features included:

- a non-resident entity with a seat or place of management in either a listed or low-tax jurisdiction will be deemed controlled by Polish (corporate or individual) shareholders
- if the non-resident entity has a seat or place of management in any other jurisdiction the control tests must be satisfied which include:
  - a 30 day/25% ownership test
  - 50% passive income test
  - the passive income is exempt from tax in the country of the foreign company's seat or place of management, or is subject to tax at the rate by at least 25% lower than the corporate (or individual) tax rate in Poland.
- the CFC regime will not apply to foreign companies established in the European Union (EU) member states or European Economic Area (EEA) countries.

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Russia

Loan guarantees are often used in international lending where a subsidiary of a foreign parent is the borrower but the foreign parent is the guarantor. Guarantees may have CFC, sourcing or thin capitalisation impact in international commerce. The Russian Ministry of Finance recently addressed the thin capitalisation consequences of such an arrangement.

In one particular case a loan was granted to a Russian company by a Russian bank and the loan is secured by the foreign legal shareholder, which directly owns more than 20% of the capital of the Russian borrower.

The tax authorities ruled that the loan provided by a non-affiliated Russian bank to a Russian company and secured by the foreign legal shareholder, which owns directly more than 20% of the capital of the Russian borrower, should be considered controlled debt. As such the thin capitalisation rules were triggered and interest would become non-deductible if the controlled debt: equity ratio exceeded 3:1. Any excess interest would be reclassified as a dividend.

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South Africa

South Africa has seen changes to corporate residency for tax purposes. Historically, a company that had its place of effective management in South Africa was deemed to be a resident of South Africa – and as such, the company was subject to tax in South Africa on its worldwide income (as opposed to being subject to tax in South Africa on its South African sourced income).

To eliminate the potential for double taxation, the definition of 'resident' was amended to provide a further exclusion and relief from the effective management test in the case of 'high taxed' CFCs.

Under this exclusion, a company is not treated as a resident in South Africa, even if it had its place of effective management in South Africa, if the company complies with certain requirements:

- incorporated, established or formed in a country other than South Africa
- place of effective management is in South Africa
- it would constitute a CFC even if it was not effectively managed in South Africa
- it was subject to a high level of tax during the relevant year of assessment (ie, at least 75% of the normal tax that would have been payable in respect of its taxable income, if the company had been a resident for that foreign tax year).

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Spain

Spain as an international centre for royalties

What is the Spanish Patent Box?

Spanish corporation income tax law has recently modified the 'Patent' or 'Innovation Box' regime. This tax regime was first introduced with effect from tax years beginning 1 January 2008 and it is similar to those previously established in other EU countries such as Belgium, France, Holland, Luxembourg and more recently the UK.

The Spanish 'Patent Box' establishes a 60% reduction for net income derived from the assignment of the right of exploitation assets (royalties), such as, patents, design drawings, formulas and know how, among others. It is important to point out that some categories of intangible assets are not subject to this tax regime (ie brands, copyright on literary and scientific works, image rights, software and industrial, commercial and scientific equipment). Nevertheless, brands can be subject to this regime in the Basque country.

This reduction applies on the net income received as royalty. The net income is calculated as the difference between royalty and certain expenses (depreciation and impairment tests) related to the intangible assigned.

Moreover, the recent law modifications allow the application in case of transfer (sale) of assets to a third party. Nevertheless, this reduction will not be applicable when the ownership of assets was transferred to a group company.

This tax incentive could be applicable for any kind of company, national or international, large or small. At the same time, any asset related to research and development (R&D) activities can be depreciated freely.

Practical application

Company X assigns an intangible asset described as 'Patent Box' to company Y for a royalty of 100 monetary units (mu), amounting the costs associated to such intangible to 30 mu.

Patent Box operation	Company X
Assignment cost Income	100
Expenses creation of asset	30
Net income	70
Reduction	42
Tax basis	28
Tax rate	30%
Tax quota	8.4
Effective quota	12%

This is a powerful tax incentive that could help companies to finance R&D activities (know-how included) on the basis of tax benefits.

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Sweden

Although trademark valuation is a transfer pricing issue, in a recent administrative court ruling the inter-relationship between income tax and trademark valuation were demonstrated. A Swedish resident company is in the business of selling coffee machines. The company sold its trademark to its group parent resident in Switzerland, for an amount of SEK 64 million. The Swedish tax authorities did not find the price at arm's length and adjusted the price by SEK 20.5 million.

The taxpayer argued the price (SEK 64 million) was set according to a valuation of the trademark made one year before the sale. The tax authorities did not challenge the valuation itself but held that the tax effects of the transfer, ie the additional cost for the seller's income tax and the tax depreciation benefit accruing for the buyer, were not considered in the valuation of the trademark as they should have been.

Affiliated companies are required to observe the arm's length principle in their internal dealings. According to this principle, a price set in a transaction between affiliated companies may be adjusted if the tax authorities believe that the price is not at arm's length.

The court stated that commercial considerations that affect the price, such as strategy, synergies, the need to invest in the brand as well as the risk of reduced income after the transfer, should have been taken into consideration when evaluating the arm's length price on the trademark. The court held no independent seller would sell an asset for a price that would give a significantly poorer economic outcome than keeping the asset unless the person was forced to sell at that time.

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Switzerland

Switzerland is a popular European location for limited risk distributors or commissionaires. The Swiss tax authorities have indicated the functions, activities, risks and remuneration of commissionaires and limited risk distributors should be minimal. An acceptable gross profit margin for a commissionaire or limited risk distributor should not exceed 3%.

The Swiss tax authorities believe that commissionaires or limited risk distributors must exclusively carry out a distribution activity for the principal on a legal entity basis and not on a distribution function basis. The Swiss tax authorities maintain that at least 90% of the distributor's activity should relate to distribution activities for the principal. Any other activity such as manufacturing, logistic services for the principal or any other party as well as sales on full risk basis exceeding 10% of the distributor's profits before tax, would result in a different profit allocation between the principal and the commissionaire or limited risk distributor.

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United Kingdom

The Chancellor of the Exchequer delivered the UK's 2014 budget which targets a number of key areas relevant for foreign multinational groups investing into the UK.

The headline UK tax rate will drop to 21% on 1 April and to 20% on 1 April 2015. Both measures have already been enacted as part of Finance Act 2013. In addition, the Chancellor announced a number of measures that are intended to promote investment in the UK:

- the Annual Investment Allowance (AIA) allows for immediate tax relief on qualifying capital expenditure. A temporary increase in the AIA from £25,000 to £250,000 (about $41,242 to $412,425) was due to expire on 31 December 2014. The Chancellor has extended this relief to 31 December 2015, and increased the allowance to £500,000 (about $824,850), after which it will fall back to £25,000
- as part of the 'Budget' enhanced capital allowances, will provide 100% relief. The range of assets that qualify for relief has been broadened and enhanced capital allowances to promote additional capital investment in specific enterprise zones has been extended to 2020
- Small-Medium sized Enterprises (SMEs) that are loss-making and carrying on qualifying R&D activities will be entitled to a cash credit equivalent to 14.5% of their current-year tax loss from 1 April 2014 (up from the current credit of 11%)
- the rate of the payable R&D tax credit for loss-making SMEs will be increased (from 11%) to 14.5%. The increase takes effect for qualifying expenditure incurred on or after 1 April 2014.
- the anti-loss buying rules will be amended to exclude R&D allowances from the scope thereof. The amendments will take effect for 'qualifying changes' of ownership occurring on or after 1 April 2014.

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APAC news

Australia

A court ruling in Australia involved an Australian distributor of software that was developed by a Canadian resident entity. The issue for the court's determination was whether payments pursuant to the distribution agreement were 'royalties' for the purposes of the convention between Australia and Canada (double taxation agreement (DTA)). The DTA defines:

- 'royalties' to include, relevant payments to the extent to which they are made as consideration for: (a) the use of, or the right to use, any copyright, secret formula or process
- that the term 'royalties' shall not include payments, made as consideration for the supply of, or the right to use, source code in a computer software program, provided that the right to use the source code is limited to such use as is necessary to enable effective operation of the program by the user.

The payments were held not to be excluded from the definition of the term 'royalties' in the DTA because of the nature of the rights that were acquired under the distribution agreement, in relation to the use of the software (for which the payments were made), were not limited to such rights as were necessary for the effective operation of the software but for the commercial exploitation of that software through the right to copy the software for sale to end users and the right to use the copyright for the purposes of developing its own templates to sell in conjunction with the software. As the payments were 'royalties' for the purposes of the DTA, the distributor is liable to pay an administrative penalty for failure to withhold 10% of each payment that it made.

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China

A recent notice issued by China's State Administration of Taxation (SAT) will be of interest to export service companies which are defined as a company that provides domestic small and medium-size manufacturing enterprises with export-related services (for example, logistics, customs declaration, credit insurance, financing, receipt of foreign currency payment, and the claim of tax refunds).

According to the SAT, if a company exports goods that have been contracted between a domestic manufacturing company and a foreign entity or individual, it can claim an export tax refund based on the tax rules for self-exports, provided that all of the following conditions are satisfied:

- the exported goods must have been made by the domestic manufacturing company
- the manufacturing company must have sold the goods to the export service company
- the manufacturing company must have signed an export contract with the foreign entity or individual, and the contract must state that the goods must be exported by the export service company to the foreign entity or individual and that the payment must be made by the foreign entity or individual to the export service company
- the goods must be exported by the export service company itself, under its own name.

In addition, new Chinese regulations now simplify foreign exchange control procedures, including outbound loan arrangements. Cash-rich Chinese companies can now more effectively provide an outbound loan to any of its foreign group affiliates. However, the Chinese lender will likely be subject to both business tax and corporate income tax on the interest. The foreign borrower should be able to claim an interest deduction but may be subject to a local withholding tax. Prior to 2012, Chinese companies were allowed to provide outbound loans only to their 100% owned foreign subsidiaries. In 2012 the scope of that rule was expanded to allow Chinese companies to provide outbound loans to their foreign parents. According to the most recent changes, Chinese companies can now also provide outbound loans to foreign affiliates with which they have a shareholding relationship. The cumulative loan amount should generally not exceed 30% of the Chinese company owner's equity, unless otherwise approved by the authorities. The previous two-year term restriction has also been removed, meaning that the loan term can exceed two years, subject to approval by the relevant authorities.

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Hong Kong

The Hong Kong legislative council passed an inland revenue bill which could prove interesting for multinationals with captive insurance structures in the Asia Pacific region. The Bill provides a tax concession of a 50% profits tax reduction on offshore risk insurance businesses. The development of captive insurance could reinforce Hong Kong's status as a regional insurance hub.

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India

The Indian Supreme Court recently ruled that a mere remittance will not result in an obligation to deduct tax at source. In this case, the taxpayer is a distributor of imported pre-packaged shrink-wrapped standardised software from suppliers outside India. The taxpayer made payments to the suppliers with regard to the purchase price of the software. The taxpayer argued that the payment was not chargeable to tax in India based on this position and no tax was withheld. During the audit, the tax authorities argued that since the sale of software included a license to use, the payments made by the taxpayer to the foreign suppliers constituted royalty and as such, tax had to be withheld.

The Commissioner of income tax (appeals) upheld the findings of the tax authorities. The taxpayer appealed to the Income Tax Appellate Tribunal which held that the amount paid to the foreign supplier was not royalty and did not give rise to any income taxable in India, thus taxes did not have to be withheld. The tax authorities appealed to the High Court. The High Court held that tax should have been withheld. The Supreme Court overruled the decision of the High Court.

Another interesting decision dealt with a liaison office in India. The taxpayer, a company and a tax resident of the US is a subsidiary of a public company in Sweden. The taxpayer established a liaison office in India to serve as a communication channel with its customers/prospective customers in India. The liaison office was not permitted to render any consultancy or services. The taxpayer declared a 'loss' in its tax return in India and that the liaison office had never rendered any services for the taxpayer and thus, there was no income earned in India. The liaison office only received reimbursement of expenses from its head office.

Tax authorities contended that the taxpayer was taxable in India for the services rendered by the liaison office because it was promoting the products of the taxpayer and the performance of the employees was being judged by the number of orders that the taxpayer received. Thus, the liaison office was not simply a communication channel but it was rendering the services for promotion and sales of the products of the taxpayer.

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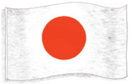
Japan



There will be a change in the international taxation applied to foreign companies with a branch in Japan. Currently such branches are subject to the 'entire income principle' and this will be changed to the 'attributable income principle'. Under the entire income principle, a foreign company with a permanent establishment (PE) in Japan is liable for corporate tax on all Japanese source income (in principle) regardless of whether such income is attributable to the PE. On the other hand, under the attributable income principle, the business income attributable to the PE of such foreign company is subject to corporate tax and the Japanese source income not attributable to the PE is taxed in the same way as Japanese source income earned by a foreign company without a PE in Japan (ie in principle, subject to withholding tax only, except for certain capital gains, etc).

Under the 'attributable income principle' income attributable to a PE in Japan will be defined as a type of Japanese source income (eg Income derived from investments into a third country by a PE will become taxable in Japan regardless of whether or not such income is taxed in the third country, which is a change from the current law).

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Korea

Several thousand taxpayers filed reports for a deemed gift tax on unfair funnelling of work to subsidiaries under a new tax system. This is quite a unique concept as countries with a gift tax generally apply such taxes to individual taxpayers in a family setting. Where there is a non-arm's length transaction between a shareholder and his company, this is most commonly dealt with through transfer pricing.

However, Korea has chosen a gift tax approach. The deemed gift tax on 'Unfair funnelling of work to subsidiaries' is calculated based on the assumption that the amount calculated by taking 'after-tax operating profit of the related party' x (related party transaction rate – 30%) x (shareholding ratio – 3%) is deemed profit derived from unfair support given to subsidiaries.

However, the rate applied to related party transaction will be reduced to 15% from the current 30% and the 3% holding rate for small and mid-sized companies will be changed to 5%. There are penalties for failure to properly report the deemed gift tax.

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Malaysia

The Inland Revenue Board has released guidance clarifying withholding taxes. A non-resident is subject to a 10% income tax in Malaysia on the following types of Malaysian-source income:

- amounts paid for services rendered by the non-resident or its employees in connection with the use of the non-resident's property or rights
- the installation or operation of any plant, machinery, or other apparatus purchased from the non-resident
- installation and commissioning services
- amounts paid for technical advice, assistance, or services rendered in connection with the technical management or administration of any scientific, industrial, or commercial undertaking
- rent or other payments made under any agreement or arrangement for the use of any movable property (including oil rigs, boats, ships, cars, and aircraft).

If Malaysia has an income tax treaty in force with another jurisdiction, the preferential tax rate provided by the treaty will apply, subject to the condition that the payee submits a letter to Malaysian tax authorities from the revenue authority of the other jurisdiction confirming the resident status of the payee.

Some payments to non-residents that are not subject to withholding tax include:

- commissions paid for sales made overseas on behalf of the Malaysian company or individual
- guarantee fees connected with any loan or indebtedness, or commissions for letters of credit
- refundable deposits paid on the signing of agreements for technical services
- payments for the testing of finished products to meet required standards.

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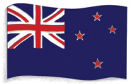

The topic of tax residency has been in the spotlight recently. In terms of judicial activity, the Court of Appeal confirmed both tax residence and tax avoidance in a recent case, details below.

A family business was carried out in New Zealand (VIL), which was financed by interest-free loans made by a Hong Kong registered sister company (WIL). VIL and the shareholders (the parents) were at all times New Zealand residents.

A restructuring in 1998 resulted in:

- the creation of 'VT Trust' and its corporate trustee (VNL). WIL was a beneficiary of the trust
- VIL agreed to pay management fees to VNL. The amount was set at this level to offset VIL's taxable income
- VNL assumed the liability of the debt owing by VIL to WIL, and interest which was set to ensure that the interest expense offset the taxable income, which VNL received by way of management fees. The interest rate was not based on any commercial reasons
- the parents transferred their shares in WIL to their three children, who were residents of Hong Kong. The children became directors of WIL, along with the parents.

The group's tax advisor described the arrangement as one "… to mitigate the NZ tax group's tax by shifting all profit up to [VNL] and paying it out by way of interest subject to VIL".

In 2002, the interest rate on the loan was reduced to avoid scrutiny from Inland Revenue.

In 2003, the advisor concluded that WIL was a non-resident as "none of the directors have, to date, performed any directorial or management function in relation to WIL while physically present in New Zealand".

The Court of Appeal decided that:

- WIL was a tax resident of New Zealand until 2004 because its centre of management was in New Zealand. Therefore, WIL was required to account for income tax and VNL was required to deduct resident withholding tax (RWT) at the rate of 30% until March 2004
- the statutory time bar preventing Inland Revenue from reassessing income after four years did not apply because VNL failed to file RWT returns
- the arrangement was a tax avoidance arrangement: tax avoidance was the dominant purpose and not a merely incidental purpose.

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Singapore

The recent budget has extended the R&D credit tax measures. To continue encouraging private R&D and to give certainty to businesses, the additional 50% tax deduction will be extended for ten years until 2025. To attract businesses to conduct large R&D projects in Singapore, the additional tax deductions will be extended for five years till 31 Mar 2020. In line with the above extensions, businesses can continue to claim tax deductions/ allowances on R&D expenditure incurred for R&D in areas unrelated to their existing trade or business as long as the R&D is conducted in Singapore. Businesses can also continue to claim a further deduction of up to 300%, on qualifying R&D expenditure up to $400,000 under the 'Productivity and Innovation Credit scheme', which has been extended until 2018.

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Americas news

Argentina

Argentina's Supreme Court recently held that a taxpayer's commission payments to two foreign companies for the purpose of obtaining loans from Chase Manhattan Bank (CMB) constitute Argentine-source income and are subject to withholding tax in Argentina. The tax authority maintained that the services rendered by the foreign companies qualify as technical or financial advice provided from abroad. Domestic tax law provides that fees paid in connection with technical financial advice are deemed Argentinian sourced income subject to withholding tax.

The lower courts rejected the tax authority's argument by holding that there was no knowledge transfer for decision making purposes in connection with the Argentinian economic activity developed or to be developed in Argentina. The lower courts also disagree with the tax authority's position on the grounds that the services were intermediary and developed outside Argentina. The Supreme Court overturned these decisions and sided with the taxpayer.

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Bermuda

Bermuda is an important location for multi-nationals with global insurance needs often put through a captive insurance company in this location. A recent US decision is of importance to Bermuda and all multi-nationals with captive insurance arrangements.

Taxpayer Inc is a Bermuda corporation that is engaged in the business of reinsurance. It sells reinsurance policies to other insurance companies, offering 'protection' against, or compensation/indemnity for, the liability of to pay valid claims to its policyholders.

In an effort to protect itself, Taxpayer Inc sometimes buys reinsurance for a portion of its potential liabilities under the reinsurance contracts it sells. These transactions are called 'retrocessions' and they protect the plaintiff against the risk that it will have to make payments to other insurance companies under its reinsurance agreements with those companies. In 2006, Taxpayer Inc paid premiums on nine retrocession policies, and all the retrocessionaires from whom taxpayer obtained insurance are considered 'foreign reinsurers'.

In February 2012, the IRS first requested that Taxpayer Inc consent to the assessment of an excise tax. Although the taxes were considered over six years delinquent, the IRS noted that it would not impose penalties because Taxpayer Inc had a reasonable cause for its position of non-taxability. Taxpayer Inc paid the assessment in full, plus interest, and it then filed a refund claim with the IRS. After six months and no action by the IRS, Taxpayer Inc filed with the court seeking a refund of the excise tax and interest that it paid.

The case involves whether the excise tax applies to retrocession premiums. The excise tax is imposed on a variety of insurance transactions that involve a foreign insurer or reinsurer. The challenged excise taxes in this case were imposed upon premiums paid on policies of reinsurance that the plaintiff purchased to cover the risks associated with its own reinsurance contracts. According to the court 'an excise tax is to be imposed on each policy of insurance or policy of reinsurance', but those words are specifically defined in the statute in a manner that excludes the policies involved here. Accordingly, the court concluded that the retrocession premiums were not subject to the US excise tax.

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Brazil

Regulations for a special tax regime for the defence industry have recently been issued. Under the provisions, strategic defence are eligible for certain tax breaks for imports and sales of items associated with the manufacturing of defence equipment. Criteria include:

- the corporate purpose is to perform (in Brazil); research, project development, manufacturing, production, repair, conservation, review, conversion, modernisation, or maintenance of strategic defence products, or to sell or resell strategic defence products integrated with manufacturing activities
- the headquarters, management, and industrial facilities are located in Brazil
- the company possesses (in Brazil), proven scientific or technological knowledge that can be documented, with association agreements, with research and development institutes
- the foreign equity holders do not have voting rights in excess of two-thirds of the voting rights exercisable by Brazilian equity holders
- tax incentives include:
  - the Program for Social Integration contribution (PIS), including the separate PIS on imports
  - the Contribution for the Financing of Social Security (COFINS), including the separate COFINS on imports
  - the federal excise tax (IPI), including the separate IPI on imports.

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Canada

Budgets often provide a glimpse of the thought process of the legislative process forthcoming. The recent Canadian budget does contain some key targeted international tax measures and updates that will be of interest to certain groups of individual and corporate taxpayers. The government is seeking input on how Canada should address aggressive international tax planning by multinational enterprises and the perceived abuse associated with treaty shopping. Budget measures aimed at stopping perceived abuses in the international context (involving both inbound and outbound planning) include:

- proposals to address some back-to-back loan arrangements involving a Canadian taxpayer, a non-arm's-length non-resident, and a third party that are designed to circumvent Canada's thin capitalisation rules or avoid withholding tax on non-arm's length interest
- the tightening of the foreign accrual property income rules (FAPI which is the Canadian offshore anti-deferral regime) to ensure that insurance swap arrangements cannot be used to avoid Canadian taxation of offshore income earned by some Canadian financial institutions
- a significant restriction on the current exception from the definition of investment business contained in the FAPI rules for certain foreign regulated business activities.

In terms of treaty shopping, the government is seeking input on a proposed rule to prevent this. The rules would address arrangements identified as improper use of Canada's tax treaties in the consultation paper and, therefore, protect the integrity of Canada's tax treaties. The rules would use a general approach focused on avoidance transactions and, in order to provide more certainty and predictability for taxpayers, building on comments received on the 2013 consultation paper, the rule would contain specific provisions setting out the scope of its application.

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Chile

Legislation has been approved by congress enhancing the foreign tax credit (FTC) in Chile. Before the change, Chilean companies could claim foreign tax credits on up to second-tier subsidiaries, but only if the parent company had direct ownership. However, the new rules allow parent companies to obtain FTCs for taxes paid by the in-country subsidiary of a company distributing profits without requiring direct ownership by the parent. The only requirement is that the profit-distributing foreign company holds at least a 10% stake in the same-country subsidiary, either directly or indirectly. Specifically, the amendments are as follows:

- the indirect foreign tax credit is also granted with respect to taxes paid by subsidiaries of the company remitting the profits to Chile, provided that all the companies are domiciled in the same country and at least 10% of their capital is directly or indirectly owned by the company remitting the profits
- the maximum foreign tax credit is increased from 30% to 35% with respect to countries with which there is a tax treaty, and from 30% to 32% with respect to other countries
- the excess of foreign tax credit may be carried forward without limits.

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Colombia

To implement recent tax reforms, Colombia's Ministry of Finance recently issued three decrees.

1. The introduction and regulation of the PE concept, defining the terms 'foreign company', 'fixed place of business', and 'preparatory and auxiliary activities' and establishing rules for the taxation of profits attributed to PEs, as well as branches. The provisions generally follow the OECD model tax treaty and commentary.
2. Thin capitalisation rules limit the deductibility of interest expense when the amount of interest-bearing debt exceeds a 3:1 debt-to-equity ratio. The second decree establishes that the interest on financing for regulated housing projects carried out by companies, legal entities, or special purpose vehicles can be deducted based on a 4:1 debt-to-equity ratio.
3. The third decree deal with tax residence:
   - the tax reform substantially changed the concept of residence for individuals in Colombia. With the reform, individuals (regardless of citizenship) are considered to be resident if they stay in Colombia for more than 183 days within a 365-day period. Furthermore, Colombian citizens are resident if they have close ties in Colombia (family); if 50% of their assets are sourced, administered, or located in Colombia; if they have not proved their residence in another country; or if they are residents of a tax haven. The decree introduces rules for the 50% test.
   - tax reform introduced the criterion of place of effective management and the tests for determining its existence. The tests follow, to some extent, the OECD criteria:
     - the place where the key management and commercial decisions are made
     - the place where the meetings of the board of directors or equivalent body are usually held
     - the place where the senior day-to-day management of the company is carried on.

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Mexico

On 1 January 2014, the sixth resolution of modifications to the general rules on foreign trade were published in Mexico's Official Gazette (DOF). This gives the guidelines that would allow companies with maquiladora operations to avoid paying the Value Added Tax (VAT) on temporary import operations.

According to the amendments made for the 2014 tax year to the VAT law and the Special Production and Services Tax (IEPS) law, the temporary import of goods by maquiladoras will trigger the payment of VAT and IEPS.

However, there is a possibility of obtaining a tax credit for 100% of the VAT and IEPS to be paid on temporary imports, which would be credited against the VAT or IEPS payable for such activities, provided that taxpayers obtains a new certification that will be issued by the Mexican tax authority (SAT).

The certification will be based on a rating system that will assess a maquiladora's overall tax and customs compliance. Each rating has specific requirements and benefits which will be used to assess a maquiladora's control and overall tax and customs compliance. Those taxpayers that do not obtain the certification will be required to pay the VAT and IEPS on the temporary importation of goods starting on 1 January 2015.

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Puerto Rico

On 12 March 2014 the Puerto Rico treasury department issued an 'Administrative Determination', the purpose of which is to clarify, in the case of members of a group of related entities, the requirements to submit audited financial statements with the Puerto Rico income tax returns, and provides guidance to determine the additional tax (Patente Nacional) on gross income.

On 16 September 2011 the Puerto Rico treasury department issued an administrative determination to establish that, for taxable years beginning during 2011, a group of related entities whose volume of business was $3 million or more, were not required to submit consolidated audited financial statements and were able to elect to submit stand-alone financial statements instead for every member with at least $1 million of volume of business, if certain requirements were met. The stand-alone financial statements must include a note with a list of names of all related entities engaged in a trade or business within Puerto Rico. It also established that an entity which is part of a group of related entities, whose volume of business for its first taxable year beginning after 31 December 2010, was less than $1 million, was not be required to submit audited financial statements for such year.

Later, on 9 October 2012, the treasury department issued an 'Informative Bulletin' to clarify that the requirements set forth on 16 September 2011 continued to apply for all taxable years commenced during 2012 and also clarified that the requirement of including an attachment that shows, in columns, the financial situation and results of operations of the group of affiliated entities will be considered fulfilled by including appropriate forms with the income tax returns.

'DA 14-07' establishes that groups of related entities must aggregate all members' gross income in order to determine the applicable rate of the additional tax on gross income, including any member distributive share of gross income from a flow through entity and gross income of any member for which a waiver has been granted. The applicable rate of the additional tax corresponding to all members of a group of related entities will be also determined in form 'SC 2652'.

The announcements also provide guidance on how to determine the 'Patente Nacional' when members of the group have different taxable years. The determination of which corporations form part of a group of related entities must be made annually as of 31 December, regardless of the closing date of the taxable year of the individual members of the controlled group.

The Puerto Rico treasury department issued revised forms in order to facilitate compliance with all the new applicable requirements. Only electronic submissions are acceptable.

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United States

The multi-level industry has seen explosive growth not only domestically but also internationally. This industry was recently addressed in IRS guidance.

The taxpayer, a US corporation, produces and sells products to US and foreign distributors, with some sales income sourced within the US, and some sales income sourced outside the US, under applicable rules. The taxpayer sells its products to the ultimate customers through a multi-level marketing arrangement, using distributors who are treated as independent contractors for US federal income tax purposes.

A distributor's income depends on several criteria, including the amount of products the distributor purchases from the taxpayer and the resells, and the success of the distributor in sponsoring, training, and supporting other distributors (lower-tier distributors). These lower-tier distributors may sponsor additional distributors, creating a sponsorship chain, with all distributors in the chain potentially purchasing additional products from the taxpayer.

A distributor may earn income in two ways:

1. A distributor may buy products directly from the taxpayer and sell those products to the ultimate customers. The distributor earns the difference between the price the distributor pays for the products and the price paid by the ultimate customers to the distributor.
2. In addition, a distributor may receive earnings based on purchases of products from the taxpayer by lower-tier distributors in the distributor's sponsorship chain.

The IRS held that:

- earnings of a foreign distributor based on purchases of the taxpayer's products by lower-tier distributors in the foreign distributor's sponsorship chain constitute income from performance of personal services by the foreign distributor
- the source of earnings derived from performance of personal services is based on where the services of the foreign distributor are performed
- the taxpayer is required to withhold tax on earnings of a non-resident alien individual that constitutes compensation for the performance of services within the US
- the taxpayer is required to withhold tax on earnings of a foreign corporation that constitutes compensation for the performance of services within the US unless the foreign corporation provides it is taxed as a business in the US
- if the foreign distributor is a resident of a foreign country that has an income tax treaty in force with the US and does not have a fixed base or PE in the US to which earnings are attributable, the taxpayer will not be required to withhold tax if the foreign distributor provides certain treaty clearance documentation.

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Transfer pricing news

Organisation for Economic Co-operation and Development (OECD) transfer pricing comparability data and developing countries

The OECD issued a paper to address the concerns expressed by developing countries on the quality and availability of the information on comparable transactions that is needed to administer transfer pricing effectively. This paper sets out and briefly discusses four possible approaches to addressing the concerns over the lack of data on comparables expressed by developing countries.

1. Expanding access to data sources for comparables, including steps to improve the range of data contained in commercial databases, expand developing country access to such databases, and improve access to comparables data in developing countries with a significant number of sizeable independent companies.
2. More effective use of data sources for comparables, including guidance or assistance in the effective use of commercial databases, the selection of foreign comparables, whether and how to make adjustments to foreign comparables to enhance their reliability, and alternative approaches to finding comparables.
3. Approaches to identifying arm's length prices or results without reliance on direct comparables, including guidance or assistance in making use of proxies for arm's length outcomes, the profit split method, value chain analysis, and safe harbours, an evaluation of the impact, effectiveness and compatibility with the arm's length principle of approaches such as the so called 'sixth method', which is increasingly prevalent particularly in developing countries in Latin America and Africa, and a review of possible anti-avoidance approaches.
4. Advance pricing agreements (APAs) and mutual agreement proceedings (MAPs), including a review of developing country experiences with the pros and cons of APAs and negotiations to resolve transfer pricing disputes, as well as guidance or assistance with respect to mutual agreement proceedings.

To discuss this information in more detail please contact your local Grant Thornton office.

US IRS transfer pricing roadmap

In recognition of the strategic importance of transfer pricing, the IRS has established a dedicated team of transfer pricing specialists (Transfer Pricing Operations or TPO) headed by an executive and encompassing both the Advance Pricing and Mutual Agreement Program (APMA) and the Transfer Pricing Practice (TPP). This team has developed a transfer pricing audit roadmap (the roadmap) to provide the transfer pricing practitioner, whether employed in TPO or International Business Compliance (IBC), with audit techniques and tools to assist with the planning, execution and resolution of transfer pricing examinations.

The roadmap is a practical, user-friendly toolkit that is organised around a basic audit time-line and that provides advice and links to useful reference material. It is not intended as a template – every transfer pricing case is unique, and the team will need to exercise its own judgment about how to best use these guidelines. The roadmap is a work in process – users are strongly encouraged to contact the Income Shifting Issue Practice Networks (IPN) with any corrections, proposed additions or deletions, or other suggestions for improvement.

Transfer pricing specialists must be involved in assessing potential transfer pricing issues at the earliest possible stage – ideally, before the official audit commencement date. Their early involvement will ensure that the audit plan and timeline are appropriate given the complexity of the case and the resources available. Transfer pricing specialists can provide valuable guidance in staffing decisions, including identification of necessary expertise. Transfer pricing specialists can help weed out issues that are not worth pursuing, thereby preserving resources for more important work.

The key in transfer pricing cases is to put together a compelling story of what drives the taxpayer's financial success, based on a thorough analysis of functions, assets, and risks, and an accurate understanding of the relevant financial information. Fact development is the 'bread and butter' of exam teams – it's what they are trained for and good at. An effective story explains the taxpayer's value chain, competitive position in its industry, and financial results, in a clear and compelling fashion. If indications are that the tax result claimed by the taxpayer is at odds with common sense and economic reality – too good to be true – chances are it is a good candidate for further scrutiny. Early identification and aggressive pursuit of cases that have this potential is important. Conversely, if indications are that the taxpayer's financial results are reasonable, and the taxpayer's method fits its fact profile, it may not be worth pursuing the issue.

The Roadmap provides the transfer pricing practitioner with a comprehensive toolkit to address the key themes underlying a transfer pricing examination.

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Indirect taxes news

China

On 30 December 2013, the Ministry of Finance and the SAT issued a public notice concerning the VAT treatment of retail products exports through e-commerce, with effect from 1 January 2014. E-commerce export enterprises are entitled to a VAT refund on exported goods, unless the goods are expressly excluded from tax refunds, provided that the following conditions are satisfied:

- the exporter is registered for the normal VAT system and recognised by the tax authorities as an enterprise qualifying for export tax exemption or refund
- the exporter holds a customs declaration form, which is specially issued for tax refunds for export, and the information on that form is consistent with the electronic information of the customs authorities
- the exported goods have been paid prior to the expiry of the deadline for filing the application for tax exemption or refund for that export transaction
- where the e-commerce export enterprise has been authorised to import and export goods (a foreign trade enterprise), the exporter must present special VAT invoices for the purchase of the exported goods, a certificate of VAT payment on the imported goods, and the information contained in these documents must match with that contained in the export customs declaration form.

Where the conditions described above are not fulfilled and the exporter is not entitled to a tax refund, a tax exemption may still apply where the following conditions are satisfied:

- the exporter is registered with the tax authorities for VAT
- the exporter has received the customs declaration form for the exported goods, issued by the customs uthorities; and the exporter holds a valid receipt for the purchase of the exported goods.

The regular procedure for the application of the tax exemption and refund for export equally applies to e-commerce export enterprises. The procedure only applies to e-commerce export enterprises that carry on business through their own cross border sales platform or through the cross-border sales platform of a third party. Enterprises that provide a cross border sales platform, as third parties, are not covered by this notice.

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EU

On 22 October 2013, the European Commission announced the creation of a high-level expert group on 'Taxation of the Digital Economy'. The task of this group will be to examine the best ways of taxing the digital economy in the EU, weighing up both the benefits and risks of various approaches. The expert group will focus on identifying the key problems with taxation of the digital sector from an EU perspective, and presenting a range of possible solutions. The commission will then develop the necessary initiatives to improve the tax framework for the digital sector in the EU. The expert group will be comprised of up to seven members, who will be internationally renowned experts on the digital economy and on taxation. The expert group should report back to the commission in the first half of 2014. This is a different working group than the OECD BEPS working party for taxation in the digital economy.

To discuss this information in more detail please contact your local Grant Thornton office.

US

The Massachusetts Department of Revenue has revised a letter ruling that addresses the sales and use tax aspects of cloud computing.

For cloud computing, the service provider provides its customers with an infrastructure, a platform and operating system software, which enable the customers to carry out a variety of activities, including, but not limited to, running their own software applications. In order to have access to cloud computing, customers must use specific operating system software.

Charges for cloud computing are not subject to tax when cloud computing is used in combination with the customer's own application software or open-source (free) operating software because, in those cases, there is no sale of prewritten software.

Cloud computing services that include the provision of operating system software that a third party has licensed to the service provider are also not subject to tax if the license fee for the use of the third party's operating system software is included in the charge to the customer for cloud computing and the service provider does not sublicense the software to its customers and does not separately charge them for the use of the software.

Under those circumstances, the object of cloud computing remains the provision of access to the service provider's computing resources and storage capacity. The inclusion of the operating system software in the cloud computing service is incidental, as the operating system software merely enables the customer to use the service provider's computing resources and storage capacity.

The service provider is liable for 'use tax' on the apportioned cost of prewritten operating system software that it uses for the purposes of providing the non-taxable cloud computing services to its customers in Massachusetts. Charges for remote storage services are not subject to tax because the object of the transaction is the use of the service provider's storage capacity for storing or backing up the customer's data.

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Treaty news

OECD

The OECD issued a discussion draft on proposals to address treaty abuse as part of the BEPS action plan. The proposals address treaty shopping and other types of abuses that result in double non-taxation. The discussion draft reports on model treaty provisions and recommendations for domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. The discussion draft includes the following:

- Treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances
  - – cases where a person tries to circumvent limitations provided by the treaty itself
  - – treaty shopping
    - limitation-on-benefits provision
    - rules aimed at arrangements one of the main purposes of which is to obtain treaty benefits.
  - – other situations where a person seeks to circumvent treaty limitations
    - splitting-up of contracts
    - hiring-out of labour cases
    - transactions intended to avoid dividend characterisation
    - dividend transfer transactions
    - transactions that circumvent the application of Art. 13(4)
    - ice-breaker rule for determining the treaty residence of dual-resident persons
    - anti-abuse rule for permanent establishments situated in third states.
  - – cases where a person tries to abuse the provisions of domestic tax law using treaties.
- clarification that tax treaties are not intended to be used to generate double non-taxation
- tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.

To discuss this information in more detail please contact your local Grant Thornton office.

Italy/Malta

The Italian Supreme Court recently overruled a lower court decision and held that a company incorporated under the laws of Malta that offered online gaming services in the Italian market should not be considered an Italian tax resident because Italy was not the main place of business.

The case involved a Maltese corporation that provided online gaming services through a server located in Malta. The online gaming service was offered almost exclusively to customers in Italy, and the company had obtained a license to operate in the Italian market. An Italian group company provided the Maltese company with marketing and client assistance services, while the gaming platform was managed entirely from Malta.

The Maltese company deposited the money it received from the online gaming activities in its bank account in Italy. The company requested a transfer of those funds to a foreign bank account, but the Italian bank suspended the request because of applicable anti-money-laundering legislation.

Based on these facts, the Italian tax authorities claimed that the Maltese corporation should be considered an Italian tax resident because its main place of business was Italy. Therefore, as an Italian tax resident, the corporation should have regularly filed corporate income tax returns and paid corporate income taxes on the profits derived from the online gaming activities.

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Germany

Germany now has a model treaty, joining the likes of the US, the United Nations, the OECD, Belgium and Austria.

The purpose of the German model is to:

- further develop their economic relationship
- enhance their cooperation in tax matters
- ensure an effective and appropriate collection of tax.

The German model follows the same order as the OECD model for the majority of articles however the German model contains several articles that do not exist in the OECD, such as:

- article 27 (procedural rules for taxation at source; investment funds)
- article 28 (application of the agreement in special cases)
- article 30 (protocol).

The German model contains an attachment for a protocol. The protocol contains not only detailed explanations but also material rules that sometimes contradict the rules in the tax treaty itself.

According to the German model, when a country is required to counter-adjust profits, it must agree on the adjustment of profits with the treaty partner.

The German model provides for a withholding tax rate of 15% for portfolio dividends (less than 10% participation) and 5% for substantial participations (less than 10% participation).

Unlike the OECD model, article ten, paragraph two of the German model does not contain a provision that requires the competent authorities of the treaty partners to seek consent regarding the limitation of withholding taxes. This issue is contained in article 27.

Germany does not levy any withholding taxes on interest and royalties.

The German model does not contain a source rule, which leads to legal uncertainty. Hopefully, the treaty practice does not prevent the implementation of a source rule.

The German model also contains a rule regarding exit taxation that has no equivalent in the OECD model.

The German model provides an overview of the general principles in German international tax law, in particular regarding the German methods of choice to prevent double taxation.

The Treaty outlines the types of income that Germany generally exempts from taxation in a tax treaty situation, primarily:

- income from foreign permanent establishments
- capital gains regarding immovable property
- dividend income other than portfolio dividend income (less than 10% participation) and dividends distributed to shareholders other than companies.

The treaty provides that income cannot be exempt unless it meets all of the following anti-avoidance and anti-double-non-taxation provisions:

- the subject-to-tax clause
- the switch-over clause
- the activity clause
- the anti-treaty-shopping clause.

The German model contains a new measure to prevent double non-taxation. The participation exemption will be denied for 'tax exempt companies' such as foreign real estate investment funds, mutual funds, and similar tax-exempt vehicles.

The treaty applies the credit method in tax treaty situations to portfolio dividends, and capital gains from real estate companies.

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Tax policy

OECD

The OECD released a discussion draft in response to its base erosion profit shifting (BEPS) action plan on addressing the tax challenges of the digital economy. Action 1 of the BEPS action plan is to deal with the taxation of the digital economy, this action specifically states:

> The OECD released a response to its base erosion profit shifting (BEPS) action plan.

Action 1 – address the tax challenges of the digital economy

Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.

The contents of the discussion draft include:

- information and communication technology and its impact on the economy
- the digital economy, its key features and the emergence of new business models
- identifying opportunities for BEPS in the digital economy
- tackling BEPS in the digital economy
- broader tax challenges raised by the digital economy
- potential options to address the broader tax challenges raised by the digital economy.

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