

# International Tax Services

## Contents

### Legislative and Tax/Administrative Court News

- Brazil: Expanded definition of low-taxed jurisdictions provided by new Law 11,727/2008
- Canada: Important Court Ruling on Treaty Interpretation - International Holding Company Structures
- Ireland: Reform of Taxation of Foreign Dividends
- Italy: New Rules on Capital Gains Realized by Foreign Investors
- Luxembourg: 2009 Tax Reform
- Netherlands:
  - Participation Exemption
  - Participation Exemption – Explanatory Decree
- Portugal: New Disclosure Rules on Aggressive Tax Planning Schemes (TPS)
- United Kingdom: Update on Controlled Foreign Company (“CFC”) anti-avoidance

### International Treaties to avoid Double Taxation

- Belgium – Brazil
- Spain – Malaysia
- Singapore - Malta

This newsletter has strictly informative character and its only purpose is to provide a summary of news which, in our opinion, represents a major interest in terms of international taxation, with no intention of exploring the totality of the matter. If you are interested in deepening any topic of this Newsletter or if you want to contact any of the Uruguayan professionals that integrate PwC International Tax Services Network, please contact us through the telephone (5982) 518 2828 or write to one of the following electronic addresses:

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## Legislative and Tax/Administrative Court News

### Brazil

#### Expanded definition of low-taxed jurisdictions provided by new Law 11,727/2008

On June 23, 2008, the Brazilian Congress enacted Law 11,727/2008, which introduced, amongst other provisions, a broadened definition of low-taxed jurisdictions that will enter into force as of January 1, 2009. Prior to the new Law, low-taxed jurisdictions, also called “tax havens”, were considered countries which do not tax income or tax it at a rate lower than 20%. The latter definition is included as part of the Brazilian transfer pricing provisions, which comprise not only cross-border transactions with related parties, but also transactions with unrelated parties domiciled in a low-taxed jurisdiction.

Brazilian tax consequences on transactions with low-taxed jurisdictions can be summarized as follows: (i) merchandise and service transactions (including non-registered loan transactions) with low-taxed jurisdiction are subject to Brazilian transfer pricing regulation even if the beneficiary is not related to the Brazilian entity (i.e. arm’s length transaction); (ii) remittances of income such as interest, service fees and royalties to a beneficiary located / domiciled in a low-taxed jurisdiction trigger Brazilian withholding income tax at the rate of 25% (rather than the usual 15% rate); and (iii) sales of Brazilian investments (e.g. shares) by a resident of a low-taxed jurisdiction trigger capital gains withholding tax at the rate of 25% (rather than the usual 15% rate).

As per the new provision introduced by Law 11,727/2008, a country or dependency, which internal legislation does not allow access to information relating to the ownership of shares of local entities, and/or access to information relating to the actual beneficiary of earnings attributed to non-Brazilian residents, will also be considered a tax haven.

The new Law also sets forth that the provisions regarding

prices, costs and interest rates related to transfer pricing regulations are applied to transactions performed in privileged tax regime, between individuals or legal entities resident or domiciled in Brazil and any individuals or legal entities, even if not related, resident or domiciled abroad. According to the Law, a privileged tax regime is considered to be the one which:

- does not tax income or taxes it at a rate lower than 20%;
- grants tax benefits to non-resident individuals or legal entities: (i) without requiring substantial economic activity in the country or jurisdiction; and (ii) to the extent that the non-resident does not conduct substantial economic activity in the country or jurisdiction;
- does not tax or taxes at a rate lower than 20% earnings generated outside the territory of the respective country or jurisdiction; and
- does not allow access to information relating to the ownership of shares of local entities, the ownership of goods and/or rights or information regarding economic transactions.

It is initially understood that the new definition of low-taxed jurisdictions focus mainly on transfer pricing provisions, that is, will have the effect to increase the transactions subject to transfer pricing. Nevertheless, it is still unclear at this time to what extent the new provisions will affect cross border payments performed by Brazilian residents to beneficiaries located in tax havens (i.e. potential increase on the withholding income tax rate applicable on interest, royalties and service payments, as well as capital gains). Further regulations are expected on this regard.

## Canada

### Important Court Ruling on Treaty Interpretation - International Holding Company Structures

A Canadian lower court decision, *Prévost Car Inc v Her Majesty the Queen* released on April 22, 2008, provides valuable guidance on how receptive the courts are likely to be when the Canada Revenue Agency (CRA) challenges some international structures. The CRA has stated its intention to challenge certain international structures that result in reduced or nil withholding tax on dividends, interest or royalties from Canada, or other treaty benefits, especially structures that involve an “intermediary company” that does not have significant activities or other assets. The CRA argued unsuccessfully in another Canadian court decision (*MIL (Investments) S.A.*) that a non-resident had engaged in abusive “treaty shopping” that was subject to the general anti-avoidance rule (GAAR) when he chose to hold certain Canadian assets through a Luxembourg company.

In “*Prévost*”, the CRA took a different approach, arguing that a holding company established in a treaty jurisdiction (the Netherlands) was not the beneficial owner of the income in question (dividends). However, the court found in favour of the taxpayer, concluding that the dividends paid by the Canadian operating company to the Netherlands holding company were beneficially owned by the Netherlands holding company. The court determined that the relevant provisions of the Canada-Netherlands tax treaty required the court to look primarily to the domestic meaning of “beneficial ownership” in applying the dividend article. Implicitly, the court rejected the approach followed in at least one U.K. case, in which the court suggested that, when treaty interpretation is concerned, “beneficial ownership” has an “international fiscal meaning” different from its domestic law meaning. The CRA has not yet announced whether it will appeal the lower court’s decision.



## Ireland

### Reform of Taxation of Foreign Dividends

With effect from January 31, 2008 dividends received by Irish companies from both EU and double tax treaty resident companies will only be liable to Irish corporation tax at 12.5% (with a foreign tax credit) provided the dividends are sourced from the trading profits of EU or treaty resident companies. Dividends paid out of passive income, or paid by companies not resident in treaty countries will remain taxable at 25%. “Mixed” trading and passive dividends will be apportioned and each element taxed at the appropriate rate. However, there will be no apportionment of the passive element of a dividend where the paying company can meet a 75% trading profits test and the recipient company meets a 75% consolidated trading assets test. For foreign tax credit purposes, credits are computed on a per item basis, and then excess credits are transferred to an “active” and a “passive” basket (by reference to the rate at which the dividend has been taxed), much like the US position. Excess credits in the active basket can offset tax due on other active dividend income and is then carried forward

indefinitely to future years. Excess credits in the passive basket can offset tax due on all dividend income (both active and passive) and is then carried forward indefinitely to future years. Portfolio corporate investors (5% or less holdings) will be automatically deemed to have received dividends from EU or treaty resident companies out of trading profits and therefore subject to tax at 12.5%.

## Italy

### New Rules on Capital Gains Realized by Foreign Investors

On April 16, 2008, a Ministerial Decree modified the tax regime applying to capital gains realized by foreign investors on the disposal of qualified participations. Sales before December 31, 2008 should result in a reduced 11% tax cost on realized gains, compared to the 13.7% charge applicable from January 1, 2009. Under the old regime, capital gains realized by non-resident investors on the disposal of a qualified participation have been taxed at only 40% (i.e. 60% exempt) of their amount at a Corporate Income Tax Rate (CIT) of 33%. The resulting effective tax rate was 13.2% (= 33% x 40%). For non-qualified capital gains, a 12.5% tax applies with some exceptions. The Finance Bill 2008 reduced the CIT to 27.5% as from January 1, 2008. As a consequence, the effective tax rate on qualified capital gains amounts to 11% (= 27.5% x 40%). The new regime has changed the percentage of tax recognition of capital gains realized on the disposal of qualified shareholdings. The change, effective as from January 1, 2009, implies that only 49.72% of the gain will be recognized for tax purposes, resulting in an effective tax cost of 13.7% (= 27.5% x 49.72%). The decree does not affect foreign investors protected by a double tax treaty.

## Luxembourg

### 2009 Tax Reform

In his annual State of the Nation speech, the Luxembourg Prime Minister announced two tax measures to promote Luxembourg's international tax competitiveness: (i) Capital duty, which has already been reduced to a rate of 0.5% as from January 1, 2008, should be entirely abolished as from January 1, 2009, and (ii) the Corporate Income Tax rate (currently a global rate of 29.63% for companies having their

seat in Luxembourg city) should be decreased in several steps down to 25.5%. The real impact of this reduction is not yet known as it may be partially counter balanced by other tax measures due to budget constraints.



## Netherlands

### Participation Exemption

Based on recent informal discussions with the Dutch Revenue we understand that most ruling requests for the application of the Dutch participation exemption (the tax authorities mentioned a percentage of more than 95%), are granted as regards subsidiaries with active operating activities and subsidiaries acting as parent companies for an active (sub)group. Exceptions to the aforementioned policy apply to situations in which clearly the proceeds from "passive" financing and licensing activities are to be sheltered under a Dutch holding company.

### Participation Exemption – Explanatory Decree

On March 6, 2008 the Dutch Ministry of Finance published an explanatory decree providing further guidance with respect to the application of the Dutch participation exemption. Under the legislation effective as from January 1, 2007, the Dutch participation exemption applies to shareholdings of at least 5%, unless the shareholder's interest is considered a low taxed portfolio investment. Whether or not a shareholder's interest in a company is a

portfolio investment is to be determined on the basis of the direct / indirect assets of that company (“asset test”). Although this would in principle require the preparation of a detailed aggregated balance sheet, the decree indicates that in many cases a consolidated commercial balance should suffice to demonstrate the nature of the (sub)group’s activities. As mentioned in our previous newsletter, recent experience shows that most ruling requests in respect of active operating activities and subsidiaries acting as parent companies for an active (sub)group are granted. The Decree further provides approval that successive loans within a group of companies should not result in a duplication of ‘portfolio assets’ for the purpose of the asset test.



## Portugal

### New Disclosure Rules on Aggressive Tax Planning Schemes (TPS)

Legislation requiring tax intermediaries to disclose tax planning schemes or advice on schemes to client enters into force on May 15, 2008. TPS involving (i) tax havens; (ii) financial transactions allowing income requalification or change of beneficiaries; (iii) use of fully or partially tax exempt entities; (iv) use of tax losses, as well as any TPS proposed by tax promoters that have their liability limited, have to be disclosed to the tax authorities. Penalties for non-compliance can arise up to a maximum of Euro 100,000.

## United Kingdom

### Update on Controlled Foreign Company (“CFC”) anti-avoidance

The Budget on March 12, 2008 introduced anti-avoidance changes to the UK CFC rules. One change amends the definition of control for the purposes of determining whether or not a company is a CFC. The amendments now take into account rights to income, share capital and assets of the company, rather than just voting rights under the current legislation. Companies with voting rights held outside the UK but with profit entitlement retained within the UK should review their structures to determine whether additional companies now fall within the CFC regime and whether one of the statutory exemptions is available. The other changes amend the scope of “profits” for a number of purposes within the CFC regime where a CFC has an interest in a partnership or trust. Groups with non-UK companies holding such interests should consider whether a statutory exemption is available based on those profits.

## International Treaties to avoid Double Taxation

### Belgium – Brazil

Belgium and Brazil recently concluded a new tax treaty, replacing the existing one with effect from January 1, 2008. Dividend, interest and royalty withholding tax are capped at 10% if conditions are satisfied. Note that the tax treaty also contains a tax sparing clause (allowing a tax credit of local WHT increased by 5% if the conditions are met). The purpose of the tax treaty is to further promote investments in both contracting states.

### Spain – Malaysia

The Double Tax Treaty between Spain and Malaysia was signed on May 24, 2006. The Treaty entered into force on December 28, 2007. Its provisions apply to Spanish taxes for tax years starting from January 1, 2008. The text of the Treaty was published in the Spanish Official Gazette on February 13, 2008. The main highlights are: (i) Dividend taxation is capped: at 0% if the receiving company holds directly at least 5% of the capital of the paying company

and at 5% in any other case; (ii) Interest: 10% at source if the beneficial owner is a resident of the other contracting state; (iii) Royalty and technical assistance service taxation is capped: 7% for royalties and 5% for technical assistance services. Technical assistance services include any technical, managerial or consultancy services; (iv) Capital gains arising from the alienation of shares deriving more than 50% of their value, directly or indirectly, from immovable property, may be taxed in the State where the property is located; (v) Highlights of the Protocol to the Treaty: If Malaysia signs a Treaty with another OECD / EU member that provides lower withholding tax rates (including zero) for interest, the rates of the Spanish - Malaysian Treaty will be replaced upon request of the Spanish authorities. Articles 6 to 21 will not apply to beneficiaries of the 1990 Labuan Offshore Business Activity Act. Articles 10, 11, 12 and 13: a holding company with at least 50% non-resident shareholders may not be entitled to the benefits of these articles, unless it also carries on an active trading, or there is a Competent Authority agreement allowing it to claim such benefits.

### Singapore - Malta

The treaty with Malta was ratified and entered into force on February 29, 2008. It will apply to income derived on or after January 1, 2009.



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