VECO TAX News

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IN THIS EDITION

CHINA/HONG KONG

Tax Arrangement with Hong Kong: guidelines on beneficial ownership

On 12 April 2013 China's State Administration of Taxation (SAT) issued the circular n. 165 providing some guidelines on the interpretation of beneficial ownership with reference to the dividend article of the Tax Arrangement with Hong Kong.

Although the circular n. 165 is addressed to the local SAT offices, the guidelines are expected to be followed by all tax authorities in China with respect to the application of similarly worded dividends articles in China's tax treaties.

Circular n. 165 supplements the guidelines laid down in the circular n. 601 aimed at identifying the beneficial owner of particular items of income under the dividend, interest and royalties articles of China's tax treaties. In particular, circular n. 601 sets out a number of "negative factors" that could affect the status of beneficial owner.

Circular n. 165 of 2013 addresses the application of the following factors:

1. Income retention

The status of beneficial owner may not be recognized if the applicant has the obligation to pay or distribute all or a substantive part of its income (e.g., 60% or more) to a resident of a third country within a prescribed frame of time (e.g., within 12 months).

Circular n. 165 clarifies that this "negative factor" is irrelevant if the applicant does not distribute its profits.

In the case where the applicant's profits are distributed to a non-Hong Kong immediate parent company, the applicant must submit documentary evidence about its obligation to make such distribution, including any contractual obligation. The competent tax authority should formulate their conclusions on this "negative factor" based on the evidence provided.

Circular n. 165 may be read to imply that the condition related to the income retention is not applicable when a Hong Kong resident company distributes profits to another Hong Kong resident company.

2. *Business activity*

Another "negative factor" is given by the fact that the applicant has no business activities other than holding the assets from which the item of income is derived.

Circular n. 165 provides that the existence of this single negative factor should, in and of itself, not disqualify an applicant from being regarded as the beneficial owner of the dividend. Therefore, a single project holding company should not be denied the treaty benefits simply based on the fact that it has only one investment. All the other factors should be taken into account in assessing the status of beneficial owner.

3. Assets

Another factor is that the applicant's assets, personnel and size are relatively small and not commensurate with the income generated.

Circular n. 165 specifies that when determining whether the assets and staffing are commensurate with the income, all the relevant facts and circumstances should be taken into account.

In particular:

a) assets should not simply equal registered capital. The examination should consider the source of funds and the investment risks borne;

b) for staffing, the analysis should look beyond the number of, and expenditure for, staff and focus on the individual staff responsibilities and the nature of their work. For example, an applicant with only a few staff members should not be viewed unfavourably as long as the staff is qualified for, and normally engaged in, formulating investment strategies and making decisions for the applicant.

4. Right of control and disposal

A further negative factor is that the applicant has no or almost no controlling rights or disposing rights on the income or the assets or rights that generate the income, or bears no or very little risk.

Circular n. 165 clarifies that the right of control or disposal should not be disregarded simply because the Hong Kong company is controlled by its immediate holding company. Instead, the following fact should be considered:

a) whether the articles of association or other legal documents allow the Hong Kong company to exercise the power of control and disposal;

b) whether the Hong Kong company has exercised such power to use the dividends other than for additional distributions (e.g., to invest in projects or to engage in merger and acquisition activity);

c) whether the decision to pay dividends is made by the Hong Kong company through board of director or shareholder resolutions.

5. Local taxation

According to circular n. 165, the fact the Hong Kong does not tax offshore source of income should not be regarded as a key factor in determining whether the Hong Kong company is the beneficial owner of the dividends received.

Furthermore, circular n. 165 addresses the application of the safe harbour rule laid down in the bulletin 30. Such rule recognizes the status of beneficial owner to a company that (i) is listed in a contracting State or (ii) is 100% owned, directly or indirectly, by a company listed (and resident) in a contracting State.

Circular n. 165 provides that the failure to meet the safe harbour rule does not necessarily result in the denial of beneficial owner status. In other word, the company failing the safe harbour rule should be allowed to go through the normal process for the beneficial ownership assessment.

This clarification is of particular relevance in the case where:

a) the applicant is, directly or indirectly, wholly owned by an unlisted Hong Kong company;

b) the applicant, although ultimately controlled by a Hong Kong company, is immediately owned by an intermediate holding company located in a third jurisdiction.

Form a procedural standpoint, on 13 September 2013 the China's SAT issued some guidelines on the tax residence certificate for the purposes of the application of the Tax Arrangement between China and Hong Kong.

As a general rule, in the case where the applicant for the treaty benefits is a legal the entity, the Chinese tax authority assesses the status of tax residence in Hong Kong on the basis of the certificate of incorporation issued by the Hong Kong Registrar of Companies or the business registration certificate.

However, a tax residence certificate issued by the Hong Kong tax authority is required in the case:

a) the Chinese tax authority is suspicious about the applicant's resident status;
b) the documents presented by the applicant are not sufficient to prove the resident status, in particular in the cases where a legal entity incorporated outside Hong Kong claims that its effective management is in Hong Kong.

PORTUGAL /PANAMA

Removal from the black list

On 31 July 2013, the government of Panama issued a press release indicating that Portugal has undertaken actions to remove Panama from the black list of tax heavens.
The removal from the black list represents a further step aimed at strengthening the relationship between the two countries. As an earlier step, in 2010 Panama and Portugal signed a tax treaty. The treaty entered into force on 10 June 2012; it generally applies from 10 June 2012 in respect of exchange of information matters and from 1 January 2013 for withholding and other tax matters. In particular, it is worth mentioning that the article on exchange of information follows the OECD standards as it does not permit the contracting States to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity.

CYPRUS

Registration of trust introduced

On 9 September 2013, the amendments to the law regulating trust were published in the Official Gazette. Under the new provisions, persons managing and administering trusts are obliged to determine, verify and maintain the following information:
a) the beneficial owner;
b) the settlor;
c) the trustee;
d) the beneficiary;
e) the protector;
f) the investment and tax consultants and accountants;
g) the activities of the trust.
Such information may be disclosed or rendered available for inspection by the competent authority only upon request.
In their course of business, the persons managing and administering the trust will provide the newly established Trust Registries with the following details:
a) name of the trust;
b) name and address of the trustees;
c) date of creation of the trust;
d) date of changes of the law governing the trust;
e) date of termination of the trust.
Such information may, under conditions, be exchanged among the various trust registries but is not available to the public.

SINGAPORE

International cooperation framework

On 14 May 2013 the Ministry of Finance, the Monetary Authority and the Tax Authority (IRAS) of Singapore issued a joint press release on plans to bolster Singapore's framework for international cooperation so as to combat cross-border tax evasion. The press release outlines the following four key measure:
1. Exchange of information (EOI). Singapore is committed to extend the EOI assistance to all existing tax agreement partners, without having to update the terms of its bilateral agreements.
2. OECD Convention of Administrative Assistance. The press release announces that Singapore is going to sign the OECD Convention on Mutual Administrative Assistance in tax matters. A press release published by OECD on 29 May 2013 reports that Singapore has effectively joined the OECD Convention. Singapore's network of exchange of information partners is thus expanded by 13 jurisdictions, including Brazil and the United States.
3. Gathering of information. Singapore will allow the IRAS to obtain bank and trust information from financial institutions without the need for a court order. This change is designed to streamline the administration of the EOI framework. It should, however, be noted that the rest

of the current safeguards will remain in place, such that taxpayers' rights will continue to be observed.

4. FATCA. Singapore will conclude an inter-governmental agreement (IGA) with the United States in order to implement the Model 1 Foreign Account Tax Compliance Act (FATCA). The IGA will streamline compliance with the FATCA provisions by foreign financial institutions (FFIs) in Singapore. Significantly, under the Model 1 framework, FFIs will report account information to the Singapore authorities that will exchange the information automatically with the US Internal Revenue Service (IRS). This will eliminate the need for Singapore FFIs to enter into FATCA agreements individually with the IRS and to report account information directly to the IRS.

FRANCE/ SWITZERLAND

Inheritance Tax Treaty

On 11 July 2013 France and Switzerland signed a new inheritance tax treaty. Once in force, the new treaty will replace the one signed in 1953.

Under the 1953 treaty, which generally favoured Swiss residents, the taxing powers were attributed to the jurisdiction in which the deceased lived. This means that a Swiss resident could leave Swiss assets to his French-resident relatives without subjecting those assets to French inheritance taxes. Because inheritance taxation is much more favourable in Switzerland, in 2011 France informed Switzerland that it was considering denouncing the 1953 treaty as it had created significant tax losses. To avoid a termination, France and Switzerland began negotiating a revision that has resulted in the treaty signed in 2013.

The main changes of the new treaty are the following:

1. Residence of the heirs. Inheritances will be taxed according to the jurisdiction in which the beneficiary is resident. Therefore, France would be able to tax heirs domiciled in France in the case they inherit goods from a person resident in Switzerland. However, this taxation would apply provided that the heirs have been resident in France for at least eight of ten years preceding the year in which they receive the goods. It should be noted that, in absence of a treaty, French tax law provides that this period is six out ten years. Taxes paid in Switzerland can be deducted from the inheritance tax due in France.

2. Real estate companies. Properties held indirectly through a company would be taxable in the jurisdiction where those properties are located. Therefore, if a Swiss resident person owns property in France through a company, such property would be subject to French inheritance taxes. This taxation would apply only if the deceased owns at least half of the company and the properties represent more than a third of the total assets of this company. For example, in the case of a deceased person in Switzerland who owned 50% of the shares of a company whose real estate component represents less than 33%, taxation would occur in Switzerland.

Real estate assets used by a corporation in its own commercial activity would not be taken into account.

The new treaty will enter into force after the text is approved by the French and Swiss parliaments and the deadline for the optional referendum (three months in Switzerland) has expired. Originally, the application of the agreement had been envisaged from 1 January 2014.

The treaty's protocol provides for enhanced administrative assistance between the two countries on all tax issues. The exchange of letters of 11 February 2010, which restricted the scope of information exchange on holding bank accounts, should be terminated as stated in the joint statement. The ministers have agreed to establish a joint working group on the topics of administrative assistance in tax matters, regularization of untaxed assets, and lump sum taxation.