Accountants, Tax & Legal Advisers

TRUST ALERT

"Everything you always wanted to know about 'tax and audit', but were afraid to ask."

(inspired by Woody Allen)

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Trust Alert Index 2009

	Page
Edition 1	
Refund of foreign VAT	1
"Waiting time" and size criteria are critical in Dutch consolidation exemption	3
Dutch thin capitalisation rules	5
The Cyprus Holding Company regime	7
Edition 2	
Electronic invoicing for VAT purposes	1
Exemption from preparing financial statements	3
Main features of a Dutch Coop	4
Corporation Tax in Ireland	6
Edition 3	
New definition of tax-liable location for cross-border business services	1
In "nachgründung" transactions, an auditor's report is required	3
Base erosion rules on interest	5
Substantial interest and taxation of foreign corporate shareholders	6
Edition 4	
New Dutch white paper proposes significant fiscal changes	1
Mandatory group interest box	2
New limitations on interest deduction	3
Amendments to Dutch participation exemption	5
New (2008) disclosure guidelines regarding related party transactions	6
Edition 5	
Corporate income tax law adjusted	1
Dutch participation exemption for Real Estate subsidiaries	2
IFRS for Private Entities	4
Changing Income Tax Policies in China	6

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Dutch participation exemption for Real Estate subsidiaries

From 1 January 2007, the Dutch participation exemption was also made available for so-called real estate subsidiaries. A real estate subsidiary qualifies for the Dutch participation exemption if its assets on a consolidated basis consist almost completely out of real estate. Dutch tax law defines almost completely as: 90% or more. As such, dividends received from a (non-resident) real estate subsidiary are exempt from Dutch corporate income tax. The same exemption applies in case the shares of this subsidiary are sold.

With regard to the applicability of the Dutch participation exemption, it should be noted that the above mentioned requirement (90% or more) is a continuing test. Thus if a non-resident real estate subsidiary is contemplating a dividend distribution to your client's Dutch holding company its asset position should be determined (on a consolidated basis if applicable). Special attention should be paid to those real estate subsidiaries that, for example, rent their real estate and to subsidiaries that have other activities next to holding real estate. The reason for this is that renting generates liquid assets which can jeopardize the 90% real estate asset test.

Dutch participation exemption as of 1 January 2010

As described in our previous HLB Trust Alert regarding the 'white paper' published by the Dutch Under Secretary of Finance, the Dutch participation exemption is expected to change for the better. As of 2010 the Dutch participation exemption would be applicable for those subsidiaries that are not held as portfolio investments. A real estate subsidiary is not considered to be held as a portfolio investment if at least 50% of its assets consist of real estate.

As such the Dutch participation exemption can apply to subsidiaries whose assets consist of at least 50% of real estate instead of the current 90%. However, if a subsidiary does not meet the 90% real estate asset test (and the participation exemption is not applicable) but does meet the 50% real estate test, then the Dutch participation exemption will only be applicable for profits derived or value created as of 2010.

For the Dutch participation exemption to apply to dividends or capital gains, the years in which the profit was derived or value was created has to

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be assessed to see whether the subsidiary would qualify for the exemption in those years using the test applicable in those years.

To avoid any adverse Dutch tax consequences for your client, we advise you to contact your tax advisor if a real estate subsidiary is contemplating distributing a dividend or is going to be sold. Naturally, we can assist in this matter.

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IFRS for Private Entities

In issue 4 of Trust Alert 2008 (page 5/6) we briefly discussed IFRS for Private Entities (previously named “IFRS for Small and Medium-sized entities”). Since the International Accounting Standards Board (IASB) has released the final version of these Standards we would now like to update you about these Standards.

From January 1 2005, listed companies in the Netherlands (and EU) are obliged to prepare the (consolidated) financial statements in accordance with International Financial Reporting Standards. Non-listed companies are allowed to (voluntarily) apply IFRS. However, it appeared that not many companies decided to apply IFRS since this is considered to be too complex and too extensive.
Therefore the IASB decided to release a “light version” of IFRS, IFRS SME, which is not as complex and extensive as full IFRS. The final version of IFRS SME was released on July 9 2009.

Why has IFRS SME been developed?
IFRS SME is considered to be a good alternative to full IFRS since it is less extensive and complex. Furthermore it meets the need of stakeholders in the international environment who are looking for a uniform standard which makes it possible to compare financial information. At the moment companies can only choose local GAAP or IFRS. This makes it difficult to compare the information about companies in the same industry, in different countries.

Status of IFRS SME
The IASB is considered to be authoritative in the development and setting of international accounting standards. However it has no legal status. Standards become legal when they are adopted by a country or by the European Union. Therefore, at the moment it is not yet allowed to apply IFRS SME.
It is a matter for authorities in each territory to decide which entities are permitted or even required to apply IFRS for SMEs.

However it is expected that IFRS SME will soon be incorporated.
In August 2009, South Africa became the first country to adopt IFRS SME as standard.

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Main differences with full IFRS

One of the main differences with full IFRS is that IFRS SME has reduced the disclosure requirements. For example, the disclosure requirements for financial instruments has significantly been reduced.
Besides these disclosure requirements, IFRS SME has also simplified the recognition and measurement requirements. When there is a policy choice, the IFRS for SMEs generally adopts the simpler option.

Treatment of goodwill and pension obligations, in particular defined benefit obligations, can be regarded as one of the most important differences. Full IFRS requires impairment testing on goodwill. Under IFRS SME goodwill is carried at cost less any accumulated amortisation and any accumulated impairment losses.

Defined benefit plans under full IFRS require the accrued benefit valuation method (the projected unit credit method). It is normal practice for entities to engage an actuary to perform the actuarial valuation needed to calculate its defined benefit obligation. Under IFRS SME, it is allowed to apply the “obligation approach” when the accrued benefit valuation method leads to undue costs and effort. In this case the costs for an actuary can be saved.

Relevance for trust sector

As we also indicated in our Trust Alert of 2008, companies served by the Dutch trust sector are normally part of an international group or structure. Since it seems that the introduction of IFRS SME is still a few steps away, we believe it is important to inform you about these new standards, the differences and the status. We are more than happy to help you with identifying the differences (if any) as well as by assisting with implementing these new standards in the financial statements of clients.

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Changing Income Tax Policies in China

Contributed by Shanghai ThinkBridge CPAs, HLB China

The Corporate Income Tax Law of the People's Republic of China ("the new CIT Law") which was approved by the National People's Congress on 16 March 2007 has been effective since 1 January 2008. It is a clear signal that China's central government has intentionally standardized treatment for all enterprises in China. Especially, it has eliminated the differences between local enterprises and foreign invested enterprises ("FIE"). Some of the key changes of income tax policies for foreign invested enterprises should be brought to the attention of foreign investors who are planning to make investments in China.

Income tax rate

According to the new CIT Law, the statutory income tax rate is 25% (before 2008: 33%). Under the old income tax law, most FIEs could enjoy a preferential tax rate (say 15% or 24%) by selecting their place of registration or enjoy a preferential tax holiday (say "two-year exemption and three-year half rate" policy) by establishing a manufacturing enterprise. Although some FIEs had the burden of a higher rate of 33% before 2008. The change of the corporate income tax rate as of 1 January 2008 has increased the tax burden for most FIEs.

Resident enterprises

The new CIT Law has extended the scope of resident enterprises. It stipulates that an enterprise which is set up in accordance with the law of the foreign country (region) still will be recognized as a resident enterprise if its actual administration institution is in China. This is to prevent that offshore companies become tax shelters.

Favorable tax policy

For FIEs, the new CIT Law has also canceled some favorable tax policies which were used to encourage them to make more investments, increase exports, etc. Furthermore, the distribution of dividends from a FIE shall be subject to income tax at a general rate of 10%. This is an important change because it was tax-exempted under the old income tax law before 2008. On the other hand, some revised principle has enabled enterprises which are involved in the agriculture, high-tech, environment-protection and R&D sectors to enjoy newly added favorable tax policies.

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Tax deduction

The new CIT Law has stipulated severe regulations to restrict the deductible amounts in terms of advertisement expenses and entertainment fees for taxable income purposes. On the other hand, it has changed tax treatment for asset recognition and depreciation to make it converge with general accounting principles.

Transitional provisions

For the FIEs who previously enjoyed preferential income tax policies, some transitional provisions are applicable:

From 1 January 2008, the lower preferential tax rates enjoyed by certain enterprises will gradually be increased to the statutory tax rate within 5 years of the date on which the new CIT Law came into effect. The existing tax rate of 15% applied to some enterprises was increased to 18% in 2008, 20% in 2009, and will be increased to 22% in 2010, 24% in 2011 and 25% in 2012, while the existing tax rate of 24% applied to other enterprises was increased to 25% in 2008.

From 1 January 2008, preferential tax policies enjoyed by certain enterprises, such as the "two-year exemption and three-year half rate" policy and the "five-year exemption and five-year half rate" policy, will continue to be enjoyed by such enterprises in the manner and for the period specified in relevant tax laws, administrative rules and other documents following the implementation of the new CIT Law. For enterprises that do not benefit from such preferential policies due to their non-profit making status, the period of time for which such policies apply will be calculated commencing from the 2008 tax year.

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