International Tax Planning Newsletter

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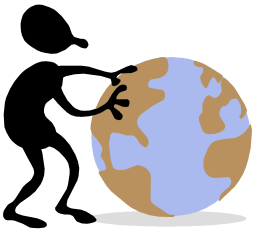
Change in the tax treatment of UK non-doms

Introduction

Following the announcement of a review of the tax treatment of non-domiciled individuals in 2003, the UK Government has made some major, although not entirely unexpected changes to the taxation of UK resident but non-domiciled individuals, so-called “UK non-doms”.

Current tax treatment of non-doms



Under the current rules, individuals with strong connections to other countries, i.e. who are not domiciled in the UK or are not ordinarily resident in the UK, can be resident in the UK but will not be taxed on income and capital gains arising outside the UK, provided this foreign income and gains are not brought into the UK; the so-called “remittance basis” of taxation.

Such individuals - according to the UK Treasury there are in fact only 112,000 registered non-doms- may fall into one of several categories, including employees on secondment to a business in the UK; entrepreneurs attracted to run their businesses in the UK as a major financial centre; spouses of UK residents; and the internationally wealthy.

They are only taxed on foreign income and gains if (and only to the extent that) such income and gains are remitted to the UK, which is in contrast to UK domiciled individuals, who pay tax on all of their worldwide income and gains on an “arising” basis.

New rules effective from 6 April 2008

The UK government appear to have decided that the advantageous treatment afforded to UK non-doms, which helps to attract them to the UK, is beneficial to the UK economy and should continue. However, they have also decided that the time is right to introduce a charge for this benefit.

The new rules, as announced by the Chancellor in the pre-Budget report 2007 of 9 October and outlined below, will take effect from 6 April 2008. There will be consultation on the detail of the changes based on draft legislation due to be published later this year.

Use of remittance basis of taxation only if payment of additional tax charge of GBP 30,000

As from 6 April 2008, non-domiciled individuals who have been resident in the UK for seven years or more (including years prior to 2008) will be able to continue using the remittance basis of taxation only if they pay an additional tax charge of GBP 30,000 per year.

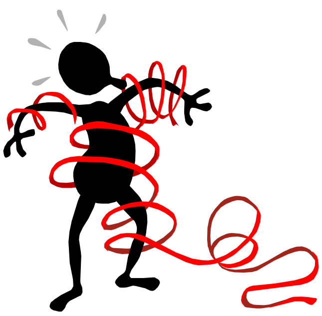
Use of remittance basis only if payment of additional tax charge of GBP 30,000

Where an individual decides not to use the remittance basis and not to pay the additional tax charge, he or she will be taxed on their worldwide income, whether remitted or not.

The seven year time limit runs from the first year of residence in the UK, i.e. if the individual has already been UK resident for five years, the new rules will apply after a further two years. The Government also intends to consult on whether individuals who have been resident in the UK for longer than 10 years should make a greater contribution.

Automatic end to entitlement to certain personal allowances

The new legislation which will come into force from 6 April 2008, will also end the automatic entitlement to certain personal allowances for individuals resident in the UK who are using the remittance basis, unless their annual un-remitted foreign income is less than GBP 1,000. This is likely to cost at least GBP 2,000 per annum.



Other changes to the remittance basis of taxation

In addition, a number of alterations will be made to the remittance basis of taxation, which are aimed at tightening up the relevant rules:

- Changes to the rules to determine UK residence will also be brought in from 6 April 2008. Under current rules, an individual who is present in the UK for 183 days or more in a tax year is regarded as resident. Alternatively an individual can be resident if visits to the UK amount to an average of more than 90 days per annum. It has been normal practice to treat the day of arrival in and day of departure from the UK as being days of absence for this purpose. From 6 April 2008, the days of arrival and departure will be regarded as days of presence when determining the residence status of an individual. This measure may affect anyone who claims to be non-UK resident for tax purposes but who spends a significant amount of time in the UK, irrespective of where he or she is domiciled.

- At present, offshore investment income, which is taxed on the remittance basis, is taxable in the year of remittance, but only if the source of that income is in existence in the tax year in which the remittance arose. This "source ceasing" rule is to be removed with effect from 6 April 2008. This means it will no longer be possible to cease a source of income in one tax year and remit funds tax-free in the following tax year, e.g. by closing a bank deposit account in one tax year and remitting the accumulated interest from that account in a subsequent tax year.

- It will no longer be possible to remit income arising in one year tax-free the following year by claiming the remittance basis in the first year but not the second.

- There will also be a tightening of the rules relating to the use of offshore companies and trusts to convert UK source income and gains into overseas income and gains. Using companies and trusts in this way is not unusual amongst non-UK doms and, as far as they are concerned, the devil is likely to be in the detail.

- A general extension of anti-avoidance legislation, which currently do not apply to individuals using the remittance basis.

Going forward

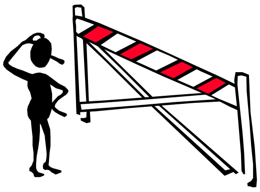
The new rules represent a major change in the position of non-domiciled tax payers. The new tax treatment of UK non-doms will be a matter for them to choose. Going forward, such taxpayers will need to calculate whether they are better off paying the annual charge of GBP 30,000 or giving up the benefits of their status in relation to their foreign income and gains.

Please note that only limited information is available in respect of these new proposals, and action should not therefore be taken on the basis of this brief synopsis. ■

Luxembourg capital duty to be abolished

Only 7 EU Member States to levy capital duty
On 4 December 2006, the European Commission proposed a phasing out of capital duty by 2010. Capital duty is an indirect tax levied on contributions of capital for capital companies and restructuring operations involving capital companies. Currently, only 7 EU Member States (Greece, Spain, Cyprus, Luxembourg, Austria, Poland and Portugal) continue to levy a capital duty.

Proposal of the European Commission
Given its detrimental economic effects, it is an obstacle to economic growth and therefore the European Commission proposed to abolish capital duty and to reinforce the prohibition on creating or levying other similar taxes.



The proposal of 4 December 2006 gives a phasing out in two steps:

It proposes a limit of 0.5% on the rate of capital duty by 2008 and a phasing out of capital duty by 2010.

Luxembourg Bill of 10 October 2007
Supporting the EU proposal, the Luxembourg government introduced a Bill regarding the 2008 Budget on 10 October 2007, wherein it announced a gradual abolition of the 1% capital duty, which is currently due on contributions of capital to Luxembourg companies and partnerships.

Reduction to 1% effective 1 January 2008, abolition by the end of 2009
Pursuant to the Bill, the capital duty will be reduced from 1% to 0.5% effective 1 January 2008. Furthermore, in the explanatory comment to the Bill the government announces a complete abolition by the end of 2009. ■

China enacts new enterprise income tax law

Effective as of 1 January 2008
On 16 March 2007, the National People's Congress of the People's Republic of China enacted the new Enterprise Income Tax Law which will take effect on 1 January 2008. Implementation rules to the new law are expected to be published shortly. The content of the new law is summarized below.

Scope of application
The new law applies to enterprises and organizations deriving income within China. Self-employed individuals and partnerships are not subject to the enterprise income tax.

Level playing field for foreign and domestic enterprises
From 1 January 2008, all foreign or domestically owned enterprises in China will be on a level playing field regarding tax as the new law joins the two existing sets of income tax laws applicable to foreign-invested enterprises ("FIEs") and domestic enterprises:

1. The Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises, which applies to foreign-invested enterprises (FIEs) and foreign companies) and
2. The Provisional Regulations of the PRC on Enterprise Income Tax, which applies to domestic enterprises.

Tax liability of resident and non-resident enterprises
A resident enterprise is defined as:
- An enterprise established in China; or
- An enterprise that has been established under foreign laws but whose effective management is in China.

A non-resident enterprise is defined as an enterprise:
- An enterprise established under foreign laws, with an establishment, office, etc. in China but whose effective management is not in China; or
- An enterprise that is not established in China and does not have an establishment, office, etc. in China, but derives income from sources in China.

A resident enterprise is subject to income tax on its worldwide income while a non-resident enterprise is only subject to income tax on its income derived from sources in China.

Reduction standard tax rate to 25%
The new law defines reduces the standard tax rate from 33% to 25%, but removes many tax rate reductions and tax holidays currently available to FIEs.

Tax incentives for FIEs are industry and technology-focused
Rather than focusing on location and being manufacturing and

export-focused, the tax incentives for FIEs provided in the new law are industry and technology-focused. China has been shifting from the previous economic strategies of bringing wealth to the people in particular regions first, securing employment of its masses and achieving growth through exports, to the current focus of bringing economic development to all regions of China and achieving growth through satisfying internal demand – so this change is tax law coincides with this change in strategy.

While the new law will increase the income tax burden of many FIEs that are currently receiving tax incentives, it will also decrease the income tax burden of some others, such as those who are not currently entitled to tax rate reductions or tax holidays.

Introduction of a 20% dividend withholding tax
At present dividends paid by a qualified foreign investment enterprise to a foreign investor are exempt from withholding tax. Under the new tax law, the standard withholding tax rate for dividends will be 20%.

The distribution of dividends by a qualified foreign investment enterprise (25% of the foreign participation) to it's foreign investor would be subject to a 10% withholding tax. The distribution of dividends by a foreign investment enterprise, which is designated as high and/or new technology by the State Council, should continue to be exempt from withholding tax.

Summary of the new tax law
Below, we will give a summary of the most important features of the new law.

1. Tax rate

- The standard tax rate is reduced (from 33%) to 25%.
- A tax rate of 20% is available to small-scale enterprises deriving small profits.
- The rate of enterprise income tax on investment income derived by a non-resident without an establishment or place in China is 20%.
- Hi-tech enterprises that are encouraged by the country will enjoy a 15% tax rate.

2. Tax payers

- The new tax law applies to enterprises, i.e. organisations that derive income.
- The concept of a tax-resident enterprise, which is new to China’s income tax system, is introduced.
- Resident enterprises are enterprises established under the laws of the People’s Republic of China (“PRC”) whose effective management is based in China.
- A resident enterprise is subject to tax on its worldwide income.
- Domestic enterprises that have set up foreign companies as holding companies will have to consider whether these foreign companies will be caught in the PRC tax net as resident enterprises, on account of having their place of effective management in China.
- An enterprise established outside China may be regarded as being resident in China if its effective management is in China, and such an enterprise will be subject to tax on a worldwide basis. An enterprise will be deemed to be effectively managed in China if the overall management and control of the production and business of the enterprise is in China.
- A non-resident enterprise is subject to tax on income derived from its place of business in China and income earned outside China that is effectively connected with its place of business in China.
- China-sourced dividends, rentals, interest, royalties, capital gains and other income of a non-resident enterprise and which is not effectively connected with its place of business in China will be subject to withholding tax.
- A tax year is referred to as a calendar year starting from 1 January to and including 31 December each year. An enterprise is required to file the tax return within 5 months after a tax year is ended. The tax must be calculated and paid in the Chinese currency. If a provision of this law conflicts with that of a tax treaty concluded by China, the provision of the tax treaty will prevail.

3. Taxable income
Taxable income is defined to include income from: the sale of goods; the provision of labour services; the disposal of property; dividends, profit and other returns on equity investment; interest; rent; royalties; and donations.

4. Exempt income
The following income is not subject to tax:

- Funds allocated by the government.
- Income from government charges and government funds.
- Other income that is specified by the State Council to be non-taxable.

5. Non-deductible expenditures
Expenditures that are non-deductible for tax purposes include:

- Dividends, profit distribution and other returns on equity investment.
- Enterprise income tax.
- Fines for late tax payments.
- Certain expenditures for non-business purposes.

6. Loss relief
Losses incurred in a tax year can be carried forward for 5 years. Losses incurred by an overseas establishment of an enterprise may not set off against the profits attributable to its establishments in China.

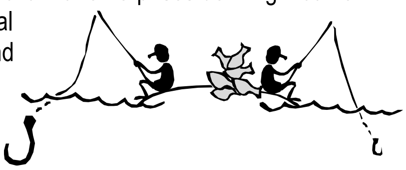
7. Tax base for income derived by a non-resident enterprise
Dividends, profit distributions, other returns on equity investments, interest, rent, and royalties are taxed on a gross basis.

Taxable income derived from disposal of property should be calculated on the net basis (i.e. proceeds from sale less the value of acquisition). Other taxable income has to be computed by reference to one of the bases mentioned above.

8. Tax Incentives

Tax incentives that are introduced are technology and industry focused and apply across the nation rather than being location-oriented. They include:

- Tax holiday incentives for manufacturing and exporting FIEs (i.e. the 2-year exemption and 3-year at half rate tax holiday and extended tax holiday) and many location-based tax rate reductions will no longer be available.
- The dividend reinvestment tax refund for foreign investors of FIEs is also being withdrawn.
- Tax exemption or reduction for enterprises deriving income from agriculture, animal husbandry, forestry and fishery industries, encouraged infrastructure projects, qualifying environmental protection, energy or water-saving and technology projects.



- A tax rate reduction to 15% for 'encouraged' hi-tech enterprises.
- Venture capital enterprises making 'encouraged' investments will be eligible to reduce taxable income by an amount equal to a percentage of the investment.
- Income derived by enterprises engaged in comprehensive utilisation of specified resources to produce stipulated products will be reduced in calculating taxable income.
- A percentage of the investment by an enterprise in purchasing equipment specifically for the purpose of environmental protection, production safety or energy or water saving can be set off against tax payable.
- Super-deductions are available for qualified R & D expenditures, salaries and wages of the disabled and qualified unemployed persons.
- Tax incentives for encouraged industries in certain regions (not specified in the law but we believe it is likely to be the Western region).

9. Foreign Tax Credits

Taxes paid on foreign income may be credited against taxes due in China provided that the tax credit does not exceed the amount of the tax payable on such income according to the enterprise income tax law. The unused foreign tax credit can be carried forward for 5 years. Subject to the same credit limitation, a tax credit can also be granted to the underlying corporate income tax that is attributable to dividends, profit distributions or other returns on equity investments received by the resident enterprise.

10. Withholding Tax

- The standard withholding tax rate for interest, dividends, rental income, royalties, capital gains and other income will be 20%, although it is said that in the implementation rules to new Enterprise Income Tax Law it is mentioned that the withholding taxes on interest, royalties, rentals, and capital gains should remain at 10%.
- The payer of dividends, interest, rent, royalties and other income to a non-resident enterprise is obliged to act as withholding agent. The withholding tax must be filed and paid within 7 days of the due date of the withholding tax. The payer of project price and fees for labour service can be designated as withholding agent and is therefore required to withhold tax on the amounts paid.
- If the withholding agent falls to fulfil the withholding obligation, the taxpayer must pay the tax at the place where the income arose. If the taxpayer falls to make the tax payment, the tax authority may recover the tax payable from other payments due to the taxpayers within China.

11. Anti-avoidance/ abuse measures

- Based on transfer pricing rules, the tax authority has power to make adjustments if the transactions between related parties are not concluded at the arm's length and as a result the tax due or taxable income is reduced.

  In determining taxable income, the costs shared by related parties in respect of joint development or transfer of intangible assets, or provision or receiving of services, should be allocated at the arm's length. An enterprise is required to provide documentation on the transactions of related parties and submit report on the related transactions together with financial reports. An enterprise may apply to the tax authority for an advance pricing agreement.
- Based on Controlled Foreign Corporation rules, a portion of income from an overseas controlled enterprise must be included in the taxable income of the resident enterprise controlling the first enterprise if:
  - The overseas enterprise is established in a jurisdiction where the tax burden is obviously lower than 25%; and
  - The overseas enterprise does not distribute or distribute a little without justified operational reason.
- Based on thin capitalization rules, the interest on the excess debt may not be deducted in computing taxable income if the debt and equity ratio exceeds the prescribed standard. The new law does not state what the prescribed standards are, but the authorities are expected to issue further details/ clarifications.
- The implementation rules to new law are said to provide separate debt-equity ratios for financial institutions and other industries.
- Under a general anti-abuse rule, the tax authority is empowered to make adjustments on arrangements which can result in reduction of tax payable and are made without any justified business reason.

12. Permanent establishment

The new law provides that a non-resident enterprise that has an establishment or place in China shall be subject to tax on the income derived by such establishment or place from sources in China or from sources outside China but effectively connected to China.

Under the draft rules, it is said that an establishment or place has a definition similar to existing laws but the term business agents has been expanded to include persons and entities that regularly represent the non-resident enterprises in business (services), other than purchase and sale.

13. Transitional Relief

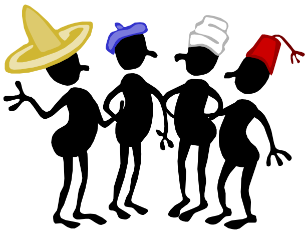
- Enterprises approved to be established prior to the promulgation of the new tax law that are enjoying a preferential tax rate under existing law are given a period of five years to progressively move up to the 25% tax rate under the new law.
- Enterprises entitled to tax holidays under existing law are permitted to continue their tax holiday after the coming into effect of the new law.
- Enterprises that have not commenced their tax holiday on account of losses, the tax holiday period will be deemed to commence upon the effective date of the new law.

Revisit international tax planning strategies into China

Foreign investors will need to consider the impact of the new tax law on their existing enterprises and future investments in China. They may wish to re-examine tax planning strategies of their existing Chinese subsidiaries, such as:

- How to make the best use of their existing tax incentives.
- The operational considerations such as availability of resources and infrastructure.
- The proximity to market

These operational matters may play a larger role in planning rather than simply tax considerations. Also, the abolition of broad-based tax incentives currently available to FIEs will mean that China will cease to be a low-tax country. With the introduction of various anti-avoidance provisions in the new tax law that are new to China, it is important for multinational groups with investments in China to revisit their international tax planning strategies. ■



OECD removes the Marshall Islands from the list of unco-operative tax havens

On 7 August 2007, the OECD announced the removal of Liberia from the OECD's list of uncooperative tax havens, following Liberia's commitment to implement a programme to improve transparency and establish effective exchange of information in tax matters.

Liberia joins 34 other jurisdictions that have made similar commitments in relation to OECD's work to curb harmful tax practices. Only three countries remain on the OECD's list of unco-operative tax havens, published in April 2002: Andorra, Liechtenstein and Monaco. ■

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ITPS GROUP PROFILE

The International Tax Planning Newsletter is a quarterly newsletter of The ITPS Group, an independent provider of international tax planning and structure services. It provides these services in the Netherlands, the Netherlands Antilles, Aruba, the British Virgin Islands, Belgium and Luxembourg.

Needs of clients

As business is becoming more international, organizations are seeking ways to minimize the incidence of taxation linked to it. On the other hand, organizations as well as individuals are seeking international ways to optimize their profits and to protect their assets.

The increasing complexity of (tax) laws necessitates careful planning and consideration of the structure to be established and maintained. Customers require highly specialized professional services.

Mission

The purpose of ITPS is: doing the best the things that the customer values most. The focus is long term customer satisfaction.

The mission of the ITPS Group is to create value for it's customers through the provision of professional services in the field of international tax planning and structure, designed to optimize the customer's after tax profits.

Services

The objective of ITPS is to meet customer needs for international tax planning and structure by rendering "total offering" services with the highest standards of professional and personal service combined with complete confidentiality.

This comprehensive offering comprises not only the advice for international tax planning (i.e. for legal and tax questions), but also implementation to establish and maintain structures.

These services include, but are not limited to:

- International tax planning;
- Company formation, registered office facility, management, accounting and tax compliance;
- Trust and foundation formation and administration;
- Licensing and sub-licensing of intellectual property rights.

The services ITPS does not provide, but which we are rendered by correspondents, include auditing, legal opinions, litigation and portfolio investment.

Clients

The client base of ITPS consists of prominent individuals, including sportsmen and artists, small to large companies, including other professional firms, but also multinational (stock quoted) companies.

Why you should use ITPS

The ITPS Group holds an unique position in each of these jurisdictions for the following reasons:

1. Market oriented (and not product oriented):
ITPS focuses on meeting the needs of the clients;

2. Rendering international tax planning and structure (trust) services:
Tax planning and structure services are complementary. Planning is of no use if you do not structure it. Moreover you can not efficiently structure if you do not take the first step: plan the structure. Therefore, the services of ITPS are not restricted to trust services. Since ITPS has the combined skill and experience for more than ten years, high quality is ensured;

3. All included fixed fees for structure (trust) services:
In each jurisdiction, tax structure services are charged at annual fixed fees, generally payable in quarterly installments in advance. Tax planning services are charged at an hourly rate;

4. One contact person is possible for several jurisdictions;

5. Independent:
There is no conflict of interest. ITPS works with all other skilled professionals and (financial) institutions as the client deems appropriate;

6. Personal contact and continuity:
ITPS focuses on long-term customer satisfaction, providing proactive, personal, attentive and competent services;

7. Regular meetings:
Customers and correspondents are visited on a regular basis (three to four times a year) to touch base and to discuss opportunities and problems that may have arisen, without a fee being charged;

8. Tax sparring and education:
ITPS strives to built up a (tax) sparring relationship with customers and correspondents in order to keep each other abreast in a fast changing environment. A quarterly newsletter on international tax planning, the International Tax Planning Newsletter, is sent to inform customers and correspondents on the changes in legislation;

9. An excellent network:
Since ITPS is not part of an international network, it has built up a network of highly skilled professionals to work with.

For questions please contact
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