

# Global Dispatch

## Angola

### Angola proposes transfer pricing documentation rules

A draft legislation package has been issued that includes significant new rules for Angolan taxpayers concerning transfer pricing. This legislation is proposed to be inserted in the Statute of Big Taxpayers, which establishes, among other aspects, declarative and administrative obligations for such taxpayers. These rules will be applicable to Group A Corporate Income Tax taxpayers included on a list to be published by Ministerial Order of the Minister of Finance.

The taxpayers affected by these rules are covered on a draft list, already made available, that identifies the 300 companies that are the biggest taxpayers in Angola. With respect to transfer pricing, the new rules establish the mandatory preparation of a Dossier for each fiscal year that characterizes the relationships and prices established by the taxpayer with the companies with which they have "special relations," whenever the total turnover at date of closing of accounts exceeds 300 million UCFs (approximately USD 280 million).

The proposed legislation calls for the obligation of documentation applicable to tax years and transactions beginning or occurring on or after 1 January 2012. Taxpayers will have to justify arms-length pricing in the cases of commercial transactions of the taxpayer with other "special relations" entities, whether or not these transactions are subject to Industrial Tax. The proposed rules generally cover commercial transactions including any transaction of goods, rights or services, and they also include financial transactions. The Transfer Pricing Dossier would have to be prepared by each company individually and sent to the Tax Administration within six months of the date of closing of the fiscal year.

In general, the rules correspond to the basic principles established in the OECD Transfer Pricing Guidelines, with a key exception that the proposed rules have only three methods: comparable uncontrolled price, resale

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minus, and cost plus. Taxpayers with unique circumstances, facts and/or transactions may have difficulty fitting into one of the allowed methods, and this may give rise to controversy related to the potential use of alternative approaches (i.e., profits-based methods such as the Transaction Net Margin or Profit Split).

Finally, the penalties and other consequences related to this regime will be determined in the new General Tax Code, which has not yet been enacted.

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## China

### China announces new Shanghai VAT pilot to replace business tax

On 26 October 2011, Chinese Premier Wen Jiabao announced that beginning 1 January 2012, Shanghai would progressively implement a value-added tax (VAT) pilot program (Pilot Program) to replace the business tax (BT) in selected industrial sectors. If the Pilot Program is successful, its implementation will be expanded nationwide to certain industries that are currently subject to BT. Detailed implementation rules, including

how VAT rates are to be applied, are expected to be issued prior to 1 January 2012.

Key features of the Pilot Program include:

- ▶ Simplification of the indirect tax system under a VAT regime
- ▶ Selected regions and industries for participation
- ▶ Introduction of two new lower VAT rates of 11% and 6%, in addition to the current 17% (general rate) and 13% (for special industries)
- ▶ During the Pilot Program period, BT revenues will be treated as VAT Pilot Program revenues in participating locations
- ▶ Current BT incentive policies continue to apply during the Pilot Program period, but transitional adjustments to the incentive policies may be necessary, depending on specific features of the VAT system
- ▶ If certain conditions are met, an input VAT credit would be available to participating taxpayers

A VAT pilot working group is putting together implementation rules to provide more details on the Shanghai Pilot Program.

BT taxpayers who will be included in the VAT pilot and companies with customers and/or suppliers who will be included in the Pilot Program may need to identify suitable

and dedicated resources, assess impacts to their business operations and prepare for the changes. Consultation with tax professionals is also strongly recommended.

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## Colombia

### Colombia eliminates restrictions on foreign debt; intercompany loans now possible

The Board of Directors of the Colombian Central Bank on 28 October 2011 issued rules that loosen the restrictions on foreign debt, which will provide flexibility to companies operating in Colombia. More specifically, Resolution No. 5 of 2011 (Resolution No 5) permits Colombian residents to contract foreign indebtedness from any nonresident. Pursuant to section 24 of this rule, "Colombian residents may contract loans in foreign currency from nonresidents, regardless of the term of payment and the destination of the funds."

This new provision constitutes a major change to Colombia's foreign exchange control policy, as it eliminates the restriction set forth in Resolution 8 of 2000, under which Colombian companies were only entitled to obtain loans from foreign lenders recognized as financial institutions by the Colombian Central Bank, thus excluding any possibility for intercompany loans. This restriction made the use of back-to-back loans a common and accepted practice.

Under the provisions of Resolution No. 5 Colombian residents may validly obtain loans from all types of foreign entities, opening the door to intercompany loans as a valid mechanism for the funding of Colombian operations, even if the entity acting as a lender is not a financial entity. The assignment of an identification code from the Colombian Central Bank will be required.

It is important to consider that the following tax effects and requirements are triggered on intercompany loans:

- ▶ The foreign loan must be reported to the Central Bank prior to or simultaneously with its disbursement in order to comply with foreign exchange regulations. In addition, disbursement of the funds and repayment of the principal and interest must be channeled through the foreign exchange market (i.e., commercial



banks of foreign bank accounts registered and reported with the Colombian Central Bank).

- ▶ The loan transaction will be subject to transfer pricing regulations, as it is a transaction with a related party abroad. These rules require that, (1) the conditions of the loan should be determined in accordance with the arm's length principle; and (2) the operation should be subject to the formal transfer pricing compliance obligations (filing of a transfer pricing informative return and preparation of transfer pricing contemporaneous documentation).
- ▶ Interest payments abroad will be subject to 14% income tax withholding if the term of the loan is equal to or greater than one year (33% if granted for a term less than one year). A reduced income tax withholding may apply if the creditor and beneficiary of the interest payment are resident in a jurisdiction with which Colombia has a tax treaty (i.e., Spain, Chile and Switzerland).
- ▶ Interest payments will be deductible for income tax purposes (as well as any exchange losses), provided that the transaction complies with transfer pricing requirements.
- ▶ The liability on the loan held with a foreign related party will be disregarded as such for tax purposes, and it will be considered an increase in the equity of the Colombian company. This will have an impact in the determination

of equity based taxes such as the income tax under the presumptive income system and the equity tax. The above applies unless the foreign related party that grants the loan is a resident of a jurisdiction with a tax treaty with Colombia that includes a non-discrimination clause (i.e., Spain, Chile and Switzerland). In this situation, the liability should be accepted for tax purposes.

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### **Colombian tax authorities confirm application of nondiscrimination provision to deductibility of certain payments**

Colombia's National Tax and Customs Administration (DIAN) has accepted that the domestic limitation on deductibility of certain expenses paid to nonresidents is not applicable under the nondiscrimination clause included in the Colombia-Spain Double Taxation Agreement (DTA).

The DIAN issued its answer in response to a petition filed by Ernst & Young in Official Interpretation No. 077842 of 6 October 2011,

Article 122 of the Colombian Tax Code limits the deduction for Colombian income tax purposes

of expenses which are paid to nonresidents which are not-subject to withholding tax. The limit is 15% of net taxable income, prior to the deduction of these expenses. The DIAN expressly pointed out that "upon the existence of the non-discrimination clause included in an Agreement to avoid Double Taxation, the internal legislation of the Contracting States should recognize its prevalence."

Consequently, the 15% limitation of net income (before computing such payments), applicable to the deduction of payments paid abroad and not subject to tax withholding, does not apply to payments made to residents in Spain when the tax withholding is non-applicable by virtue of the provisions of the DTA. Under the treaty with Spain, the payment of interest to banks resident in Spain, and the payment of services to residents in Spain without a permanent establishment in Colombia (for concepts other than royalties) are not subject to withholding tax. In this regard, the DIAN "complemented" Opinion No. 103513 of 17 December 2009, which contained an opposite conclusion.

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# Japan

## Recent changes to the Japanese transfer pricing regime

A number of changes to Japanese transfer pricing legislation came into effect on 1 October 2011. Many of these changes along with other recent changes have the purpose of aligning Japanese legislation with the updated OECD Guidelines. In addition, further updates are expected in

forthcoming updates to the Transfer Pricing Administrative Guidelines (Administrative Guidelines).

### Introduction of the most appropriate method rule

The Japanese legislation previously employed a hierarchy of methods, in which the three traditional methods (comparable uncontrolled price, resale price and cost plus) were prioritized over the profit-based methods (profit split and transactional net margin method). The profit-based methods could only be employed if the three

traditional methods were not applicable. In accordance with the update of the OECD Guidelines, the amendments in Japan remove the hierarchy of methods and enable the selection of the most appropriate method.

In practical terms, this will mean there will be less of a burden for taxpayers to first dismiss the traditional methods as possibilities before applying profit-based methods.

This revision applies to financial years commencing after 1 October 2011. Further details regarding the



application of the most appropriate method rule are expected to follow in subsequent updates to the Administrative Guidelines.

### **Addition of the range concept**

Previously, with the exception of APAs, the position of the tax authorities has been that the transfer price should be determined at a point rather than using a range. The recent amendments clarify that a range of arm's length results is now acceptable and that if the taxpayer's results are within the range, the tax authorities should not issue an assessment. Furthermore the revision clarifies that when the result of the related party transaction falls outside of the range of arm's length results the adjustment will not necessarily be to the average point but should be made to a logical point taking into account the comparable transactions available. Further clarification on the application of the range is predicted to be disclosed within subsequent updates to the legislation and associated guidance.

### **Introduction of comparable and residual profit split methods into statute**

Previously, the comparable and residual profit split methods were included within a National Tax Agency circular regarding the statutory provisions rather than included in the statutes themselves. The change to include them into the law will provide certainty to taxpayers wishing to apply these

methods though it will also provide the same certainty to the tax authorities that they can use these methods to adjust the taxpayer's profits.

### **Clarification regarding use of presumptive taxation and secret comparables**

Further clarification regarding the application of legislation governing the use of presumptive taxation and secret comparables is expected in the forthcoming updated Administrative Guidelines.

Japan has made a concerted effort to internationalize its tax regime in recent years, through, for example, relaxing CFC rules, in order to help Japanese corporations compete with overseas companies. The recent amendments to transfer pricing legislation could be seen as part of this process. At the same time, however, transfer pricing is being enforced ever more strictly in order to prevent abuse by increasingly internationalized Japanese companies, as well as their inbound counterparts.

Similar to that of many countries struggling to maintain tax revenue, actual and apparent compliance with the legislation (through documentation for example) has become all the more effective in managing assessment risks in Japan.

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## **Malaysia**

### **Corporate tax incentives highlight Malaysia's 2012 budget**

On 7 October 2011, Malaysia's Finance and Prime Minister delivered his 2012 budget (Budget). The Budget includes incentives for certain services, reflecting their anticipated increased contributions to the country's economy. The Budget demonstrates Malaysia's commitment to become one of Asia's financial hubs, as well as its continued efforts to promote environmentally friendly initiatives.

The Budget, however, does not address goods and services tax matters that have been pending since December 2009. Additionally, the Budget is silent with regard to corporate and individual tax cuts.

Further guidelines containing detailed explanations are expected to be released in the future, but the timing is not yet confirmed. The two incentives discussed below are available for a specific period, during which applications must be submitted, but the timing of when the 5-year incentive period begins, is still pending.

#### **Incentives**

Industrial design service incentives: 70% of statutory income will be exempt from income tax for a 5-year period for applications received by the Malaysian Industrial

Development Authority (MIDA) between the period from 8 October 2011 through 31 December 2016. The incentive is to encourage creativity and innovation. Eligibility for this incentive includes, but is not limited to, being registered with the Malaysian Design Council and employing at least 50% Malaysian designers.

The income tax exemption applies to the following: fees and management income earned from the provision of qualifying treasury services to related companies; interest income received from related companies; interest income and gains received from placement of funds with licensed onshore banks or short-term onshore and offshore investments as part of managing the surplus funds within the group; foreign exchange gains from managing risks for the group; and guarantee fees arising from qualifying treasury activities. Interest paid to overseas banks and related companies and loan and service agreements will be exempt from withholding tax and stamp duties respectively, provided that these are related to the qualifying treasury activities. Treasury management center services are defined as the provision of financial and fund management services to related onshore and offshore companies. The incentive is available for applications received by the MIDA from 8 October 2011 through 31 December 2016.

The Kuala Lumpur International Financial District (KLIFD) tax incentives: 100% income tax exemption for 10 years and stamp duty exemption on loan and service agreements for KLIFD status companies, industrial building allowances and accelerated capital allowances for KLIFD Marquee Status Companies, and income tax exemption of 70% for a 5-year period for property developers in KLIFD. The incentives are meant to further transform Kuala Lumpur into an international hub for banking and financial and professional services.

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## **Netherlands/ Switzerland**

### **New Switzerland- Netherlands tax treaty to take effect**

Switzerland and The Netherlands signed a new treaty for the avoidance of double taxation in 2010. Now that the ratification process in both The Netherlands and Switzerland has been completed, the new treaty will take effect as of 1 January 2012.

### **New withholding tax exemptions**

One of the features of the new treaty includes the abolishment of withholding tax on interest payments. This is beneficial to Dutch lenders who own Swiss bank accounts or Swiss bonds, which are subject to a non-recoverable withholding tax of 5% on Swiss-sourced interest income under the current treaty. (The Netherlands does not impose a withholding tax on interest).

Moreover, the threshold for the dividend withholding tax exemption is reduced from a shareholding, of at least 25% to 10%. The new treaty also provides that the recipient of the dividend no longer needs to have "capital divided into shares" to qualify for the exemption. This reduces the current constraints on the type of holding entities that can be used. For example, under the new treaty, a Dutch cooperative (which does not have capital divided into shares) can now hold the shares in its Swiss subsidiary directly. The definition of a "dividend" is expanded to include income received in connection with a (partial) liquidation or the repurchase of own shares.

It is important to note that going forward, the exemption of dividend withholding tax will also become available to pension funds or social security schemes that beneficially own the underlying shares.

Shareholders that do not qualify for the exemption may benefit for a reduced rate of dividend withholding tax of 15%.

The new treaty retains the “main purpose” test requirement to avoid treaty shopping. Thus, where a Dutch or Swiss resident is interposed with the main purpose to obtain access to the benefits of the dividend article, the benefits of this article will not be available. This is provided for in the protocol to the new treaty.

The matrix outlines the improvements of the new treaty over the currently applicable treaty that was signed in 1951. The percentages in brackets indicate the minimum shareholding required to be eligible for the reduced rate or dividend withholding tax exemption.

	Dividends		Interest	Royalties
	Qualifying	Other		
<b>Current Treaty</b>	0% (25%)	15%	5%	0%
<b>New Treaty</b>	0% (10%)	15%	0%	0%

### Residence and capital gains on shares

The current treaty has very limited provisions on capital gains. It merely determines that, to the extent not determined otherwise in the treaty, income and capital are taxable in the state of which the owner of the capital, or recipient of income, has its residence. The current treaty also does not contain a specific capital gain provision for shares. Gain on shares is therefore taxed under the main rule: in the state where the beneficiary resides. In the new treaty, capital gains on shares are specifically addressed.

The new treaty provides that capital gains derived from the alienation of shares in a company, the assets of which consist directly or indirectly for more than 50% of immovable property situated in one of the contracting states, may be taxed in that state. However, if (1) the person who derives the gains owns less than 5% of the shares in the company prior to the alienation, or (2) the gains are derived in the course of a corporate reorganization, amalgamation, division or similar transaction, or (3) the immovable property is used by a company for its own business, such gains will not be taxable in that state.

Thus, where under the current treaty any capital gain realized by a Dutch or Swiss resident on shares in a company that holds Dutch or Swiss real estate assets is allocated exclusively to the state of the transferor, this will no longer apply under the new treaty. Going forward, such capital gain is allocated under the new treaty to the state where the real property is situated.

### End of the praecipium

The protocol to the current treaty includes an upfront allocation of 10% to 20% of the profits of a permanent establishment to the head office. This “praecipium” is abolished under the new treaty. Going forward the OECD-based principles will drive the determination of the allocation of profits to a permanent establishment.

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# Norway

## Norwegian National Budget 2012 will introduce changes to tax law

On 6 October 2011 the National Budget for 2012 was presented by the Norwegian Ministry of Finance. Highlighted below are some the main proposed changes relating to corporate taxation in Norway.

It is expected that the Norwegian parliament (Stortinget) will approve the proposals by the end of December 2011.

### Amendments to 3% rule under the Norwegian exemption method

The so-called 3% rule under the Norwegian exemption, requires that 3% of dividends and gains on shares qualifying for the Norwegian tax exemption system is included as taxable income and therefore, subject to 28% corporate taxation. Thus, only 97% of the qualifying income is currently tax free in Norway. The purpose of the 3% rule is to adjust for the tax deduction of expenses incurred with respect to the tax-exempt income.

Effective from 1 January 2012, the following changes to the 3% rule are proposed:

- ▶ Capital gains will no longer be subject to the 3% rule

It is proposed that the 3% rule will no longer apply to capital gains on shares. This means that capital gains derived

from the sale of shares in limited liability companies and partnerships, etc., which are qualifying companies under the tax exemption system, will be completely tax-exempted. The amendment will apply regardless of whether the exempted capital gain is derived from a Norwegian or a qualifying non-Norwegian company.

- ▶ Intra-group dividend distributions will no longer be subject to the 3% rule

It is proposed that dividends received from Norwegian group companies will no longer be covered by the 3% rule. Accordingly, dividends distributed between group companies which are covered by the Norwegian group contribution rules (i.e., more than 90% ownership), will be tax-exempt in the hands of the receiving company.

- ▶ The 3% rule will apply to tax-exempt distributions from partnerships

It is proposed that the 3% rule will apply to profit distributions from partnerships.

The taxable income of a partnership is calculated at the partnership level, and the result is allocated to the partners and taxed in their hands. Currently, income distributions from a partnership to a corporate partner are fully tax exempt, and not subject to the 3% rule.

Hence, the Norwegian group contribution rules are neither applicable nor necessary.

However, the introduction of the 3% rule on income distributions from a partnership implies that 3% of distributions from the partnerships will always be included as income in the hands of the corporate partner (i.e., the proposed group exemption referred to above is not applicable). As a result, there will be an asymmetric treatment between limited liability companies and partnerships which this time falls in favor of limited liability companies.

- ▶ Broadening the scope of the 3% rule to cover dividends received by foreign companies with a permanent establishment in Norway

Foreign companies are in general not covered by the 3% rule as they normally will not have the right to deduct expenses incurred with respect to tax-exempt income covered by the Norwegian participation exemption.

However, if the foreign company has a PE in Norway and the shares, etc., are owned in connection with the PE, the business will have the right to deduct the expenses incurred in relation to the shares, etc.,. The Ministry therefore proposes to broaden the scope of the 3% rule to cover distributions of dividends to foreign companies (resident both inside and outside the EU/EEA) with a permanent establishment in Norway.

### Limitation on the deductibility of losses on receivables between related companies

Effective from 6 October 2011, it has been proposed to limit the right for a parent company to deduct losses on receivables on related entities where the creditor has an ownership interest of more than 90%. This limitation shall not apply to losses on customer debt, losses on debts which represent previously taxed income by the creditor and losses on receivables arising from mergers and demergers.

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## Portugal

### Portugal introduces 2012 budget act proposal

The Portuguese Government recently presented to the Parliament the 2012 Budget Act Proposal (Proposal), which is now pending Parliamentary approval. Assuming the wording of the Proposal is approved in its current form, the following changes will be introduced to Portuguese tax law, to be enacted as from 1 January 2012. These changes are likely to have a more significant impact on cross-border transactions and foreign investment, in particular, within the financial sector.

### Capital gains earned by nonresident entities on transfer of securities and other financial instruments

Removal of the restriction on the capital gains exemption available to nonresident investors, introduced by the 2011 Budget Act (in force as from 1 January 2011), according to which the exemption would not apply if the capital gains were earned by residents in a country or a territory which has not entered into a double tax treaty or an exchange of information agreement with Portugal. The previous restriction - nonresident investors located in tax havens - continues to apply, along with the pre-existing restrictions.

### Increase in capital gains rate for individuals investors (residents or nonresidents)

The capital gains tax rate should be increased to 21.5% (instead of the 20% rate which is currently in force).

### Increased WHT on investment income obtained by entities domiciled in a "black-list" jurisdiction

The domestic withholding tax rate on investment income paid to entities resident in a country, region or territory included on a list approved by a ministerial order of the Portuguese Minister of Finance (Portuguese black-list) should be increased to 30% (instead of the current standard rate of 21.5%).

### Increased tax rate on income derived from investments made in entities/vehicles located in a "black-list" jurisdiction

Portuguese individuals should be subject to an increased tax rate of 30%, in relation to income paid by an entity or vehicle located in a "black-list" territory (instead of the current standard rate of 21.5%).

### Strengthening of CFC rules

New criteria are established to determine the conditions in which a foreign company's income is apportioned to its resident shareholder.

### Tax representation for entities resident in the EU

The need to appoint a tax representative for nonresidents without a permanent establishment in Portugal should become voluntary for entities resident in the EU.

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## South Africa

### New South Africa - UK tax protocol enters into force

The amending protocol (Protocol) to the 2002 South Africa-United Kingdom income tax treaty signed on 8 November 2010 entered into force on 13 October 2011. It generally applies from that date.

Importantly, South Africa will replace its current secondary tax on companies (STC) system with a new dividends tax system from 1 April 2012. The STC, calculated at a rate of 10% on the net amount of a dividend declared by a South African resident company other than a headquarter company is not a dividend tax, and therefore cannot be reduced under the dividend article of a double tax treaty. In contrast, the new dividends tax (also calculated at a rate of 10%) will apply under the dividends article of an applicable double tax treaty.

Under the new Protocol, the dividends tax is limited to:

- ▶ 5% of the gross amount of the dividends, if the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends,
- ▶ 15% of the gross amount of the dividends in the case of qualifying dividends paid by a property investment company which is a resident of a Contracting State, or
- ▶ 10% in all other instances.

For UK purposes, property investment companies are real estate investment trusts (REIT structures). South Africa currently does not have specific REIT legislation (this is expected to

be introduced towards 2013/2014); hence, for South African purposes, the Protocol simply refers to a company that may be agreed between the competent authorities as corresponding to a REIT. The two most common types of REIT-like property vehicles in South Africa are property loan stock (PLS) companies and collective investment schemes in property (CISPs). Returns to PLS shareholders generally take the form of interest (the shareholder holds a linked unit consisting of a 99% debenture and 1% equity), while CISPs are effectively treated as trusts. Income, mostly in the form of rental or taxable dividends from property companies thus retains its nature and passes through to the CISP unit holder.

In addition to an exchange of information and a newly inserted assistance in the collection of taxes article, the Protocol contains a most favored nation clause.

In contrast to the South Africa - Netherlands tax treaty which provides for an automatic application of a lower rate if South Africa concludes a double tax treaty with a third state, the Protocol states that in such an event, South Africa must inform the UK government of such action through diplomatic channels, and enter into a negotiation process to achieve a similar result.

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Our dedicated international tax professionals assist our clients with their cross-border tax structuring, planning, reporting and risk management. We work with you to build proactive and truly integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

The ITS Global Dispatch is a monthly communication prepared by Ernst & Young summarizing recent international tax developments pertinent to multinational companies. For additional information, please contact your local international tax professional.

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