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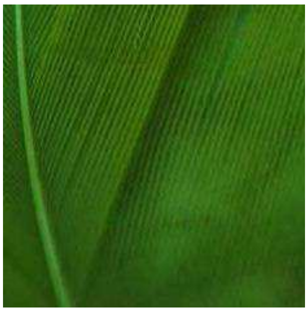

TAX ALERT

September 2012

Can preparations be made for next year's planned changes to income tax?

We already know the substance of the changes to income tax proposed by the Minister of Finance which, according to the author of the bill, are to come into effect next year. Our analysis of the proposed regulations shows that in order to safeguard against adverse consequences of the changes specific steps should be taken this year.

Limited joint-stock partnership (LJSP) as taxpayer

After the contemplated changes, LJSPs will be treated in the same way as capital companies. As a result, tax on a partnership's profit will, from the partners' (being shareholders) perspective, no longer be deferred to the profit pay-out date. Moreover, tax will also be payable on retained profits in the event they are paid out, if the partnership is transformed into a partnership of another type, if profit is transferred to share capital, or if profit is disposed of in any other way to the partners (shareholders). The proposed regulations do not include any transitional provisions as regards partners (shareholders) and profit retained in LJSPs to the end of 2012 and paid out after the new regulations have entered into effect.

The above solutions mean that in the future an LJSP will no longer be a useful entity in tax optimisation terms. Furthermore, tax optimisation already implemented in an LJSP may be under threat.

There are legal solutions that allow tax neutrality of transactions and optimisation already implemented in an LJSP to be retained and that also allow an LJSP (this year) to implement tax optimisation the effects of which will be retained after the change in provisions. However, these solutions require the appropriate steps to be taken in 2012.

Changes to thin capitalisation

There will also be a change to thin capitalisation provisions. According to the new regulations, restrictions on including interest on loans in tax costs will apply not only to entities directly related to the taxpayer (as at present) but also to entities indirectly related. The term "indebtedness" will also be tightened up and will no longer be limited to indebtedness under loans but will also effectively include trade debts.

The key regulation here is, however, a transitional provision which shows that the new regulations could also cover loans arising before the new provisions entered into effect, as according to this provision the new regulations will not apply to loans under which monies were actually transferred to the taxpayer under an agreement concluded with this taxpayer. As a result, there will be no protection against the new regulations for indebtedness (loans) arising from, e.g. debt take-over, transformation of trade liabilities into loan, or arising in another form unconnected with conclusion of a loan agreement and actual transfer of funds in respect of such loan.

In our view, in order to avoid applying the new regulations to indebtedness arising before the end of 2012, steps should be taken to restructure taxpayers' financing structures. These steps should be taken this year.

Changes to transfer pricing

According to the proposed provisions, the obligation to draw up transfer pricing documentation will also apply to partnership deeds concluded between related entities. This will mean that after entry into force of the new regulations it will not be possible (in a tax-safe way) to use partnerships for the reallocation of assets or profit in a capital group. All solutions in this respect should therefore be implemented before the end of 2012.

In our view there are legal solutions that should allow steps to be taken to minimise or eliminate the negative effects of these changes. However, these steps need to be implemented in 2012. If you are interested in tax advisory in this area please contact us.

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